

Absolute advantage is a country's ability to produce a good using fewer resources than another country. So production using fewer factor inputs (capital, enterprise, land, labour) than another nation.

Trade allows countries to benefit from more goods and services by specialising in goods and services where they have comparative advantage. So if there is a difference in the opportunity cost ratios between two nations, international trade will bring benefits to both parties.

The law of comparative advantage

If each country completely specialises, and trade were to occur on a one-unit-to-one-unit basis, the total output can be increased leading to better allocative efficiency and welfare. As it would expand the consumption possibilities for both countries.

Therefore the law of comparative advantage states that overall output can be increased if countries specialise completely in the production of goods where they have comparative advantage.

Mutually beneficial trade

For a mutually beneficial trade to occur, both nations must agree on an acceptable rate of exchange of one product for the other.

An example of absolute advantage

Absolute advantage is a country's ability to produce goods using fewer factors of production.

In this example, let's assume that India and China use exactly the same factor inputs which they can use to produce electronics such as microwaves or kettles.

Country	Microwaves	Television	Televitions
India	400	600	
China	800	100	

We already know that India and China both have an equal number of the same resources. However China can produce more microwaves than India and India can produce more televisions than China.

Therefore, China has absolute advantage in the production of Microwaves. And India has absolute advantage in the production of televisions.

China and India could decide to specialise in the goods they have absolute advantage over. This would mean China would only produce microwaves and India would only produce televisions which would ultimately allow the total output to increase.

If a reasonable exchange rate for microwaves and televisions are found and is accepted by both parties, then China and India could benefit from an increase in allocative efficiency and economic welfare. There would be an increase in world production.