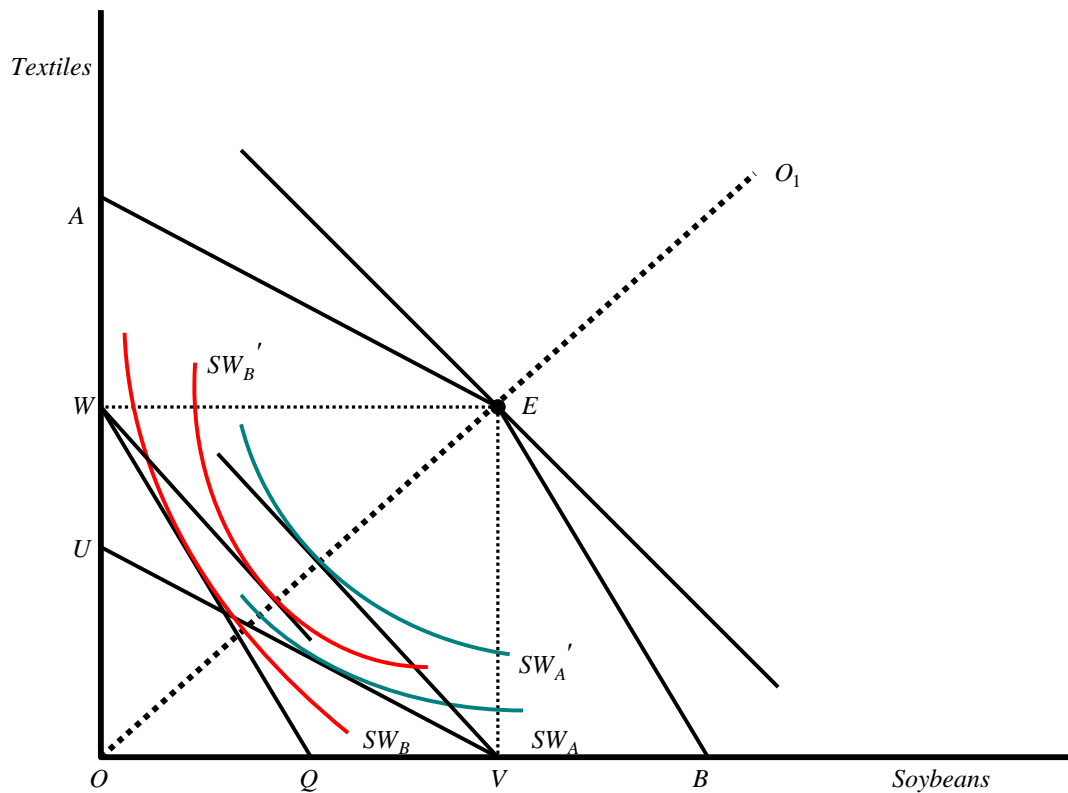


[Lecture 4] Gains from Trade in Ricardian (CA) Model



ΔOUV : Country A's PPF (slope = $\left(\frac{P_S}{P_T}\right)_A$). ΔOQW : Country B's PPF (slope = $\left(\frac{P_S}{P_T}\right)_B$)

1. Post-trade Equilibrium

If trade is allowed under the terms of trade of $(P_S / P_T)^*$, country A and B will produce S and T at V and W respectively, through the complete specialization. And they want to consume them at C_A and C_B . Is it possible through the trade? In other words, can country A export Soybeans by FV and import Textiles from B by $C_A F$? And can country B import Soybeans by GC_B and export Textiles by WG ?

Let's compare $\Delta WC_B G$ and $\Delta C_A VF$. They are not only geometrically similar but also congruent (identical). The economics version of this law is known as (), which states that if there are n markets in the world and any $(n-1)$ of these markets are in equilibrium, so too will be the n th market.

Suppose the two trade triangles are not congruent but only similar. It must be the case geometrically, then, that one triangle has both a larger side and a larger base than the other. In terms of economics, residents of the country with the larger triangle want to trade more than their foreign counterparts. In this case, how can a trading equilibrium be attained? The geometric answer to this question is simple. The smaller triangle must become larger and the larger triangle must become smaller. Is there an economic process that would bring this about? The answer is yes. The process is known as **reciprocal demand**.

