

## Econ Notes: Chapter 3

### *A Parable for the Modern Economy*

- Two goods: Meat and potatoes
- Two people: rancher and farmers
- If rancher produces only meat
  - And farmer produces only potatoes
  - Both Gain from trade
- If both rancher and farmer produce both meat and potatoes
  - THEY still gain from specialization and trade

### **Specialization and Trade** (See Chapter 3 in the book)

- Farmers- Specialize in growing potatoes
  - More time growing potatoes
  - Less time raising cattle
- Rancher- specialize in raising cattle
  - More time raising cattle
  - Less time growing potatoes
- Trade
  - .5oz of meat for 15oz of potatoes
- Both gain from specialization and trade

\*if you are rational you will not trade if it leaves you worst off

\*farmer can produce beyond the frontier bc of specialization of trade

\*David Ricardo –comparative advantage (foundation...

### *Comparative Advantage*

- Absolute advantage
  - Produce using fewer inputs than another producer
- Opportunity cost
  - whatever must be given up to obtain some ite
  - Measures the trade off between the two good that each produce faces
- Comparative Advantage
  - Produce a good lower cost than another produce
  - Reflects- relative opportunity cost
- Principle of comparative advantage
  - Each good- produces by the individual that has the smaller opportunity cost of producing that good

### One person

- Can have absolute advantage in both goods
- Cannot have a comparative advantage in both good

- For different opportunity costs
  - One person- comparative in one good
  - The other person- comparative advantage in other good.
- Opportunity cost of one good
  - Inverse of opportunity cost of the other
- **Gaines from specialization and trade**
  - Based on comparative advantage
  - Total production in economy rises
    - Increase in the size of the economy pie
    - Everyone- better of
- Trade can benefit everyone in society
  - Allows people to specialize in activities
    - Have a comparative advantage
- **The Price of Trade**
  - Must like between the two opportunity costs
- Principle of comparative advantage explains”
  - Interdependence
  - Gains from Trade
- **Should the Us Trade with countries**
  - Imports
  - Exports
- Principle of comparative advantage
  - Each good- produces by the country
    - Smaller opportunity cost of producing that goods
- Specialization and trade
  - All countries- greater prosperity

