

# Module 4

## Comparative Advantage

Mr. Hess  
AP Macroeconomics

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## Ricky Ricardo



- ◆ Lucy's Cuban-American husband drumming on the bongo

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## David Ricardo



- ◆ English economist responsible for promoting comparative advantage as the basis of trade. No relation to Ricky Ricardo.

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## Absolute Advantage vs. Comparative Advantage

- ◆ Absolute Advantage
  - Individual - exists when a person can produce more of a certain good/service than someone else in the same amount of time
  - National - exists when a country can produce more of a certain good/service than another country can in the same amount of time
- ◆ Comparative Advantage
  - Individual/National - exists when an individual or nation can produce a good or service at a lower opportunity cost than can another individual/nation

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# Specialization

- ◆ Individuals and countries can be made better off if they will produce what they have a comparative advantage in, and trade with others for whatever else they want/need.

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# Example

- ◆ Assume David Ricardo and Ricky Ricardo are going to throw a party in exactly one hour. They decide on serving homemade pizzas and cakes because when you guys think of a party you always think of pizza and cake. Naturally, right? Also, assume that they have 15 ovens in their apartment and plenty of pots and pans to get all their cooking done. Use the information on the next slide to determine who should produce what.

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# Example

	David Ricardo 	Ricky Ricardo 
Bake Cakes	2 cakes/hr	4 cakes/hr
Make Pizza	6 pizzas/hr	8 pizzas/hr

Who has the absolute advantage in baking cakes?   
Who has the absolute advantage in making pizza? 

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# Example

	David Ricardo 	Ricky Ricardo 
Bake Cakes	2 cakes/hr	4 cakes/hr
Make Pizza	6 pizzas/hr	8 pizzas/hr

Why?  
Well, because  $4 \text{ cakes} > 2 \text{ cakes}$  &  $8 \text{ pizzas} > 6 \text{ pizzas}$  

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# Example

	David Ricardo 	Ricky Ricardo 
Bake Cakes	2 cakes/hr	4 cakes/hr
Make Pizza	6 pizzas/hr	8 pizzas/hr

Who has the comparative advantage in baking cakes?  
Who has the comparative advantage in making pizza?

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# Example



Who has the comparative advantage in baking cakes?  
Who has the comparative advantage in making pizza?

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# Example



Ricky only gives up 2 pizzas in order to bake a cake,  
whereas David gives up 3 pizzas in order to bake a cake

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# Example



Furthermore, it only cost David  $\frac{1}{3}$  of a cake to make a pizza,  
whereas it costs Ricky  $\frac{1}{2}$  of a cake to make a pizza.

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