

Theory of International Trade

Comparative Cost Advantage Theory – Part 3

Comparative Cost Advantage Theory

ii. Gain from trade:

- More production; more consumption and hence more welfare for both the countries and for the world.

Comparative Cost Advantage Theory

- How gain:

- Gains for Portugal:

- In absence of trade, Portugal: $1 W = 0.89 C$
- After Trade, Portugal: $1 W =$ between 0.89 and $1.2 C$

Comparative Cost Advantage Theory

- So long as Portugal gets more than 0.89 unit of cloth for one unit of wine (or sacrifice less than 1.13 units of wine for one unit of cloth), she will gain.

Gains to Portugal will be more if 1 W is close to 1.2 C and vice-versa.

Comparative Cost Advantage Theory

■ Gains for England:

- In absence of trade, England: $1 C = 0.83 W$
- After Trade, England: $1 C = \text{between } 0.83 \text{ and } 1.13 W$

Comparative Cost Advantage Theory

- So long as England gets more than 0.83 unit of wine for one unit of cloth (gives less than 1.2 units of cloth for one unit of wine), she will be gain. Closer the exchange rate is towards 1.13 units of wine for one unit of cloth, more will be gain to England, and vice-versa.

To be Continued

Comparative Cost Advantage Theory

THANK YOU