The Specific Factor Model

Economics 342
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Question 1
Use the specific factor model described in class to answer. In each of the cases below draw the appropriate shifts in the value of the marginal product schedules and determine the change in the wage rate relative to the price of food, the price of clothing, the rental rate on capital, and the rental rate on land. In the exercise *assume that every* *<u>exogenous</u>* *variable not discussed explicitly* is held constant. Recall that the exogenous variables are: the price of food, the price of clothing, the capital stock, the stock of labour and the stock of land.

a) A 10% increase in the supply of labour
b) A 10% increase in the supply of capital
c) A 10% increase in the supply of land
d) A 10% increase in the price of food
e) A 10% increase in the price of clothing.

Question 2
In this case assume that there are 3 kinds of labour and two economic activities that produce manufactured goods and agricultural goods. One group has specialized skills useful only in manufacturing, one group has skills useful only in agriculture, and there is a third unskilled group who can be employed in both manufacturing and agriculture. The reward to labour specific to manufacturing is w_M, the reward to labour specific to agriculture is w_A, and the reward to unskilled labour employed in both sectors is w. In the exercise *assume that every* <u>exogenous</u> *variable not discussed explicitly* is held constant.

a) What happens to the output of manufactured goods if there is an increase in immigration of labour skilled in manufacturing? What happens to the wage rates to each type of labour (if the country is small in world markets for manufacturing goods and agricultural goods.)
b) Suppose there is an increase in the immigration of unskilled labour. What happens to relative wage rates?
c) What kind of immigration policy would skilled workers prefer? Explain.

Questions 3 (Purely for your speculation and pleasure. Only to be completed if you have time on your hands and want to impress the instructor.)

Suppose that we have the framework described in class with land, labour and capital in the usual allocations. Suppose, however, that capital is in perfectly elastic supply at rental rate r*. Now describe the impact on endogenous factor rewards that are a result of changes in commodity prices and the changes in the stock of labour and land, the factors that are in exogenous supply at home.