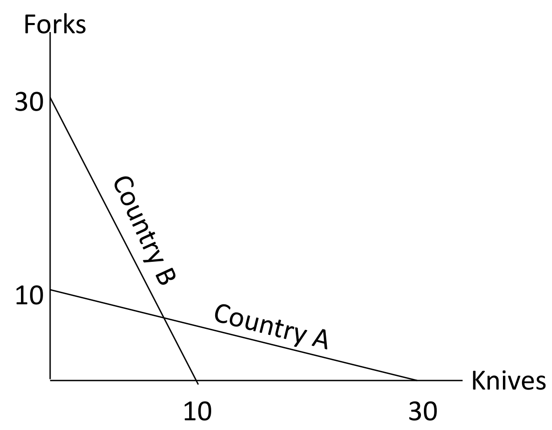
Comparative Advantage

The principle suggests a country specialise in the goods or services it can produce at the lowest opportunity cost and then trade with another country.

Countries	Forks	Knives	OC of producing fork	OC of producing knives
Country A	10	30	1 fork = 3 knives	1 knife = 1/3 fork
Country B	30	10	1 fork = 1/3 knives	1 knife = 3 forks

Before specialising and trading



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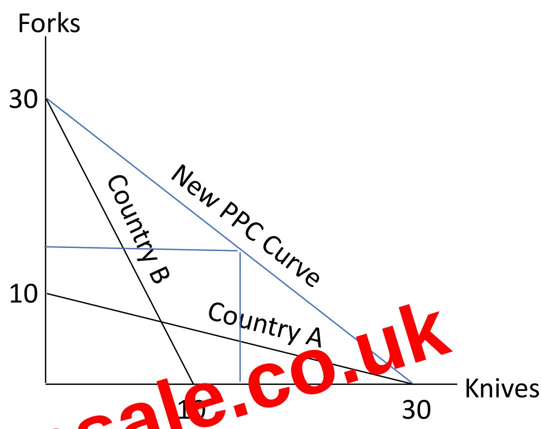
After specialising and trading



When trading with another country, the two countries (country A and country B) can now enjoy more forks and knives. The two countries can now have 15 forks and 15 knives at the same time. The trade increases countries' productive capacity.

The principle of comparative advantage concludes that a movement to free trade will result in an overall benefit to an economy if ....

- No transport costs
- No economies of scale
- Rates of inflation ignored
- No import controls
- Non-price competitiveness ignored
- Exchange rate movement ignored
- Structural adjustments ignored
- Resources re-allocation and opportunity costs that might rise ignored
- R & D investment ignored