

ECONOMICS

Paper-I : HISTORY OF ECONOMIC THOUGHT

What Is Comparative Advantage?

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Comparative advantage is an economy's ability to produce a particular good or service at a lower opportunity cost than its trading partners. Comparative advantage is used to explain why companies, countries, or individuals can benefit from trade.

When used to describe international trade, comparative advantage refers to the products that a country can produce more cheaply or easily than other countries.

While this usually illustrates the benefits of trade, some contemporary economists now acknowledge that focusing only on comparative advantages can result in exploitation and depletion of the country's resources.

The law of comparative advantage is popularly attributed to English political economist David Ricardo and his book *On the Principles of Political Economy and Taxation* written in 1817, although it is likely that Ricardo's mentor, James Mill, originated the analysis.

Diversity of Skills

People learn their comparative advantages through [wages](#). This drives people into those jobs that they are comparatively best at. If a skilled mathematician earns more money as an engineer than as a teacher, they and everyone they trade with are better off when they practice engineering.

Wider gaps in opportunity costs allow for higher levels of value production by organizing labor more efficiently. The greater the diversity in people and their skills, the greater the opportunity for beneficial trade through comparative advantage.

Example of Comparative Advantage

As an example, consider a famous athlete like Michael Jordan. As a renowned basketball and baseball star, Michael Jordan is an exceptional athlete whose physical abilities surpass those of most other individuals. Michael Jordan would likely be able to, say, paint his house quickly, owing to his abilities as well as his impressive height.

Hypothetically, say that [Michael Jordan](#) could paint his house in eight hours. In those same eight hours, though, he could also take part in the filming of a television commercial which would earn him \$50,000. By contrast, Jordan's neighbor Joe could paint the house in 10 hours.

Explaining Comparative Advantage

Understanding Comparative Advantage

Comparative advantage is one of the most important concepts in economic theory and a fundamental tenet of the argument that all actors, at all times, can mutually benefit from cooperation and voluntary trade. It is also a foundational principle in the theory of [international trade](#).

The key to understanding comparative advantage is a solid grasp of opportunity cost. Put simply, an opportunity cost is a potential benefit that someone loses out on when selecting a particular option over another.

In the case of comparative advantage, the opportunity cost (that is to say, the potential benefit that has been forfeited) for one company is lower than that of another. The company with the lower opportunity cost, and thus the smallest potential benefit which was lost, holds this type of advantage.

Another way to think of comparative advantage is as the best option given a trade-off. If you're comparing two different options, each of which has a trade-off (some benefits as well as some disadvantages), the one with the best overall package is the one with the comparative advantage.

In that same period of time, he could work at a fast food restaurant and earn \$100.

In this example, Joe has a comparative advantage, even though Michael Jordan could paint the house faster and better. The best trade would be for Michael Jordan to film a television commercial and pay Joe to paint his house. So long as Michael Jordan makes the expected \$50,000 and Joe earns more than \$100, the trade is a winner. Owing to their diversity of skills, Michael Jordan and Joe would likely find this to be the best arrangement for their mutual benefit.

Comparative Advantage vs. Absolute Advantage

Comparative advantage is contrasted with [absolute advantage](#). Absolute advantage refers to the ability to produce more or better goods and services than somebody else. Comparative advantage refers to the ability to produce goods and services at a lower opportunity cost, not necessarily at a greater volume or quality.

To see the difference, consider an attorney and their secretary. The attorney is better at producing legal services than the secretary and is also a faster typist and organizer. In this case, the attorney has an absolute advantage in both the production of legal services and secretarial work.

Nevertheless, they benefit from trade thanks to their comparative advantages and disadvantages. Suppose the attorney produces \$175 per hour in legal services and \$25 per hour in secretarial duties. The secretary can produce \$0 in legal services and \$20 in secretarial duties in an hour. Here, the role of opportunity cost is crucial.

To produce \$25 in income from secretarial work, the attorney must lose \$175 in income by not practicing law. Their opportunity cost of secretarial work is high. They are better off by producing an hour's worth of legal services and hiring the secretary to type and organize. The secretary is much better off typing and organizing for the attorney; their opportunity cost of doing so is low. It's where their comparative advantage lies.

Comparative advantage is a key insight that trade will still occur even if one country has an absolute advantage in all products.

Comparative Advantage vs. Competitive Advantage
Competitive advantage refers to a company, economy, country, or individual's ability to provide a stronger value to consumers as compared with its competitors. It is similar to, but distinct from, comparative advantage.

In order to assume a competitive advantage over others in the same field or area, it's necessary to accomplish at least