

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?

Econ 101 M. Salemi

The New York Times

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IN SELECT THEATERS

April 16, 2009

Pipe Made in India Incenses Illinois Town

By LOUIS UCHITELLE

GRANITE CITY, Ill. — Jeff Rains, a retired steelworker at the sprawling mill here, made the discovery. Out walking a month ago, he waited impatiently at a rail crossing while a freight train slowly passed, its flatbed cars stacked with steel pipes, each wide enough for a child to crawl through. Then he noticed “Made in India” stenciled on the pipes.

That observation has made him a Paul Revere in the eyes of many townspeople. Hundreds of sections of imported steel pipe have been moving into Granite City for use in an oil pipeline. The steel mill, meanwhile, has been shut since December for lack of orders — the first time in its 130-year history — and nearly 2,000 workers are on furlough.

Review

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.

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Review

	Cost of 100 Words	Cost of One Chart
Ari	1 Chart	100 Words
Sam	½ Chart	200 Words

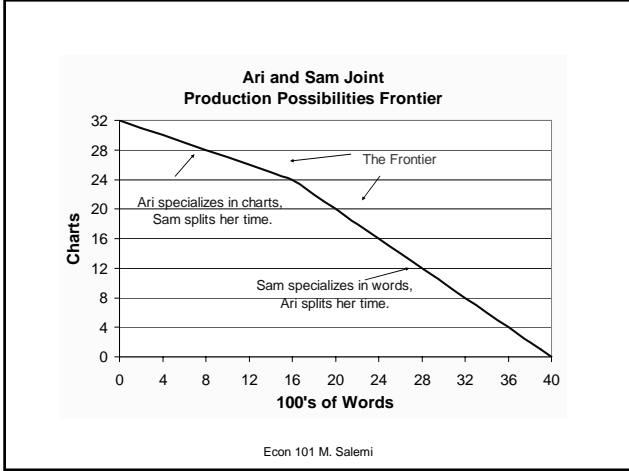
Ari and Sam must write a class report with charts. In one hour...

Ari can write 300 words or make 3 charts.

Sam can write 200 words or make 1 chart.

**Ari should Chart.
Sam should write.**

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Use Your Clickers To Answer
The Following
Graded Question

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- 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.
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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.

	Jean	Joe	Jerry	Jack
Fish (lbs)	4	3	2	1
Berries (lbs)	1	2	3	4

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Use Your Clickers To Answer
The Following
Non-Graded Question

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Review Survivors

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

	Jean	Joe	Jerry	Jack
Fish (lbs)	4	3	2	1
Berries (lbs)	1	2	3	4

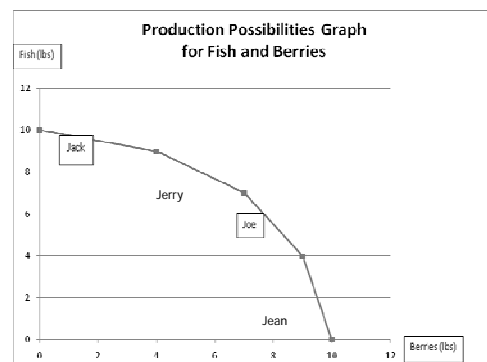
- A. 1/4 pound of berries
- B. 2/3 pounds of berries
- C. 1.5 pounds of berries
- D. 4 pounds of berries

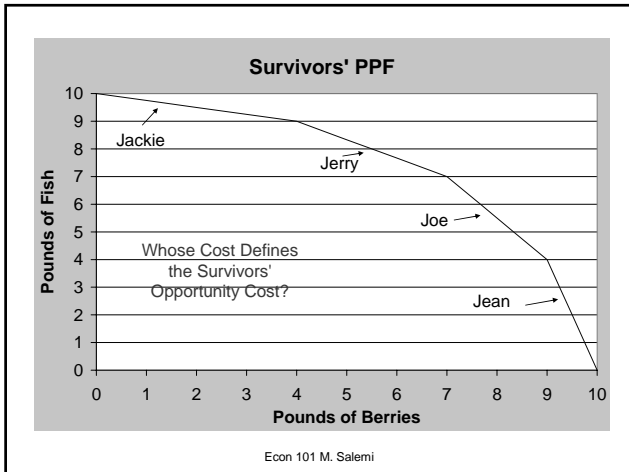
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What are the
Production Possibilities
Available
to the Survivors
Given Their Individual Skills?

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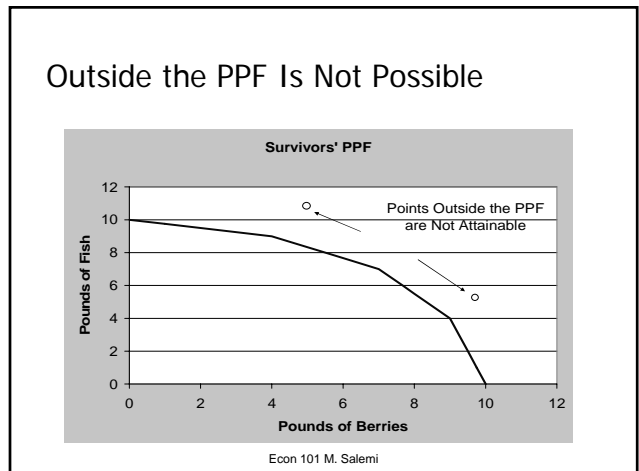
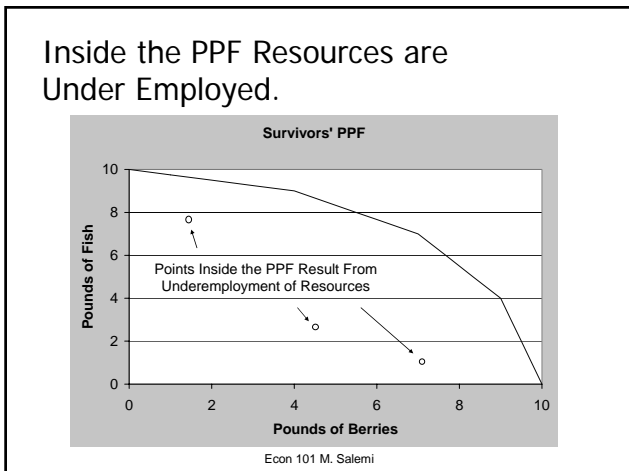
Anna Mullen's Winning Entry





Inside Outside and On The Production Possibilities Frontier

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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?

	Jean	Joe	Jerry	Jack
Fish (lbs)	4	3	2	1
Berries (lbs)	1	2	3	4

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To Benefit From Specialization People Must Trade.

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Comparative Advantage and Trade

Both Kansas and California can produce beef cattle and grapes. Assume the value of labor and other needed inputs is the same per acre in each state and for each product.

In Kansas an acre of land can be used to produce 300 pounds of beef or 100 pounds of grapes.

In California, an acre of land can be used to produce 150 pounds of beef or 200 pounds of grapes.

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Use Your Clickers To Answer The Following Graded Question

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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.

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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.

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Comparative Advantage and Trade

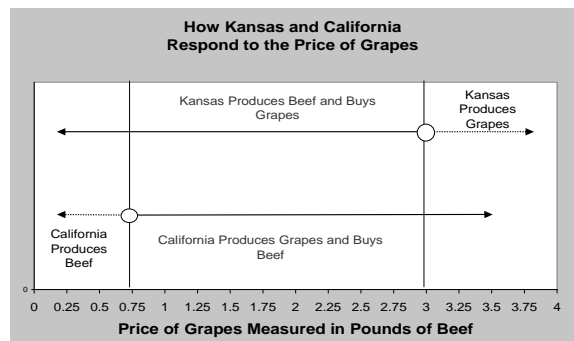
Both Kansas and California will respond to the price of grapes and beef.

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.

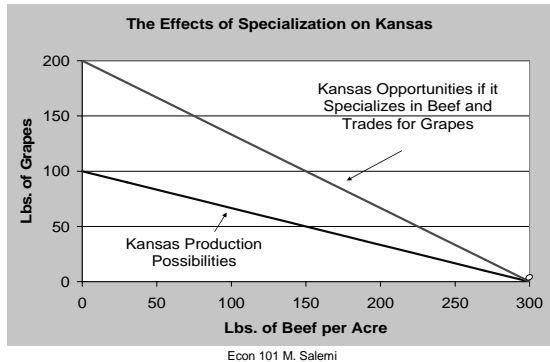
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Comparative Advantage and Trade



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Suppose the price of a pound of grapes
Is 1.5 pounds of beef...



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Comparative Advantage and Trade

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

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CAFTA Protests



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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].

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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.

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The New York Times

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Use Your Clickers To Answer
The Following
Graded Question

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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.

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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.

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