SSEIN1.A

Comparative and Absolute Advantage

Two men live alone on an isolated island. To survive they must undertake a few basic economic activities like water carrying, fishing, cooking and shelter construction and maintenance. The first man is young, strong, and educated. He is also, faster, better, more productive at everything. The second man is old, weak, and uneducated. He produces less than the younger man. In some activities the difference between the two is great; in others it is small. For instance, the younger man can gather 50 coconuts every hour, or catch 150 fish. While the older man can only gather 5 coconuts or catch 25 fish every hour.

1. Who is better at all activities in the scenario above?
2. What is the opportunity cost for the younger man if he dedicates his hour to gathering coconuts?
3. What is the opportunity cost for the older man if he dedicates his hour gathering coconuts?
4. Should they work separately or together on the island? Explain.

Advantage

- Absolute Advantage: a nation can produce more of a given product using a given amount of resources
- Comparative Advantage – a nation's ability to produce a product most efficiently given all the other products that could be produced (less opportunity cost)
- Law of comparative advantage – a nation or person is better off when it produces goods and services for which it has a comparative advantage

Coconuts or Fish?

Absolute Advantage		
	Coconuts	Fish
Young Man	50	150
Old Man	5	25

The Young Man has absolute advantage because he can produce both items more efficiently than the Old Man.

Coconuts or Fish?

Comparative Advantage		
	Coconuts	Fish
Young Man	50 150/50	150 50/150
Old Man	5 25/5	25 5/25

- “Other goes over” method shows the opportunity cost

Coconuts or Fish

Comparative Advantage		
	Coconuts	Fish
Young Man	50 150/50 = 3	150 50/150 = 1/3
Old Man	5 25/5 = 5	25 5/25 =1/5

- Young Man has comparative advantage in collecting coconuts because he gives up less fish relative to his production of coconuts than the old man
- His opportunity cost for collecting coconuts is lower relative to the old man
- The old man has the comparative advantage in catching fish because he gives up less coconuts relative to his production of fish
- His opportunity cost for catching fish is lower

Steps for Determining Comparative Advantage

- Scenario: Canada and Mexico are considering the trade of two goods. Canada can produce 100 Furs or 100 trees. Mexico can produce 50 furs or 200 trees.
- **Step 1: Input the Data**

Productive Output		
	Fur	Trees
Canada	100	100
Mexico	50	200

Steps for Determining Comparative Advantage

- **Step 2: Find the Opportunity Cost of Production**

Opportunity Cost		
	Fur	Trees
Canada	100/100=1	100/100=1
Mexico	200/50=4	50/200=1/4

- **Step 3 – Analyze the Data to Determine Comparative Advantage**
- It costs Canada _____ fur for every tree it produces.
- It costs Mexico _____ fur for every tree it produces.
- It costs Canada _____ tree for every fur it produces.
- It costs Mexico _____ tree for every fur it produces.

Kate and Carl

Productivity Per Hour		
	T-shirts per hour	Birdhouses per hour
Kate	6	2
Carl	1	1

1. Who has absolute advantage in this situation?
2. It costs Kate _____ birdhouses to produce 1 t-shirt.
3. It costs Kate _____ shirts to produce 1 birdhouse.
4. It costs Carl _____ to produce 1 t-shirt.
5. It costs Carl _____to produce 1 birdhouse.
6. _____ has a comparative advantage when producing t-shirts.
7. _____ has a comparative advantage when producing birdhouses.
8. Therefore, _____ should produce t-shirts and _____ should produce birdhouses.