Factor Price Equalisation Theorem

Part 2

Factor Price Equalisation Theorem

❖ **The Box Diagram with same Production Functions in the Two Countries:**

- **Figure 1**: The box $OCO'D$ represents total factor endowments in country I, and the box $OC'O''D'$ represents total factor endowments in country II.
- From this we read that country I is abundant in capital and country II in labour in physical terms as $\frac{C_1}{L_1} > \frac{C_2}{L_2}$

Factor Price Equalisation Theorem

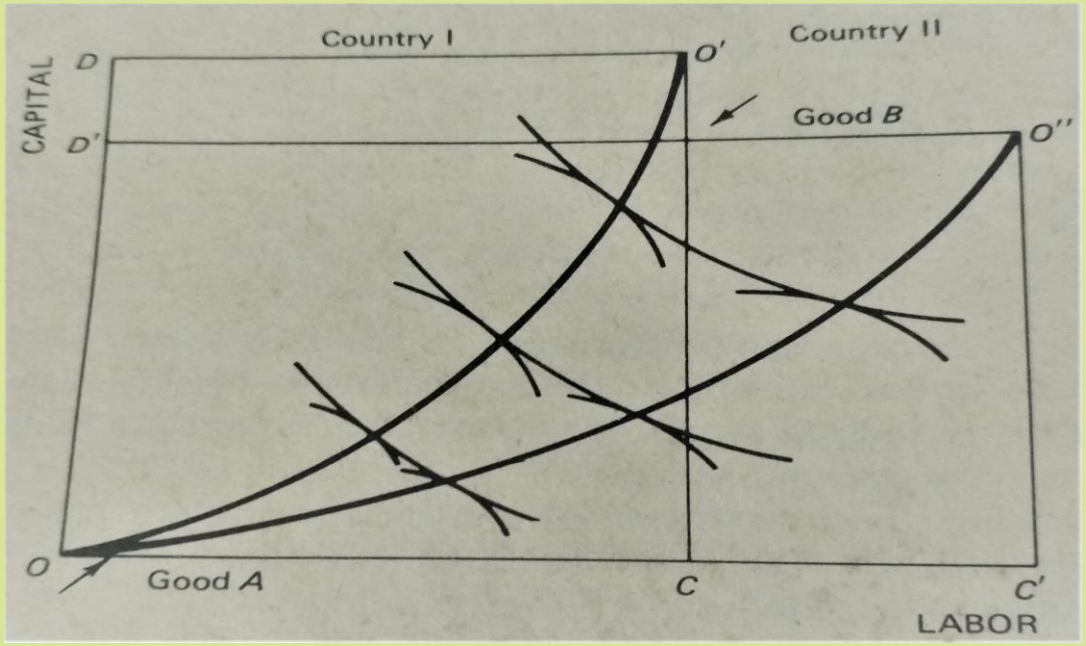

Figure 1

Factor Price Equalisation Theorem

- Production of good A is measured from lower left hand corner and production of good B from the upper right hand corner.
- As production function are same in both countries for same commodity, the **'aa'** isoquants are identical for both countries.
- The 'bb' isoquants are also the same, in the sense that they both illustrate the same production function, even though production of good B is measured from O' for country I and O" corner for country II.

Factor Price Equalisation Theorem

- Labour is measured on horizontal axis.
- Capital is measures on vertical axis.
- Isoquants show good A is labour intensive and good B is capital intensive.

To be continued ……..

Factor Price Equalisation Theorem

THANK YOU