Session 3. General equilibrium trade analysis, continued

3. General equilibrium trade modeling: Ricardian 2 x 2 x 1 trade model
   3.3 Modeling of trade
      3.3.2 Example 2. One country has an absolute advantage in production of both good

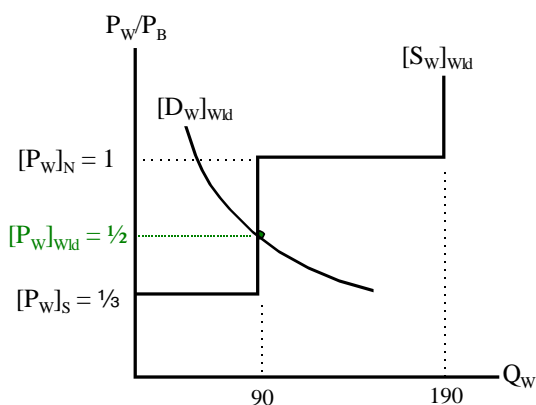| Goods	Production possibilities in:		Closed market equilibrium: Q = C		Pre-trade prices (bread in terms of wine or wine in terms of bread)		World price or terms of trade (TOT)
	North	South	North	South	North	South	
Bread	100	30	70	20	1B = 1W	1B = 3W	1B =
Wine	100	90	30	30	1W = 1B	1W = ⅓ B	1W =

Step 1. Production possibilities and supply-side analysis
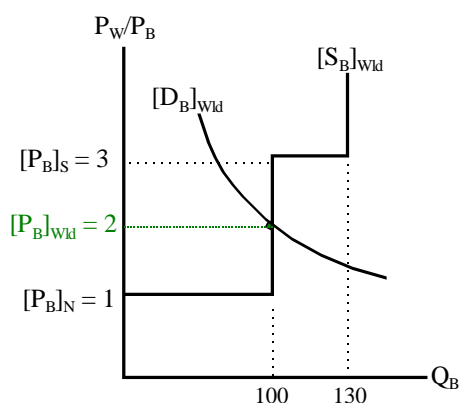Step 2. Closed economy equilibrium: supply and demand analysis
Step 3. Determination of domestic (pre-trade) prices
Step 4. Determination of a world price: terms of trade

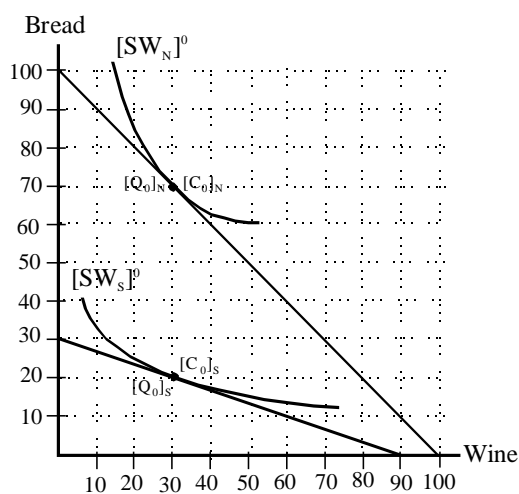World market of wine in terms of bread   World market of bread in terms of wine
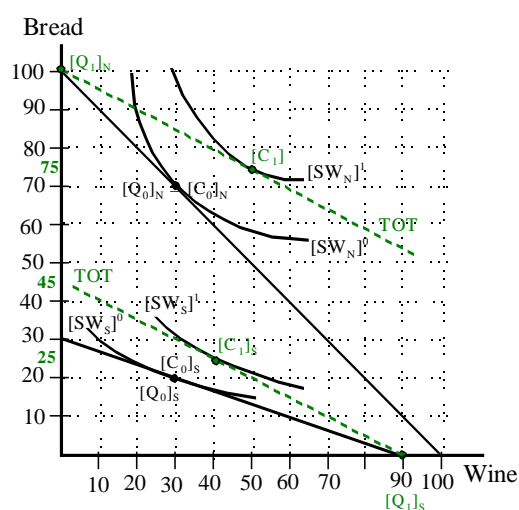

Step 5. Adjustment process: change in relative prices
Step 6. Trade and welfare implications: gains from trade

Pre-trade general equilibrium   Free trade general equilibrium

   3.4 Law of one price, world price, and terms of trade
      3.4.1 Define LOOP and TOT
      3.4.2 Meaning of changes in TOT
   3.5 Summary of the general lessons of the 2 x 2 x 1 trade model: specialization, trade and gains