

[H. 3] TRADE: 2 GOODS, 2 COUNTRIES

ADAM SMITH: "WEALTH OF NATIONS"

ABSOLUTE ADVANTAGE (AA)

ABILITY TO PRODUCE MORE
IN 1 HOUR OF LABOR
(PRODUCTIVITY)

2 COUNTRIES, 2 GOODS

	US	MEXICO
LABOR HOURS: 1 SHIRT 1 COMPUTER	2 HOURS 5 CA	4 CA 20
PRODUCTIVITY # SHIRT/HOUR # COMP./HOUR	$\frac{1}{2}$ AA $\frac{1}{5}$ AA	$\frac{1}{4}$ $\frac{1}{20}$

DAVID RICARDO:

COMPARATIVE ADVANTAGE (CA)

LOWEST OPPORTUNITY COST
(LEAST INEFFICIENT)

RELATIVE: IN U.S.
PRICES

1 SHIRT COSTS $\frac{2}{5}$ COMP.

1 COMP. COSTS $\frac{5}{2}$ SHIRTS CA

IN MEX. 1 SHIRT COSTS $\frac{1}{5}$ COMP. CA

1 COMP. COSTS 5 SHIRTS

WE'RE ALL LEAST INEFFICIENT
AT SOMETHING!

WE ALL HAVE SOMETHING TO
PRODUCE FOR OTHERS

TERMS-OF-TRADE (PRICES)

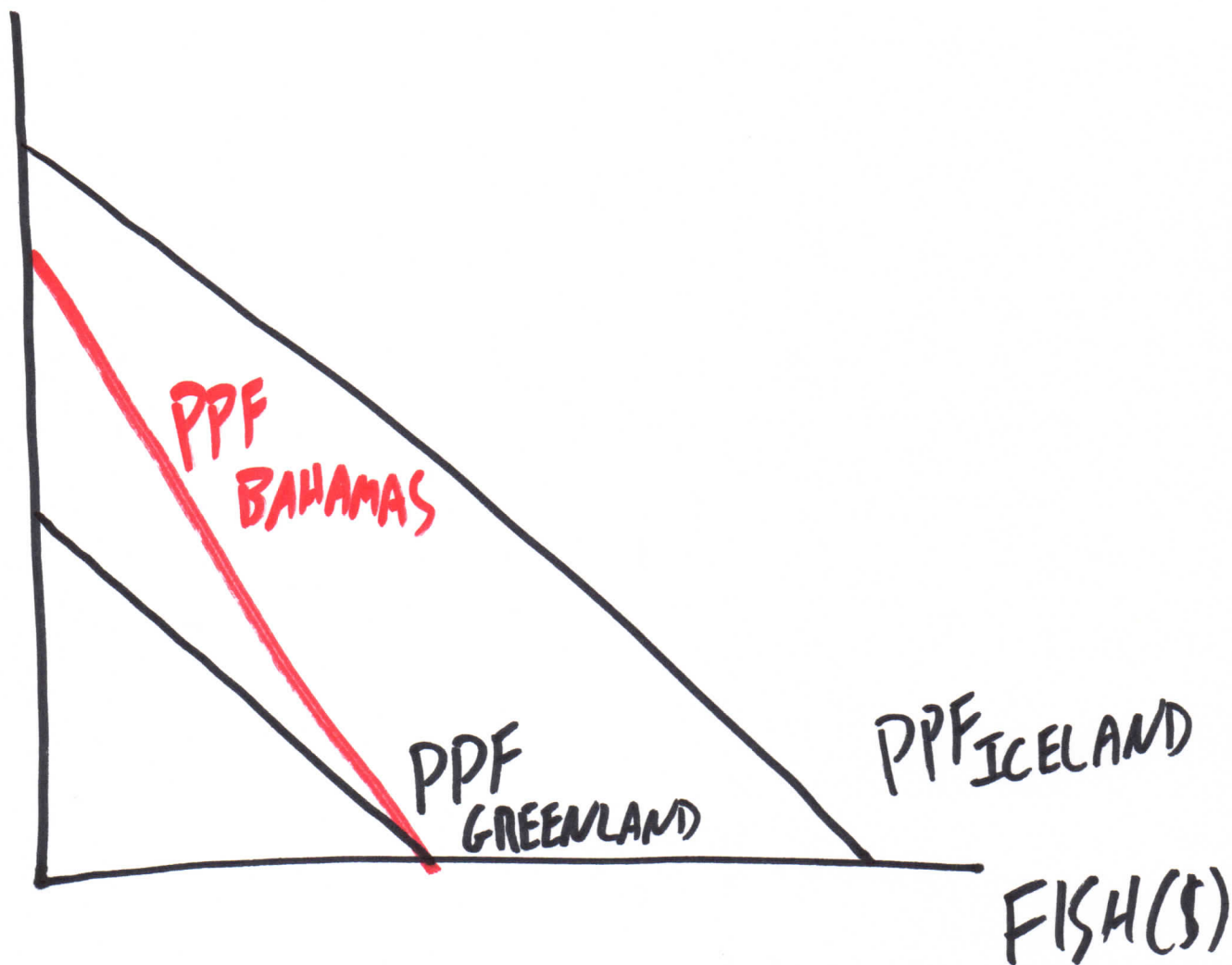
WHAT'S POSSIBLE? A COUNTRY WILL
TRADE SO LONG AS THE PRICES
MAKE THEM BETTER OFF.

CALCULATING TERMS OF TRADE?

- ① SUPPLY + DEMAND NEEDED
- ② INDIFFERENCE CURVES

IDEA OF PREFERENCES

ALL
OTHER
GOODS



- THE MORE DIFFERENT COUNTRIES ARE,
THE MORE THEY CAN GAIN FROM TRADE
 - ↳ REALLY LARGE REGION OF MUTUAL
ADVANTAGE