1. Specific Factors and Trade

Finland is capital abundant relative to potential trading partners in the rest of the world. Telecommunications is a capital intensive industry relative to the business services industry. Businesses in Finland have made investments in both industries, creating stocks of capital that are devoted to either telecommunications or business services.

a) Suppose that Finland is not trading. Draw the specific factors diagram for Finland, indicating how labor is divided between the two industries, and showing the prevailing wage $w_o$.

b) Modify your diagram to show how Finland’s labor allocation and wage change when it opens trade with the rest of the world.

c) How does the opening of trade affect capital owners in Finland’s telecommunications industry? Describe and show on your graph.

d) Are Finnish workers likely to benefit or lose from the opening of trade?

e) Suppose Finnish workers consume as much telecommunications as they can, while they buy very few business services. How does this affect the magnitude of worker gains or losses?

2. The HO Framework.

a) Mexico produces two goods, GM cars and corn. There are two factors of production, labor and capital. Total available hours of labor and capital are 100 labor and 100 capital. The unit labor requirements for the production of each good are given below. What does the production possibility frontier look like?

<table>
<thead>
<tr>
<th>Product</th>
<th>Labor Requirement (Hours)</th>
<th>Capital Requirement (Hours)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GM Cars</td>
<td>5</td>
<td>20</td>
</tr>
<tr>
<td>Corn</td>
<td>10</td>
<td>5</td>
</tr>
</tbody>
</table>

b) Following NAFTA, Mexico receives an influx of foreign direct investment from the United States, raising the available pool of capital from 100 to 200. What happens to the relative production of GM cars and corn? Please show graphically.

c) What is likely to happen to the pattern of exports in Mexico (of cars versus corn)? How is this related to the Heckscher-Ohlin Theorem?

d) If the United States continues to lose capital to Mexico, what will happen to its pattern of exports?

e) Assume Mexico has 100 labor and 200 capital. Using your knowledge of Stolper-Samuleson, what will happen to the returns to wages and capital in Mexico after trade liberalization? What if the endowment of labor and capital is reversed?