

1 The Study of Economics

2 The Production Possibility Frontier Model

3 Comparative Advantage and Trade

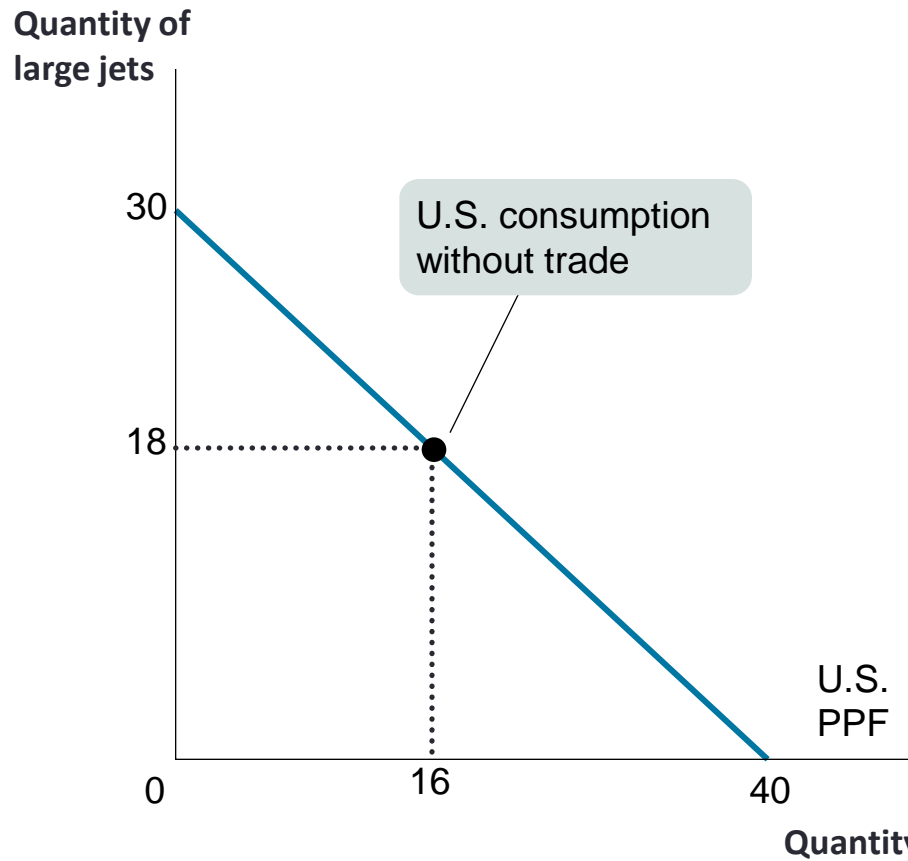


Gains from Trade

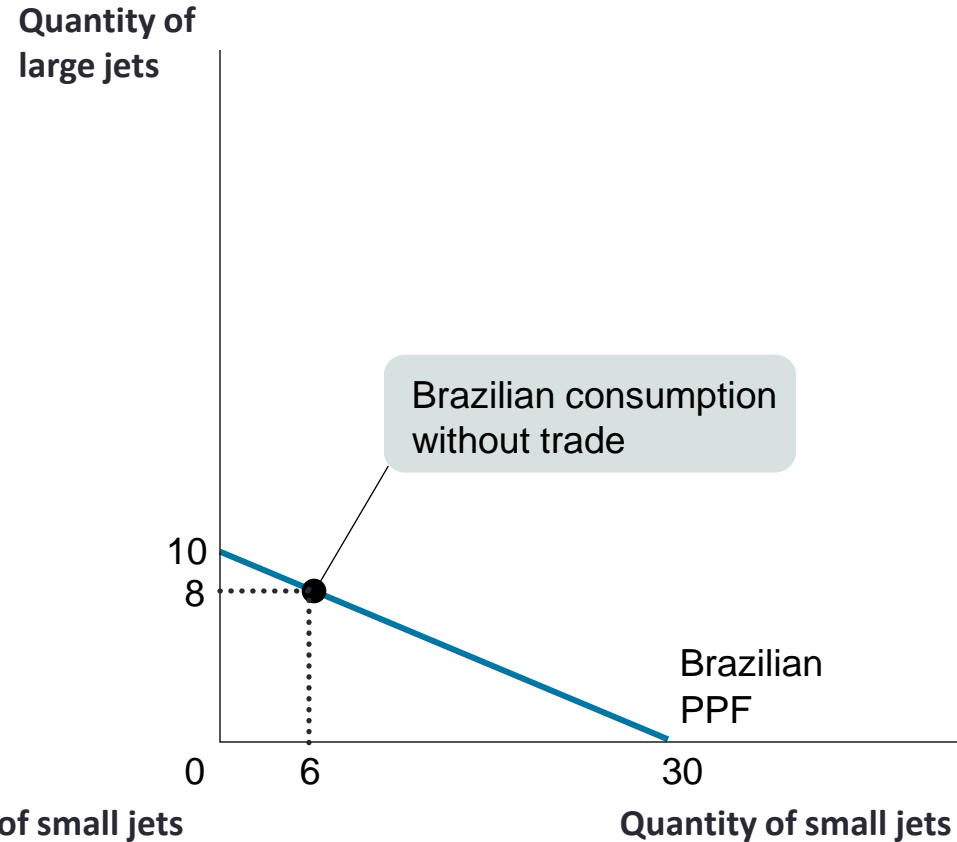
- The key to a much better standard of living for everyone is **trade**.
- The reason we have an economy is that there are **gains from trade**.
- Gains from trade arise from **specialization**.

PPF for Two Countries: Comparative Advantage & Gains from Trade

(a) U.S. Production Possibilities



(b) Brazilian Production Possibilities



Since each country has a different opportunity cost, it makes sense to specialize and trade...

U.S. and Brazilian Opportunity Costs

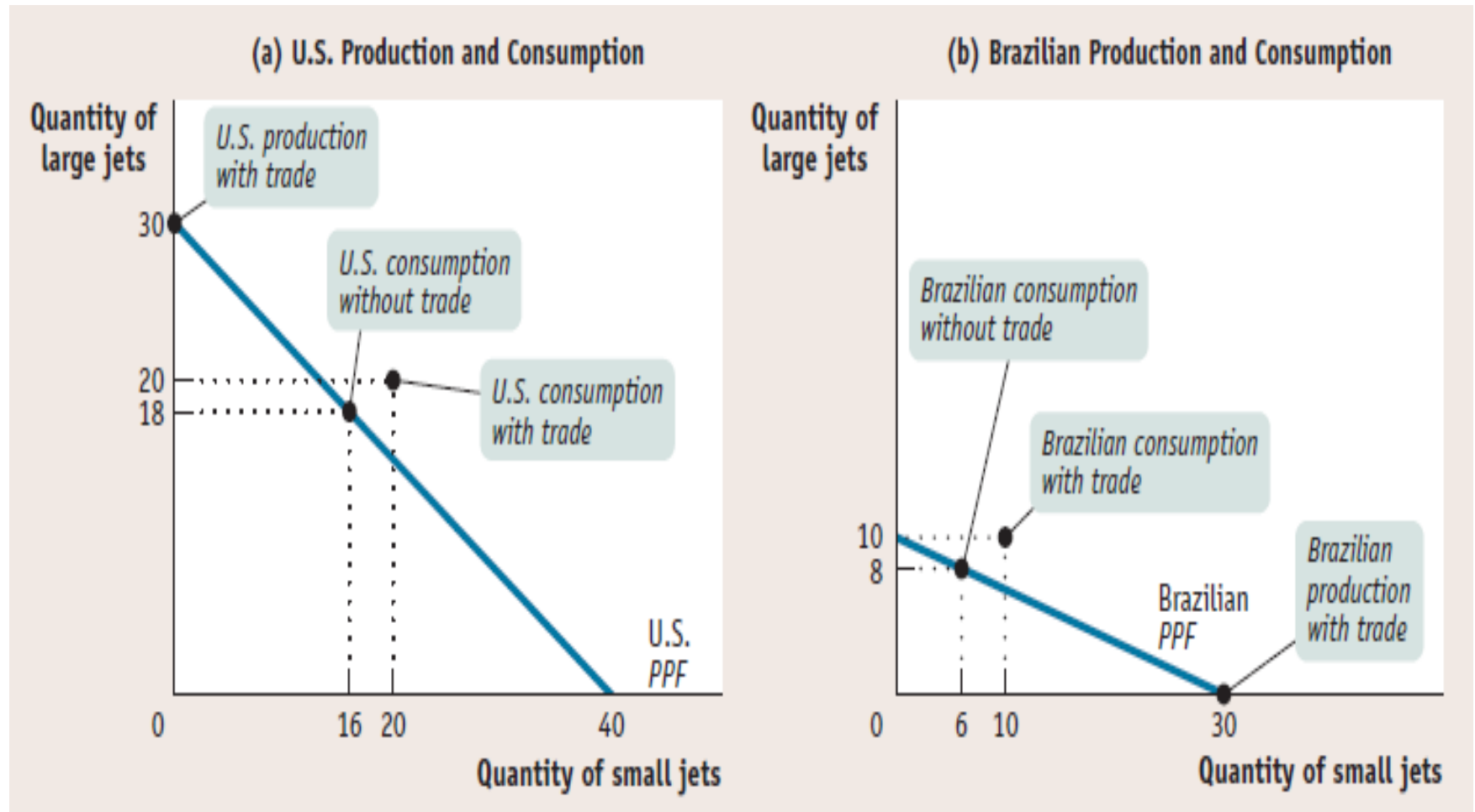
	U.S. Opportunity Cost		Brazilian Opportunity Cost
One small jet	$\frac{3}{4}$ large jet	>	$\frac{1}{3}$ large jet
One large jet	$\frac{4}{3}$ small jets	<	3 small jets

- Brazil has a **comparative advantage** in small jets. The U.S. has a **comparative advantage** in large jets.
- The U.S. has an **absolute advantage** in both jets.

How the U.S. and Brazil Gain from Trade

		<u>Without Trade</u>		<u>With Trade</u>		Gains from Trade
		Production	Consumption	Production	Consumption	
United States	Large jets	18	18	30	20	+2
	Small jets	16	16	0	20	+4
Brazil	Large jets	8	8	0	10	+2
	Small jets	6	6	30	10	+4

Comparative Advantage & Gains from Trade



Comparative Advantage and Gains from Trade

- Both countries are better off when they each specialize in what they are good at and trade.
- Brazil should specialize in small jets.
- The U.S. should specialize in large jets.

Comparative Advantage and Gains from Trade

- **Comparative advantage** is the basis for trade.
 - Trade can be beneficial to both even if one has an **absolute advantage** in the production of both goods.
- The PPF teaches two important lessons.
 - By agreeing to specialize and trade, both traders can be better off.
 - Every country has a comparative advantage in something.

Economics in Action

Most clothing is made overseas in nations poorer and less productive than the U.S. because they have a comparative advantage in the production of clothes.

