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by Kk Kk

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Comparative Advantage Theory of International Trade

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International Trade

- All economies despite their size relies on other economies and are impacted by events which are outside their borders.
- Internationalization or globalization of the US economy has taken place in all sectors , with the input and output markets and in businesses and households (Jones, & Kierzkowski, 2018).



Classical Theory of International Trade

Supply Version of Classical theory of International Trade

- Theory of absolute cost advantage by Adam Smith
- Theory of comparative cost advantage by David Ricardo

Comparative Advantages Theory

- Comparative advantage is the nation's capability to generate a good at a lower opportunity cost in comparison to other nations.
- Countries can benefit from trade in regard to comparative advantage.
- It was developed by David Ricardo who extended the ideas of Adam Smith.

Benefits of Comparative Advantage

- Even if a nation had a considerable absolute advantage in the production of goods, Ricardo would maintain that specialization and trade tend to be beneficial.
- When nations major in producing the goods that they have comparative advantage, they increase their combined output as well as allocate their resource in a more efficient manner (Gray, 2019).

Sources of Comparative advantage

- Land:
  - endowment of natural resources
- Labor:
  - Quality of labor force, to enhance labor productivity.
  - Wages costs of labor
- Capital
  - The quality of capital, it is the generation of goods as well as services through the use of technology (ATAR Survival Guide, 2021).

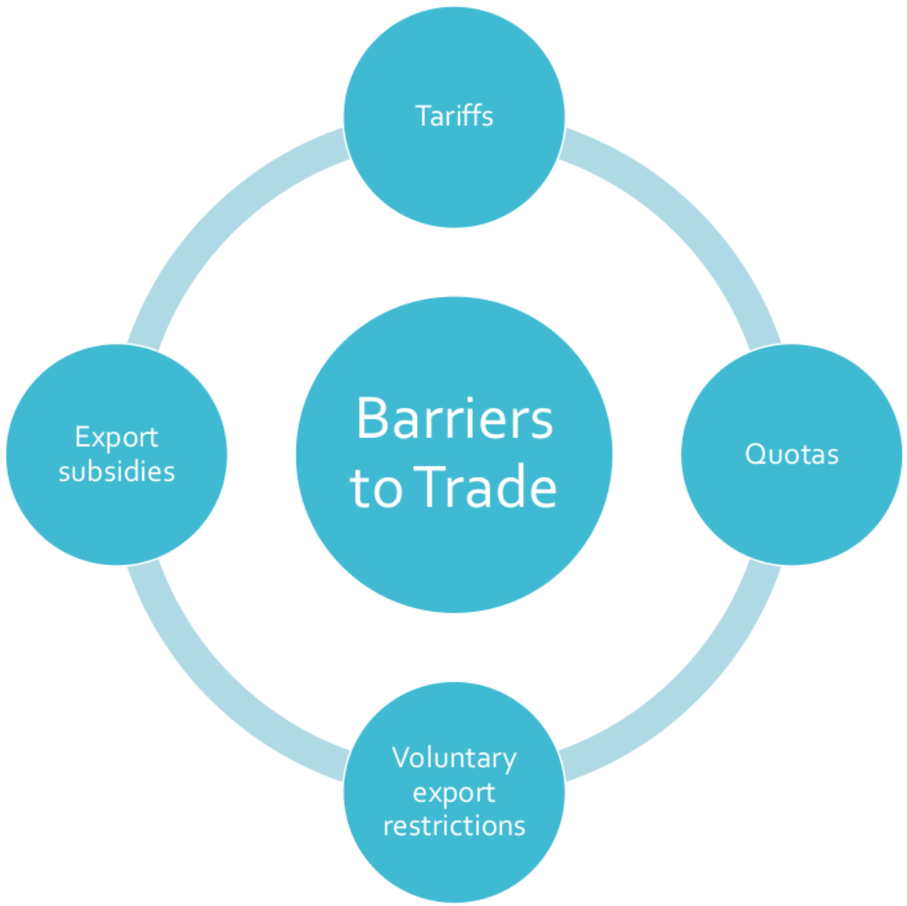


- Enterprise
  - Managerial processes to aid in maintaining efficiency of labor as well as capital
- Other cores
  - Exchange rate
  - Level of protectionism

Assumptions of the Theory

- It involves two nations that produce two commodities
- Perfect mobility of labor in each nation
- Does not involve the cost of transportation
- Does not involve any transportation expenses
- Does not involve any technical change

Barriers to Trade



Labor Cost per Unit Output

Country	Commodity	Commodity
	1 unit of wine	1 unit of cloth
Portugal	100	110
England	140	120

Continuation…

- Based on the table it is evident that to generate a single unit of wine in Portugal there is need for 100 man-hours and for one unit of cloth production 110 man hours.
- With England, in order to generate a single unit of wine there need is need of 140 man-hour and for the production cloth 120 man hours.
- Basically Portugal's comparative advantage in wine production and England tend to have comparative advantage in regard to cloth production.

Conclusion

- The theory of comparative advantage initiates opportunity cost as a factor for analysis in making between different choices for production.
- Comparative advantage shows that
  - nations will take part in trade with each other
  - Exporting the goods which they have a relative advantage in.

References

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PAGE 1

PAGE 2

PAGE 3

PAGE 4

PAGE 5

PAGE 6

PAGE 7

PAGE 8

PAGE 9

PAGE 10

PAGE 11

PAGE 12

PAGE 13