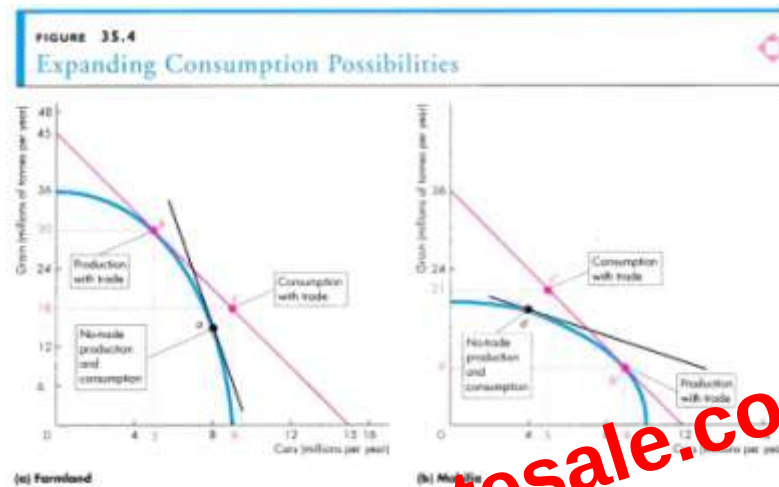


Chapter 3: Interdependence and the Gains from Trade

A Parable for the Modern Economy

-Production Possibilities Frontier vs. Consumption Possibilities Frontier

- Production Possibilities Frontier can also double as a Consumption Possibilities Frontier if the producer is also solely consuming his/her own goods



Comparative Advantage: The Driving Force of Specialization

- Absolute advantage: the ability to produce a good using fewer inputs than another producer
- Comparative advantage: the ability to produce a good at a lower opportunity cost than another producer

*Impossible for one person to have a comparative advantage in both goods; possible for one person to have an absolute advantage in both goods

-Comparative advantages → trade between two people, firms, countries, etc.

- In order for both parties to benefit from trade, the price of the good must lie somewhere in between the two opportunity costs

Applications of Comparative Advantage

- Imports: goods produced abroad and sold domestically
- Exports: goods produced domestically and sold abroad
- Trade allows all countries greater prosperity

***REFERENCE IN-CLASS NOTES FOR COMPARATIVE ADVANTAGE EXAMPLE**