

Key terms comparative advantage

Trade	Buying or selling
Specialisation	Everybody gains maximum benefit from doing what they do best and then trading
Absolute advantage	Ability to produce more than competitors using the same amount of resources
Comparative advantage	Ability to produce at a lower opportunity cost than competitors

The basis for trade is comparative advantage not absolute advantage

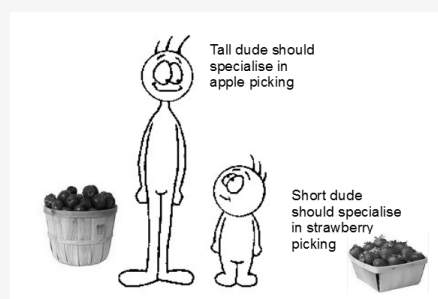
Keep in mind

Don't confuse comparative and absolute advantage

Possible to have comparative advantage with no absolute advantage

Possible to have absolute advantage with no comparative advantage

Specialisation



Do what you do best, trade for the rest

Calculating comparative advantage

Who has the lower opportunity cost?

Can be calculated as

given up / # produced of the alternate

We give up / If we make

Lowest number = highest comparative advantage

Calculating comparative advantage (cont)

E.g. Who has advantage out of 0.16 and 0.33

E.g. Who has advantage out of 6 and 3

<http://www.youtube.com/watch?v=ghqat-rsHVvA>

If asked *Who has the comparative advantage in picking strawberries* then the # of strawberries is the numerator (top part of the fraction) and apples is the denominator (whole).

Gains from specialisation

Possible gains include:

Higher output Total production of goods and services is raised

Variety Consumers have access to a greater variety of higher quality products. Eating apples and strawberries instead of just apples.

A bigger market Specialisation and global trade increase the size of the market offering opportunities for economies of scale

Competition Increased competition an incentive to minimise costs, keep and prices down and therefore lower prices: maintains low inflation. Also promotes R & D in new techs.



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