

Theory of International Trade

Comparative Cost Advantage Theory – Part 5

Comparative Cost Advantage Theory

IV. Implications:

- Though Portugal produces cloth cheaper than England but still import from England and gain by saving labour used in cloth and using the same in wine industries.
- Specialisation according comparative advantage and trade will benefit both.
- Only condition for international trade is difference in comparative cost.

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V. Comparative Cost Advantage Theory in Terms of Money:

- Prof Taussig – Labour cost can be changed in terms of money cost.
- Suppose,
 - In country A
 - 1 day labour produces 20 units of wine, and
 - 1 day labour produces 20 units of cloth, while

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- In country B
- 1 day labour produces 10 units of wine, and
- 1 day labour produces 15 units of cloth,
- Hence, Country A has absolute advantage in both but comparative advantage in wine.

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- Hence,
 - A will specialize in wine
 - B will specialize in cloth
 - To convert in monetary terms, suppose labour cost in A is Rs.500 and in B, it is 400.

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Thus,

Money Cost of Commodities

Country	1 day labour output	Money cost of labor per day (Rs)	Money Cost or supply Price per unit of Output
A	20 Units of Wine	500	25
	20 Units of cloth	500	25
B	10 Units of Wine	400	40
	16 Units of Cloth	400	25

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- Thus, like Ricardian concept, country A will specialize in wine and export to B, and import cloth from B.
- Similarly, country B will specialize in cloth and export to A, and import wine from A.

To be continued

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THANK YOU