

Econ 340
Lecture 3
Comparative Advantage and the Gains from Trade

Outline: Comparative Advantage and the Gains from Trade

- Why Countries Trade
 - Price Differences
 - Supply and Demand
 - Determinants of Prices
- Ricardian Model of Trade
 - Examples
 - Wages and Prices in the Ricardian Model
 - Lessons from the Ricardian Model
- Generality of the Gains from Trade
- Identifying Comparative Advantage
- Critiques of Comparative Advantage

Lecture 3: Comp. Advantage 2

Why Countries Trade

- Price differences
 - If prices differ by more than transport costs
 - Buyers in high-price country will import
 - Sellers in low-price country will export
 - Anybody in any country can profit by doing both
 - Buying in low-price country
 - and
 - Selling in high-price country

Lecture 3: Comp. Advantage 3

Why Countries Trade

- Thus, in all cases:

$P_A < P_B$ may lead to: trade $A \rightarrow B$
 that is, A exports
 B imports

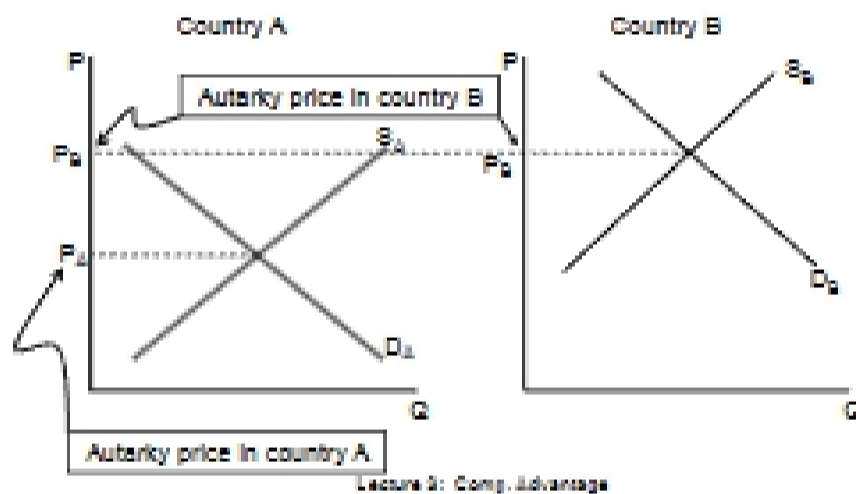
$P_A < P_B$ will lead to: trade $A \rightarrow B$
 if $P_B - P_A > t$
 $t = \text{trade cost}$

Lecture 2: Comp. Advantage

4

Why Countries Trade: Supply and Demand

"Autarky" = No trade

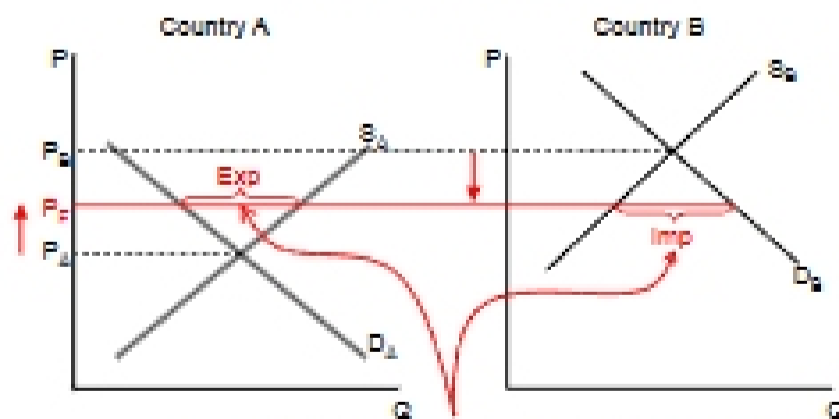


Lecture 2: Comp. Advantage

5

Why Countries Trade: Supply and Demand

Free Trade = No barriers to trade

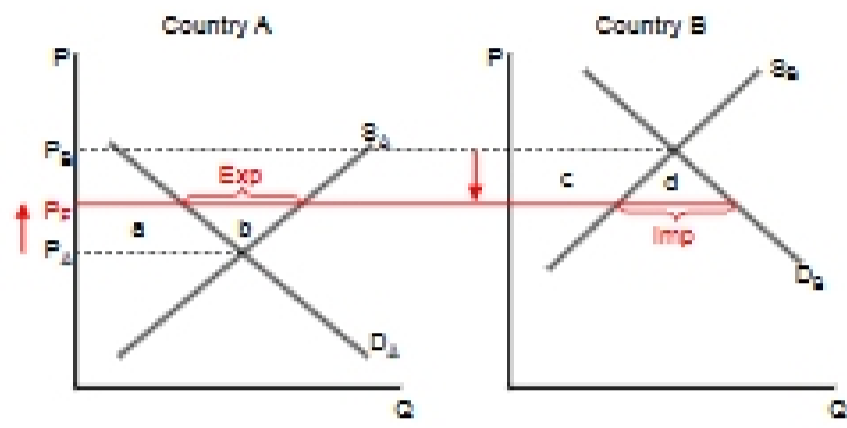


P_F is defined by these two distances being equal.

Lecture 2: Comp. Advantage

6

Use areas to measure gains and losses.



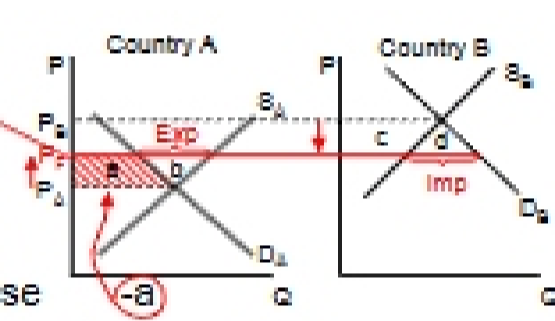
Lecture 3: Comp. Advantage

7

Loss of Consumer Surplus

Gains and losses from trade:

A's demanders lose



Lecture 3: Comp. Advantage

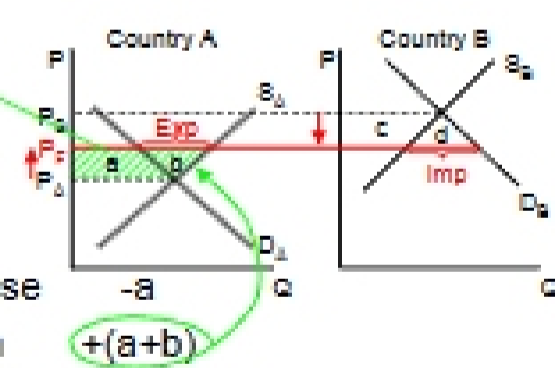
8

Gain of Producer Surplus

Gains and losses from trade:

A's demanders lose

A's suppliers gain



Lecture 3: Comp. Advantage

9
