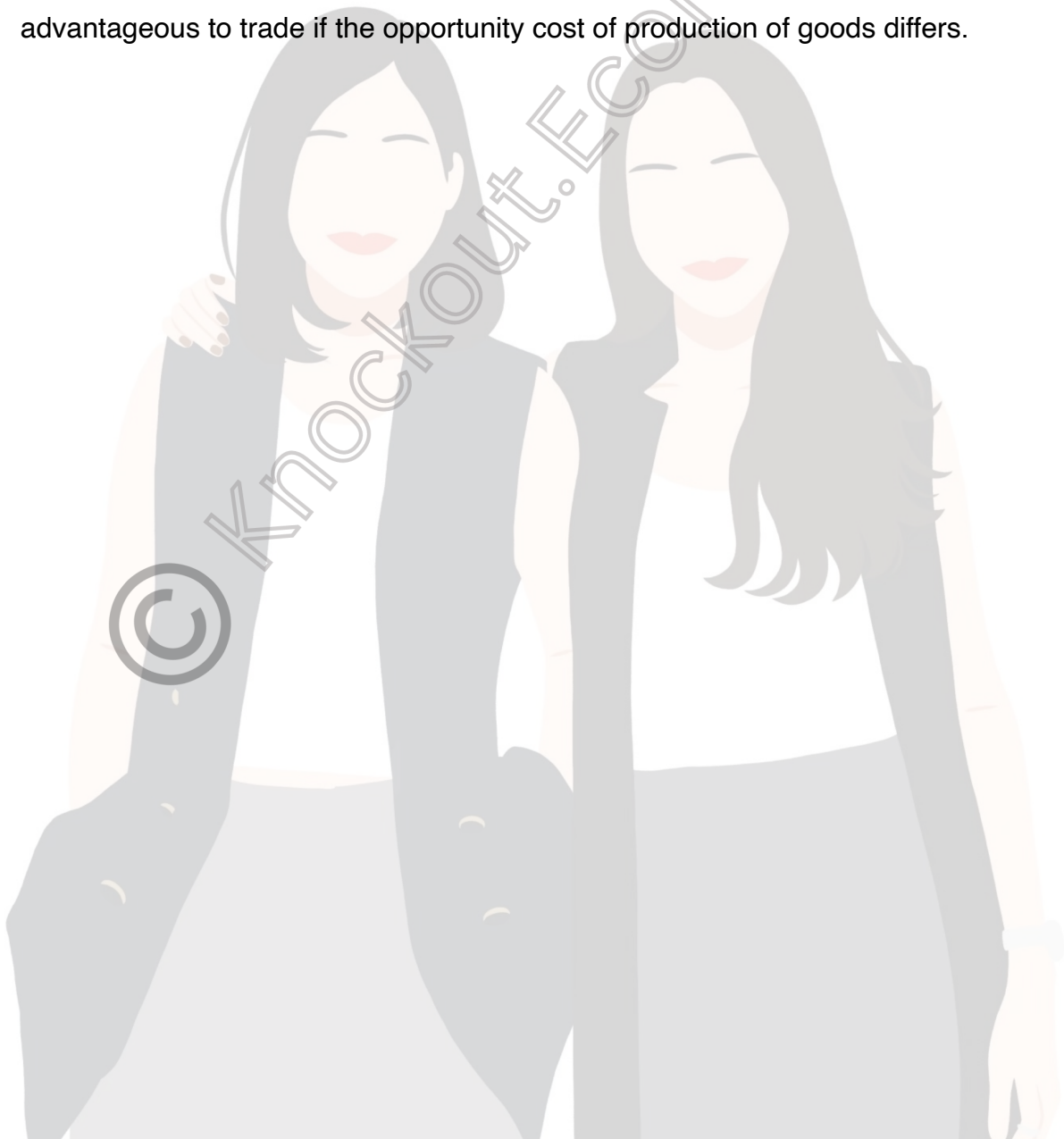


## Chapter 23

### Specialisation and comparative advantage

#### Key terms

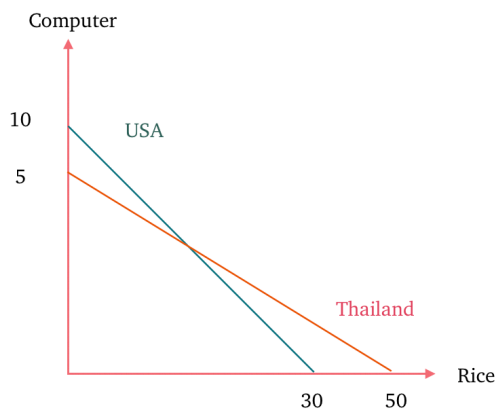
1. Absolute advantage: exists when a country is able to produce a good more cheaply in absolute terms than another country.
2. Comparative advantage: exists when a country is able to produce a good at lower opportunity cost than another country.
3. Specialisation: when nations are not self sufficient, but concentrate on producing certain goods and services and trading the surplus with others.
4. Theory of comparative advantage: states that countries will find it mutually advantageous to trade if the opportunity cost of production of goods differs.



## The distinction between absolute and comparative advantage

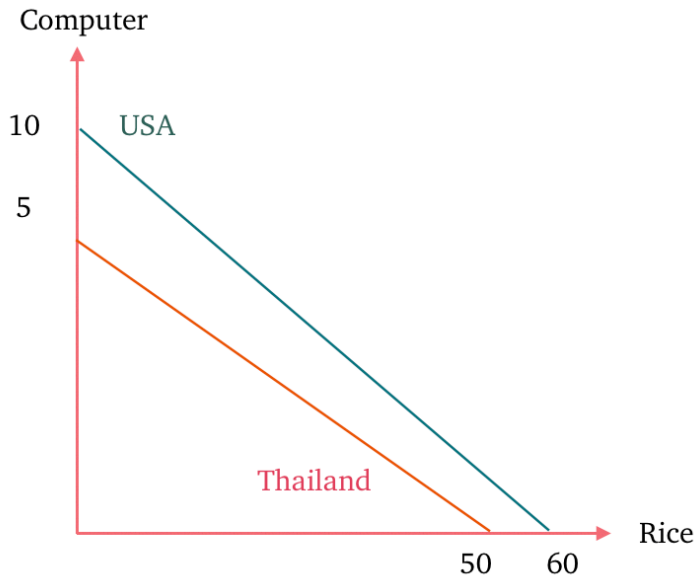
1. **Absolute advantage:** exists when a country is able to produce a good more cheaply in absolute terms than another country.

⇒ A country has absolute advantage meaning that it can produce by using **fewer resources** than other countries.



- USA has absolute advantage in producing computer, as the country can produce more computer than Thailand by limited factor endowment.
- Thailand has absolute advantage in producing rice, as the country can produce more rice than the USA, by the limited factor endowment.
- Specialisation : where USA focuses on producing computer while Thailand focus on producing rice to get the maximum output.

**2. Comparative advantage:** exists when a country is able to produce a good at lower opportunity cost than another country.



- USA has absolute advantage in producing both computer and rice.
- Based on comparative advantage

Country	Computer	Rice		Computer	Rice
USA	10	60	⇒	1	6
TH	5	50	⇒	1	10

**To sum up:** USA has a lower opportunity cost (Comparative advantage) in producing computers at 6 units of rice.

Country	Computer	Rice		Computer	Rice
USA	10	60	⇒	1/6	1
TH	5	50	⇒	1/10	1

**To sum up:** Thailand has a lower opportunity cost (Comparative advantage) in producing rice at 1/10 units of computer.

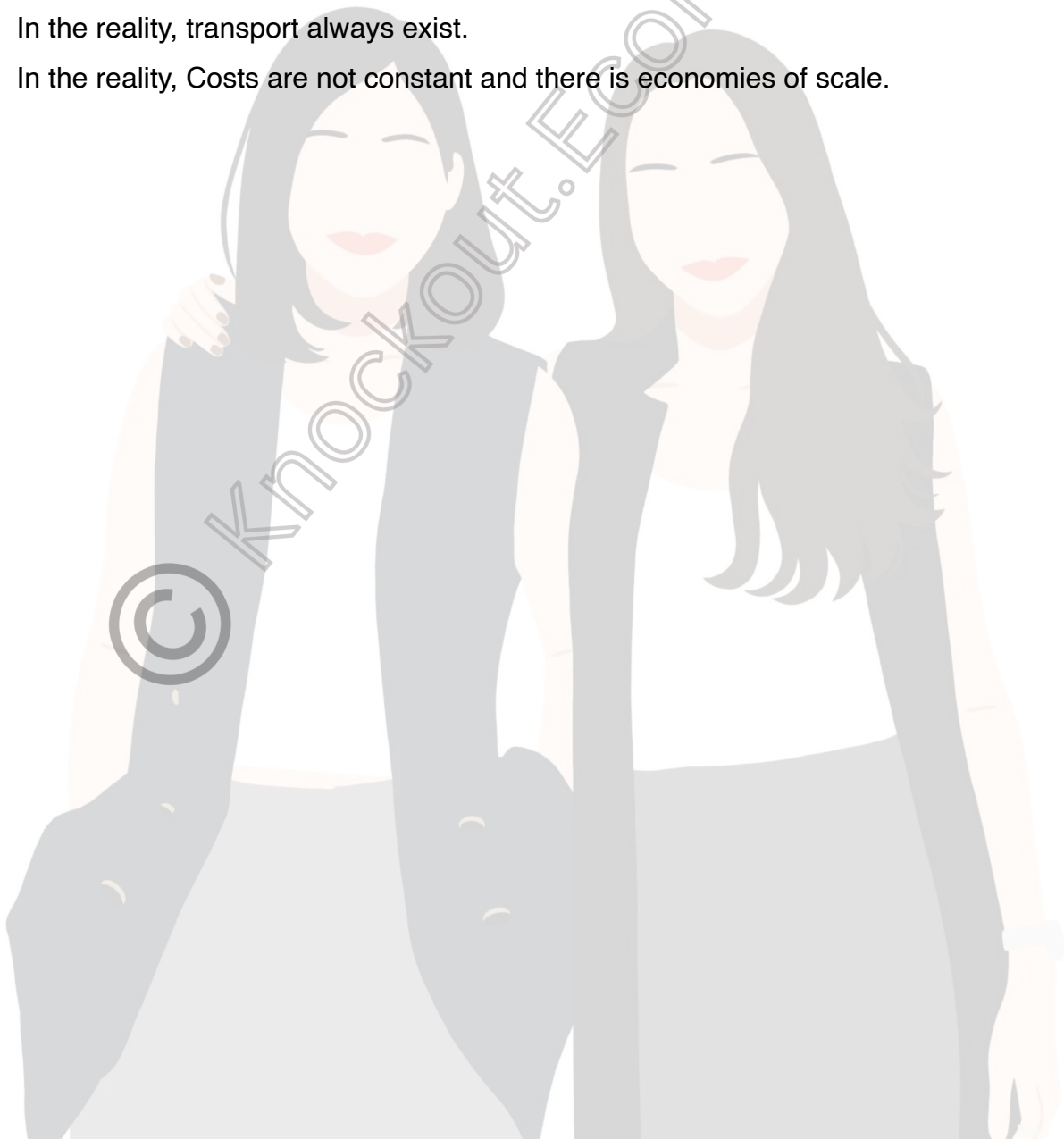
## **The assumption and limitation of the theory of comparative advantage**

### **Assumptions of model**

1. 2 countries 2 goods
2. Traded goods are homogeneous
3. Factors of production are perfectly mobile
3. No transport cost
4. No trade barrier
5. Perfect knowledge
6. Constant opportunity cost

### **Limitation of the theory**

1. In the reality, transport always exist.
2. In the reality, Costs are not constant and there is economies of scale.

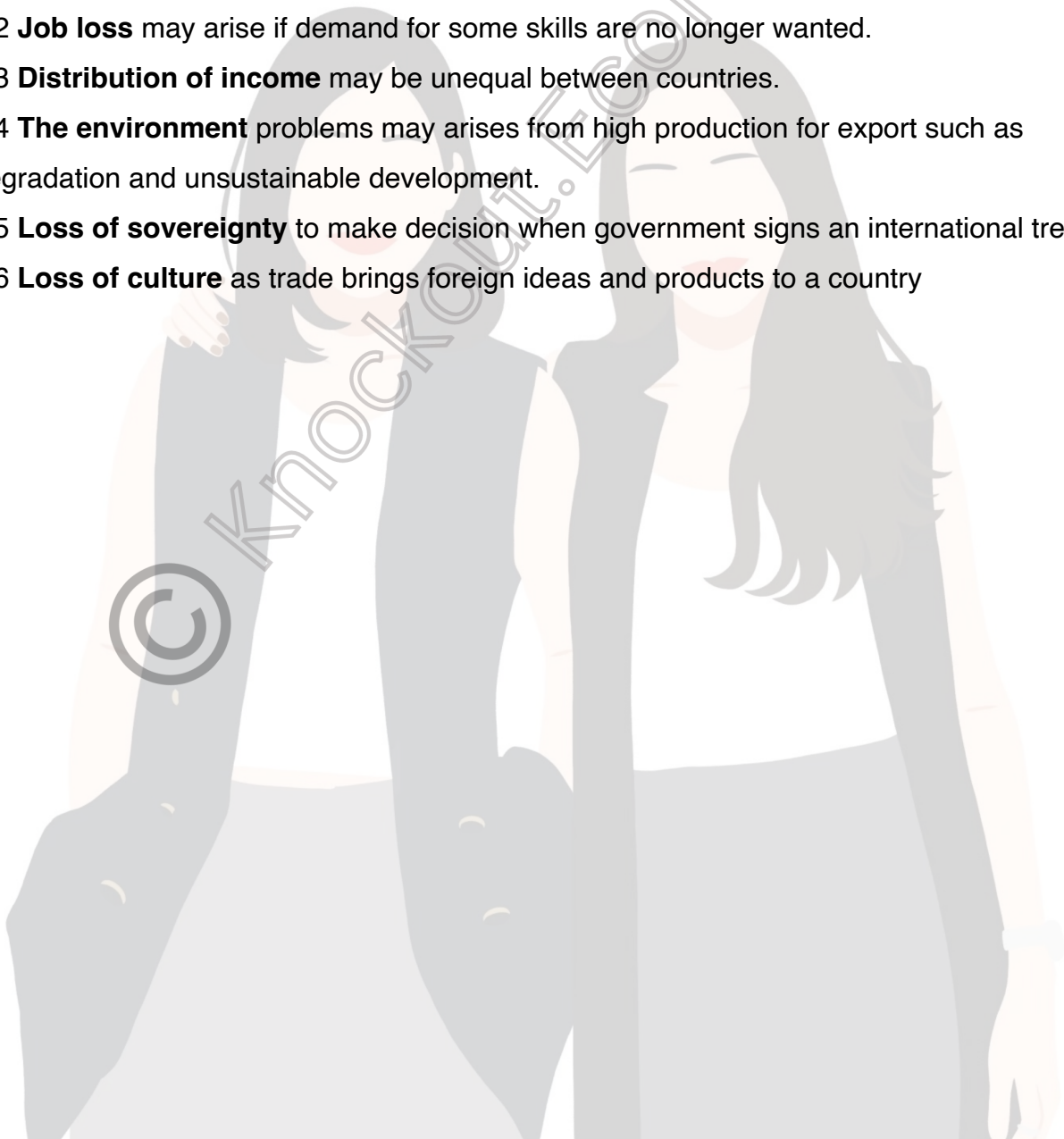


## 2. The benefits of specialisation and trade

- 2.1 Consumers have more choices from imported goods
- 2.2 Firms can achieve economies of scale from sell products abroad.
- 2.3 The total world output can be increased from specialisation.
- 2.4 Countries can achieve economic growth from higher export revenue.  
E.g China almost relies on export-led growth.
- 2.5 Competition provides a powerful incentive to innovate and improve efficiency.

## 3. Cost of specialisation and trade

- 3.1 It has a **risk from over-dependence** on export and import too much
- 3.2 **Job loss** may arise if demand for some skills are no longer wanted.
- 3.3 **Distribution of income** may be unequal between countries.
- 3.4 **The environment** problems may arises from high production for export such as degradation and unsustainable development.
- 3.5 **Loss of sovereignty** to make decision when government signs an international treaty.
- 3.6 **Loss of culture** as trade brings foreign ideas and products to a country



### Exercise

1. To what extent does the theory of comparative advantage explain increased globalisation over the past 40 years? (15 marks)

