

AP Macroeconomics

Comparative Advantage

Ricky Ricardo



- Lucy's Cuban-American husband drumming on the bongo.

David Ricardo



- English economist responsible for promoting comparative advantage as the basis of trade. No relation to Ricky Ricardo.

Absolute Advantage v. Comparative Advantage

- **Absolute Advantage**
 - Individual – exists when a person can produce more of a certain good/service than someone else in the same amount of time.
 - National- exists when a country can produce more of a good/service than another country can in the same time period.
- **Comparative Advantage**
 - Individual/National- exists when an individual or nation can produce a good/service at a lower opportunity cost than can another individual or nation

Specialization

- **Individuals and Countries can be made better off if they will produce in what they have a comparative advantage and then trade with others for whatever else they want/need.**

Example

- **Assume David Ricardo and Ricky Ricardo are going to throw a party in exactly one hour. They decide on serving homemade pizzas and cakes. Assume they have like 15 ovens in their apartment and lots of pots and pans. Use the information in the next slide to determine who should produce what.**

Example

	<u>David Ricardo</u> 	<u>Ricky Ricardo</u> 
<u>Bake Cakes</u>	2 cakes/hr.	4 cakes/hr.
<u>Make Pizza</u>	6 pizzas/hr.	8 pizzas/hr.

Example

	<u>David Ricardo</u> 	<u>Ricky Ricardo</u> 
<u>Bake Cakes</u>	2 cakes/hr.	4 cakes/hr.
<u>Make Pizza</u>	6 pizzas/hr.	8 pizzas/hr.

Who has the absolute advantage in baking cakes?
Who has the absolute advantage in making pizza?



Example

	<u>David Ricardo</u> 	<u>Ricky Ricardo</u> 
<u>Bake Cakes</u>	2 cakes/hr.	4 cakes/hr.
<u>Make Pizza</u>	6 pizzas/hr.	8 pizzas/hr.

Why?

Well, because $4 \text{ cakes} > 2 \text{ cakes}$ & $8 \text{ pizzas} > 6 \text{ pizzas}$.



Example

	<u>David Ricardo</u> 	<u>Ricky Ricardo</u> 
<u>Bake Cakes</u>	2 cakes/hr.	4 cakes/hr.
<u>Make Pizza</u>	6 pizzas/hr.	8 pizzas/hr.

Who has the comparative advantage in baking cakes?
Who has the comparative advantage in making pizza?

Example



Who has the comparative advantage in baking cakes?
Who has the comparative advantage in making pizza?

Example



Why?

Ricky only gives up 2 pizzas in order to bake a cake, whereas David gives up 3 pizzas in order to bake a cake.

Example



Furthermore, it only cost David $\frac{1}{3}$ of a cake to make a pizza, whereas it costs Ricky $\frac{1}{2}$ of a cake to make a pizza.