

## HW #2 Specific-Factors

1. In Specific-Factors model

two goods: OIL + Food

OIL produced w/ Kapital + Labor

Food produced w/ T (land) + Labor

if  $P_{OIL}$  falls, while  $P_{FOOD}$  unchanged then the ~~the~~ return to the factor of production which is specific to the oil sector will fall

$$\hat{r}_K < \hat{P}_{OIL} < \hat{w} < \hat{P}_{FOOD} < \hat{r}_T$$

zero

Wage also falls, but effect on laborers is ambiguous because:

→ real wage in terms of oil rises  $\frac{w}{P_{OIL}} \uparrow$

→ real wage in terms of food falls  $\frac{w}{P_{FOOD}} \downarrow$

owners of land benefit because

→ real return in terms of both oil + food rises

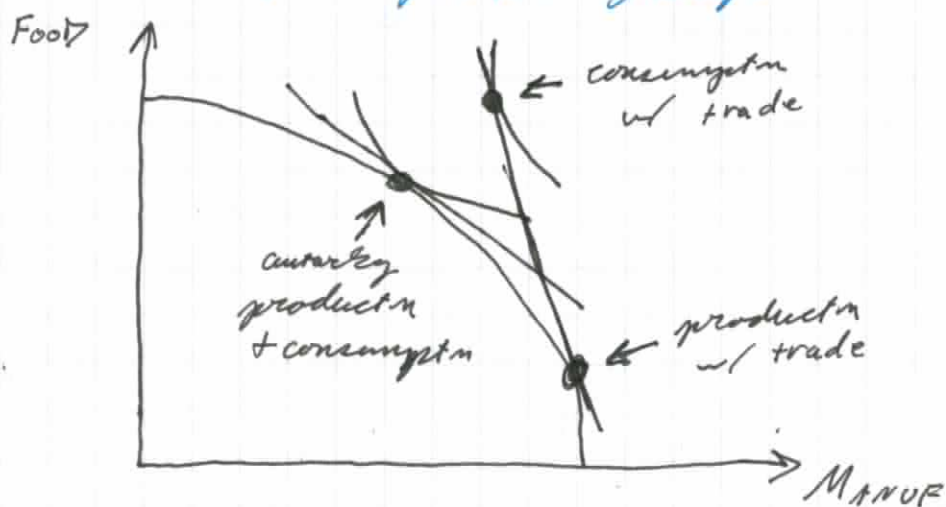
$$\text{i.e. } \frac{\hat{r}_T}{\hat{P}_{OIL}} \uparrow \quad \text{and} \quad \frac{\hat{r}_T}{\hat{P}_{FOOD}} \uparrow$$

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$$\text{NB: } \begin{array}{l|l} (w/P_{OIL}) = \hat{w} - \hat{P}_{OIL} > 0 & (r_T/P_{OIL}) = \hat{r}_T - \hat{P}_{OIL} > 0 \\ (w/P_{FOOD}) = \hat{w} - \hat{P}_{FOOD} < 0 & (r_T/P_{FOOD}) = \hat{r}_T - \hat{P}_{FOOD} > 0 \end{array}$$

economists object to using protectionist policy to mitigate the distributional effects on relative incomes of different factors of prod

beer:  $\rightarrow$  gains to society ~~exceed the loss~~ of free trade exceed the losses to specific groups



$\rightarrow$  if mitigating (or reversing) the effects considered a reasonable goal, then it would be better to tax the winners + transfer some of the revenues to the losers

$\rightarrow$  ex. two goods:

SOFTWARE produced w/ Labor + Human CAPITAL  
 MANUF produced w/ Labor + PHYSICAL CAPITAL

if trade causes  $P_{MANUF}$  to fall, then better to retrain manufacturing ~~workers~~ workers to work in SOFTWARE sector (i.e. invest in Human Capital) NB: preview a H-O model in which capital mobile between sectors

those who lose from trade are more informed, cohesive & motivated

TC of trade barrier \$10,000

TBenefit of trade barrier \$5,000

if costs (in terms of higher prices) spread over 1000 people, but benefits (to producers) concentrated on 50 people, then

→ each member of society pays \$10

→ each producer receives \$100

so those who lose from trade hire lobbyists, place commercials on TV, etc.