

MODULE 8 - TRADE

- Comparative Advantages

- DAVID RICARDO (1800s)

- METHUEN TREATY

- * Trade agreement between Portugal and

England

- ↳ Portuguese wine free of tax

- ↳ English cloth free of charge

- Imagine that the countries can produce the following in one month

	wine	clothes
PORTUGAL	100	50
England	200	500

• **Absolute Advantage:** "Which country can produce more?"

- **Wine:** England

- **Clothes:** England

• Should England produce both then?

- **David Ricardo:** No! We should look at the opportunity cost

• **Comparative Advantage:** "which country have the lowest opportunity cost?"

- wine.

Portugal: To produce 100 wine, I don't produce 50 clothes. The opportunity cost of wine is $\frac{1}{2}$ clothes

England: To produce 200 wine, I don't produce 500 clothes. The opportunity cost of wine is 2.5 clothes

Opportunity Cost Portugal < Opportunity cost England
Portugal should produce wine

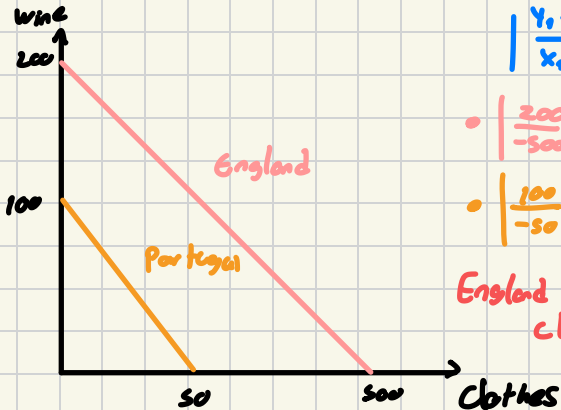
- clothes:

Portugal: To produce 50 clothes, I don't produce 100 wine. The opportunity cost of clothes is 2 wine

England: To produce 500 clothes, I don't produce 200 wine. The opportunity cost of clothes is $\frac{2}{5}$ wine

Opportunity cost England < Opportunity cost Portugal
England should produce clothes

• Another way to see it...



Angular coefficient

$$\left| \frac{y_1 - y_0}{x_1 - x_0} \right|$$

$$\bullet \left| \frac{200}{-500} \right| = \frac{2}{5}$$

$$\bullet \left| \frac{100}{-50} \right| = 2$$

England should produce clothes

Question 1

	Ranking	Cookies
OZ	1	36
LEVI	$\frac{1}{2}$	12

- Absolute Advantage: OZ has absolute advantage in both

Ranking: OZ 1 > $\frac{1}{2}$ Levi

Cookies: OZ 36 > 12 Levi

- Comparative advantage:

* To rake 1 yard Oz does not bake
36 cookies

* To rake $\frac{1}{2}$ yard Levi does not bake
12 cookies. Consequently, for 1 yard he does
not bake 24

* Op. cost Oz 36 < 24 Op. cost Levi

* Levi should bake cookies

Oz should rake the leaves

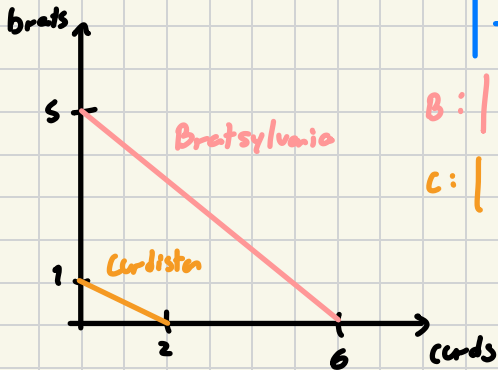
Question 2

Angular coefficient

$$\left| \frac{y_1 - y_0}{x_1 - x_0} \right|$$

$$B: \left| \frac{3}{-6} \right| = \frac{5}{6}$$

$$C: \left| \frac{1}{-2} \right| = \frac{1}{2}$$

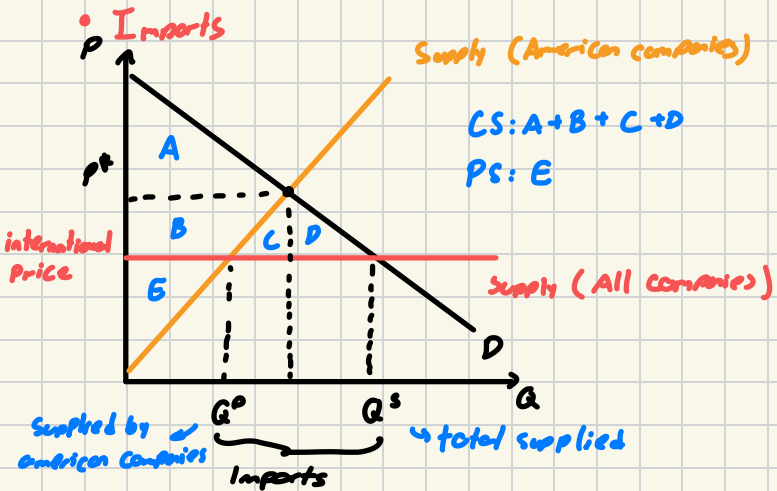


Since **op. cost C** < **op. cost B**, **C** should prod. Curds

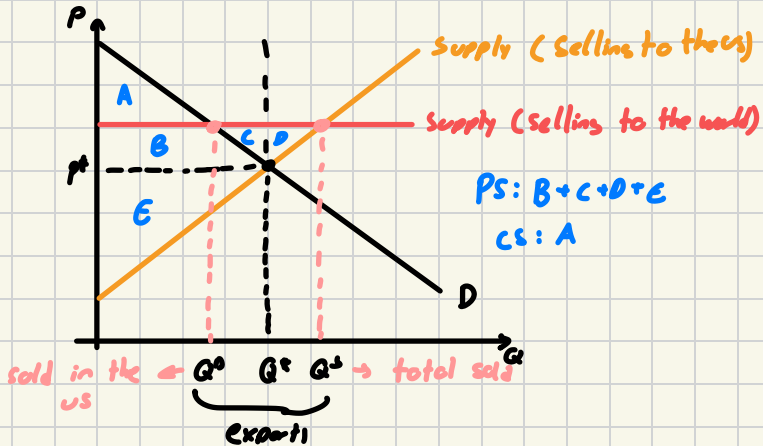
Question 3

• Idea:

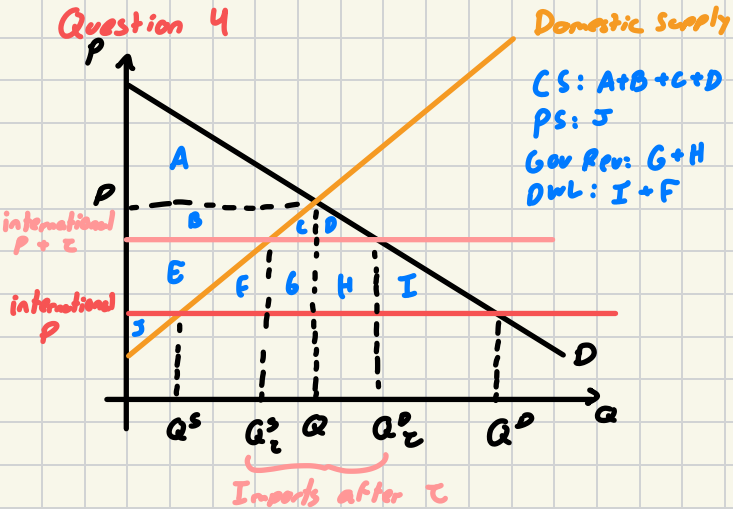
- Computer brands: Apple, Samsung, Sony, Lenovo, Dell, LG, hp, Microsoft
- When you open the market more companies can sell the good
- More competitors, more elastic is the supply curve
- Infinite competitors = perfect elastic supply



Exports



Question 4



Question 5

a) Demand: $P = 50 - Q$

Supply: $P = 10 + 3Q$

EQ: $50 - Q = 10 + 3Q$

$40 = 4Q \Rightarrow Q = 10$

$P = 50 - 10 = 40$

$$b) P_0^D: 50 - 0 = 50$$

$$P_0^S: 10 + 3 \cdot 0 = 10$$

$$CS: \frac{(50 - 40) \cdot 10}{2} = 50$$

$$PS: \frac{(40 - 10) \cdot 10}{2} = 150$$

$$TS: 150 + 50 = 200$$

c) New $P = 34$

• Demand: $34 = 50 - Q \Rightarrow Q = 16$

• Supply: $34 = 10 + 3Q \Rightarrow Q = 8$

Domestic Firms will sell: 8

Consumers will buy: 16

Imports: $16 - 8 = 8$

d) Consumer surplus:

• How much are they buying? 16

• Prices: $p_0^D = 50$ $\bar{p} = 34$

$$\frac{(50 - 34) 16}{2} = 128$$

Producer surplus

• How much domestic firms are selling? 8

• Prices: $p_0^S = 10$ $\bar{p} = 34$

$$\frac{(34 - 10) 8}{2} = 96$$

Total $96 + 128 = 224$

