

ECO 2013 Principles of Macroeconomics

Recall the concepts of Absolute vs. Comparative Advantage

Absolute Advantage is the ability to produce more of a good or service than competitors when using the same amount of resources.

Comparative Advantage is the ability of an individual, a firm, or a country to produce a good or service at a lower opportunity cost than competitors.

Comparative advantage can explain why people pursue different occupations and why countries produce different goods and services.

Countries are better off if they specialize in producing the goods for which they have a comparative advantage.

They can trade for the goods for which other countries have a comparative advantage.

Let's look at an example where Japanese workers are being more productive than American workers.

	<u>Output per hour of work</u>	
	<u>Cell Phones</u>	<u>Digital Music Players</u>
Japan	12	6
U.S.	2	4

We can see that Japan is more productive in producing both goods so they have an absolute advantage in both goods.

Who has the comparative advantage?

Let's look at the opportunity costs associated with producing cell phones and digital music players.

	<u>Opportunity Costs</u>	
	<u>Cell Phones</u>	<u>Digital Music Players</u>
Japan	0.5 digital music players	2 cell phones
U.S.	2 digital music players	0.5 cell phones

Japan has to give up 12 cell phones for every 6 digital music players it produces.

Therefore, the opportunity cost to Japan of producing one more digital music player is $12/6$, or 2 cell phones.

If the U.S. switches one hour of labor from cell phones to digital music players, production of cell phones falls by 2, and production of digital music players rises by 4.

Therefore, the opportunity cost to the U.S. of producing one more digital music player is $2/4$, or 0.5 cell phones.

Conclusion: The U.S. has a lower opportunity cost of producing digital music players, and therefore has a comparative advantage in making this product.

