15.3: Absolute and Comparative Advantage

Learning Objectives

- Explain absolute advantage and comparative advantage

Absolute and Comparative Advantage

The American statesman Benjamin Franklin (1706–1790) once wrote: “No nation was ever ruined by trade.” Many economists would express their attitudes toward international trade in an even more positive manner. The evidence that international trade confers overall benefits on economies is pretty strong. Trade has accompanied economic growth in the United States and around the world. Many of the national economies that have shown the most rapid growth in the last few decades—for example, Japan, South Korea, China, and India—have done so by dramatically orienting their economies toward international trade. There is no modern example of a country that has shut itself off from world trade and yet prospered. To understand the benefits of trade, or why we trade in the first place, we need to understand the concepts of comparative and absolute advantage.

In 1817, David Ricardo, a businessman, economist, and member of the British Parliament, wrote a treatise called *On the Principles of Political Economy and Taxation*. In this treatise, Ricardo argued that specialization and free trade benefit all trading partners, even those that may be relatively inefficient. To see what he meant, we must be able to distinguish between absolute and comparative advantage.

A country has an **absolute advantage** over another country if it can produce a given product using fewer resources than the other country needs to use. For example, if Canada can produce 100 pounds of beef using two ranchers, while Argentina needs three ranchers to produce 100 pounds of beef, Canada has an absolute advantage over Argentina in beef production.

Absolute advantage can be the result of a country’s natural endowment. For example, extracting oil in Saudi Arabia is pretty much just a matter of “drilling a hole.” Producing oil in other countries can require considerable exploration and costly technologies for drilling and extraction—if indeed they have any oil at all. The United States has some of the richest farmland in the world, making it easier to grow corn and wheat than in many other countries. Guatemala and Colombia have climates especially suited for growing coffee. Chile and Zambia have some of the world’s richest copper mines. As some have argued, “geography is destiny.” As a result, it should not be surprising if Chile provides copper to Guatemala, while Guatemala provides coffee to Chile. When each country has a product others need and it can be produced with fewer resources in one country over another, then it is easy to imagine all parties benefitting from trade. However, thinking about trade just in terms of geography and absolute advantage is incomplete. What happens if one country has an absolute advantage in both goods? Trade really occurs because of comparative advantage.

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A country has a **comparative advantage** when it can produce a good at a lower *opportunity cost* than another country. The question each country or company should be asking when it trades is this: “What do we give up to produce this good?” For example, if Zambia produces copper, the resources it uses cannot be used to produce other goods such as corn. As a result, Zambia gives up the opportunity to produce corn. Suppose it takes 10 hours of labor to mine a ton of copper in Zambia, and 20 hours of labor to harvest a bushel of corn. This means the opportunity cost of producing a ton of copper is 2 bushels of corn. The next section develops absolute and comparative advantage in greater detail and relates them to trade.

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Watch It

Watch the following video to better understand comparative advantage.

A link to an interactive elements can be found at the bottom of this page.

What Happens When a Country Has an Absolute Advantage in All Goods

What happens to the possibilities for trade if one country has an absolute advantage in everything? This is typical for high-income countries that often have well-educated workers, technologically advanced equipment, and the most up-to-date production processes. These high-income countries can produce all products with fewer resources than a low-income country. If the high-income country is more productive across the board, will there still be gains from trade? Good students of Ricardo understand that trade is about mutually beneficial exchange. Even when one country has an absolute advantage in all products, trade can still benefit both sides. This is because gains from trade come from specializing in one's comparative advantage.

Learning Objectives

[glossary-page][glossary-term]absolute advantage: [/glossary-term]
[glossary-definition]when one country can use fewer resources to produce a good compared to another country; when a country is more productive compared to another country[/glossary-definition]
[glossary-term]comparative advantage: [/glossary-term]
[glossary-definition]when a country can produce a good at a lower cost in terms of other goods; or, when a country has a lower opportunity cost of production[/glossary-definition]
[/glossary-page]

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