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Note on Trade and Comparative Advantage

Introduction

Whether nations benefit from trade is a question that has been passionately debated throughout history. The theory of comparative advantage is one of the more useful, yet frequently misunderstood, topics in economics and public policy. In the almost two centuries since David Ricardo first introduced the theory it has come to be widely accepted among professional economists. But free trade remains relatively unpopular among the general public, with only a 32% approval.[1]

This note introduces the theory of comparative advantage. It is organized into five sections. Section one provides everyday examples. Section two contains a brief intellectual history of thinking about trade. Section three introduces the basic model. Section four presents additions to the basic model. Traditional arguments against free trade are found in section five. A companion note, "Beyond Comparative Advantage: Theories of Strategic Trade" (WDI case # 1-428-935) introduces modern approaches, including game theory and strategic trade.

Everyday Examples

> A famous and wealthy impresario of stage and screen in the 1940s, Billy Rose was also a world-class typist and stenographer with many awards to his credit. He would thus have encountered enormous difficulty in hiring a secretary who could work nearly as well as he himself could. Still, he hired secretaries because even though he was the world's best at the job, he could still earn much more in an hour spent manipulating his stage and screen empire than he could in typing.[2]

This is what Ricardo's concept of comparative advantage is all about. When compared to his secretaries, Billy Rose had an absolute advantage in both entertaining the audience and typing. Nevertheless, secretaries were hired by Billy Rose to allow him to focus on his *relative* advantage—managing the entertainment business.

There are numerous examples of individuals utilizing the concept of comparative advantage in their everyday life:

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