Comparative Advantage and Trade

Review

More on Production Possibilities
Inside, On and Outside the PPF

Comparative Advantage and Trade
To take advantage of the benefits of specialization people must trade.

Why are “free trade” proposals controversial?
What have we learned?

The Principle of Comparative Advantage says that everyone does best when each person (or each country) concentrates on the activities for which his or her opportunity cost is the lowest.

The production possibilities graph describes the maximum amount of one good that can be produced for every possible level of production of the other good.

Ari and Sam must write a class report with charts. In one hour...
Ari can write 300 words or make 3 charts.
Sam can write 200 words or make 1 chart.

Ari should Chart.
Sam should write.
Which of the following best explains the connection between the principle of comparative advantage and Ari and Sam’s Production Possibilities Frontier (PPF)?

A. Sam and Ari are inside the PPF unless Sam spends all her time writing.
B. Sam and Ari are inside the PPF unless Sam spends all her time charting.
C. The steeper slope of the PPF occurs when the opportunity cost of written words decreases.
D. The steeper slope of the PPF occurs when Ari begins to write instead of to chart.

Review Survivors

Four survivors are stuck on an island. Each can either fish or gather berries. The following table shows what each survivor can produce in a day.

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<thead>
<tr>
<th></th>
<th>Jean</th>
<th>Joe</th>
<th>Jerry</th>
<th>Jack</th>
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<tbody>
<tr>
<td>Fish (lbs)</td>
<td>4</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Berries (lbs)</td>
<td>1</td>
<td>2</td>
<td>3</td>
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Use Your Clickers To Answer The Following Non-Graded Question

Review Survivors

Given the survivors produce 6 lbs of fish efficiently, what is their opportunity cost for 1 pound of fish?

A. 1/4 pound of berries
B. 2/3 pounds of berries
C. 1.5 pounds of berries
D. 4 pounds of berries

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What are the Production Possibilities Available to the Survivors Given Their Individual Skills?

Anna Mullen’s Winning Entry

Production Possibilities Graph for Fish and Berries
Inside the PPF Resources are Under Employed.

Outside the PPF Is Not Possible
Economic Growth Provides
More or Improved Resources and
Shifts the PPF Toward Higher Levels of Output

What happens to the PPF of the survivors if they discover a fifth survivor who can produce either 3 lbs of fish or 2 lbs of berries per day?

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In Kansas: 300 lbs of beef or 100 lbs of grapes.
In California: 150 lbs of beef or 200 lbs of grapes.

Which of the Following is Correct?
A. California has a comparative advantage in grape production because its opportunity cost of grapes is lower.
B. California has a comparative advantage in grape production because its opportunity cost of grapes is higher.
C. Kansas has a comparative advantage in grape production because its opportunity cost of grapes is lower.
D. Kansas has a comparative advantage in grape production because its opportunity cost of grapes is higher.

Comparative Advantage and Trade
The cost of producing a lb. of grapes in Kansas is 3 lbs. of beef.
Kansas will be better off specializing in beef, if it can buy grapes for less than 3 lbs. of beef.
The cost of producing a lb. of grapes in California is \( \frac{3}{4} \) lbs. of beef.
California will be better off specializing in grapes if it can sell grapes for more than \( \frac{3}{4} \) lbs. of beef.

Comparative Advantage and Trade
Both Kansas and California will respond to the price of grapes and beef.

The optimal response will depend on the relative price of grapes and beef.

Decision makers in both states will ask whether it is better to obtain goods by producing them or by trading for them.
Suppose the price of a pound of grapes is 1.5 pounds of beef...

Comparative Advantage and Trade

If the benefits of trade are so great, why is “free trade” so controversial?

CAFTA Protests

March 13, 2005

Thousands of Hondurans demonstrated across the country on March 8 to protest the National Congress’s March 3 vote for the Central American Free Trade Agreement (CAFTA). The protests were organized by the Popular Resistance, which estimates that CAFTA will drive 300,000 campesino families out of business, forcing 800,000 Hondurans into unemployment. Some 2,000 people marched in Tegucigalpa from Obelisk Park to the Congress building, chanting: "With this new treaty you've murdered the people."

[Tiempo (San Pedro Sula) 3/9/05].
Why is “free trade” controversial?

Reducing barriers to international trade increases the total value of goods and services produced in each nation. But it does not guarantee that each individual citizen does better when the barriers are reduced.

Use Your Clickers To Answer The Following Graded Question

Suppose the U.S. restricts imports of steel pipe. Who wins?

A. U.S. construction firms win because they are guaranteed high quality pipe.
B. U.S. steel producers win because they can sell pipe at a higher price.
C. U.S. construction firms win because they can buy pipe at a lower price.
D. Foreign steel producers win because they can sell pipe at a higher price.
Comparative Advantage and Trade

Inside the PPF, there is unemployment or underemployment. On the PPF, there is full employment. To take advantage of the benefits of specialization people must trade. Free trade is controversial because free trade creates losers as well as winners.