

Comparative Advantage

GCE A-LEVEL & IB ECONOMICS

Lesson Structure

- Comparative Advantage
- Impact of Emerging Economies
- Growth of Trading Blocs and Bilateral Trading Agreements

Comparative Advantage

Would anyone like to tell me about comparative advantage?

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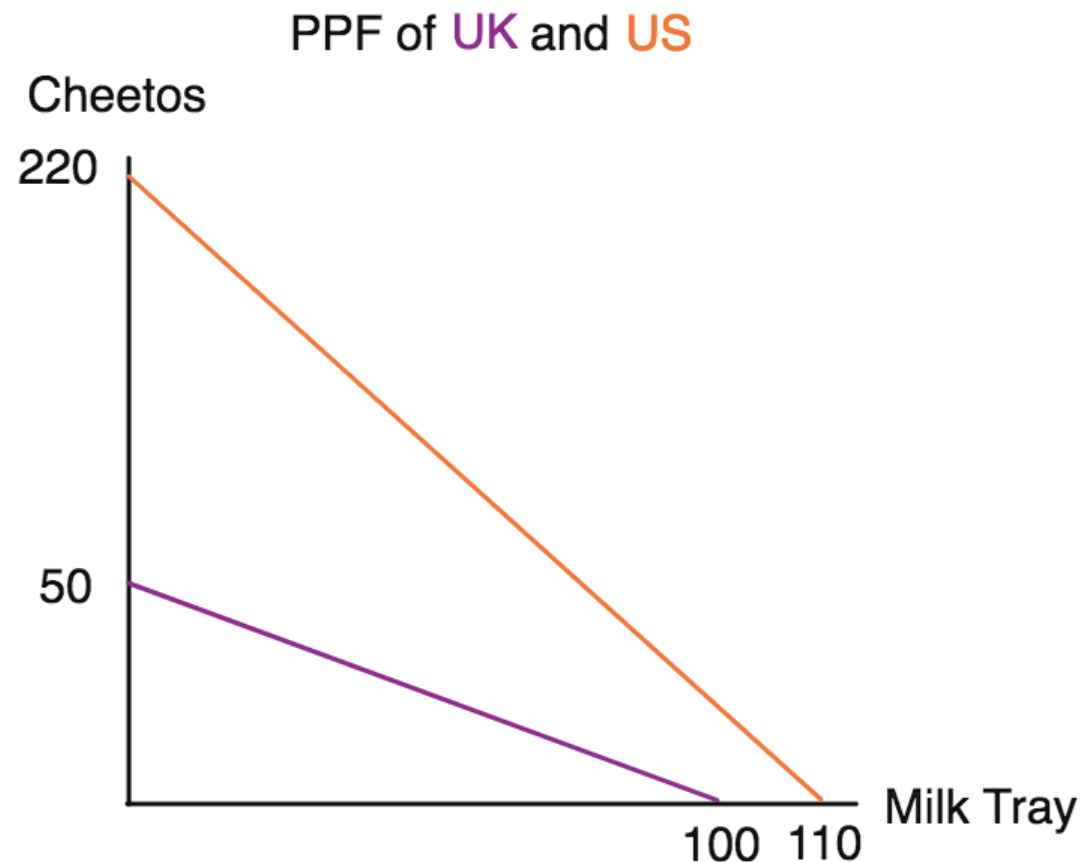
Countries should **specialize** in producing goods & services with the **lowest opportunity cost**. By doing so and **trading** with one another, this will maximize total output.



Cheetos and Milk Trays

Assume US and UK only produces Cheetos & Milk Trays.

- Which good does the US has absolute advantage in?
- What is the opportunity cost of producing one Milk Tray for the UK?
- What should each country specialize in?



Some Sources of Comparative Advantage

- Demographics
- Natural Resources
- Existing technology, research & development
- Infrastructure

Comparative Advantage & Trade

1. Discuss with your neighbour 2 sources of comparative advantage in any country, and how they made use of it.
2. Afterwards, think about how this has influenced their long term exports/imports with developed/developing countries



Sources of Comparative Advantage

- Demographics
 - E.g. China's overabundance of labor (1.4 bn people) leading to labor-intensive tasks being allocated there such as assembly of iPhones
- Natural Resources
 - E.g. Russia is rich in oil reserves (12% of world's oil in 2015)
- Existing technology, research & development
 - E.g. Self-driving car patents owned by US companies such as Uber, Waymo
- Infrastructure
 - E.g. Internet & telecoms infrastructure important for developing products such as cloud services

Effects from Comparative Advantage

- Cheap factors of production acquired by developed countries, including commodities and labour
- Reduction in poverty for developing countries, and higher living standards from higher export revenues (e.g. 88% poverty to 4% in 30 years in China)
- Shift in negative externalities taking place from developed countries to developing countries (e.g. pollution from cheap manufacturing)
- Structural unemployment in developed countries due to a lack of international competitiveness (e.g. UK Shipbuilding, Steel, Coal mining industries)

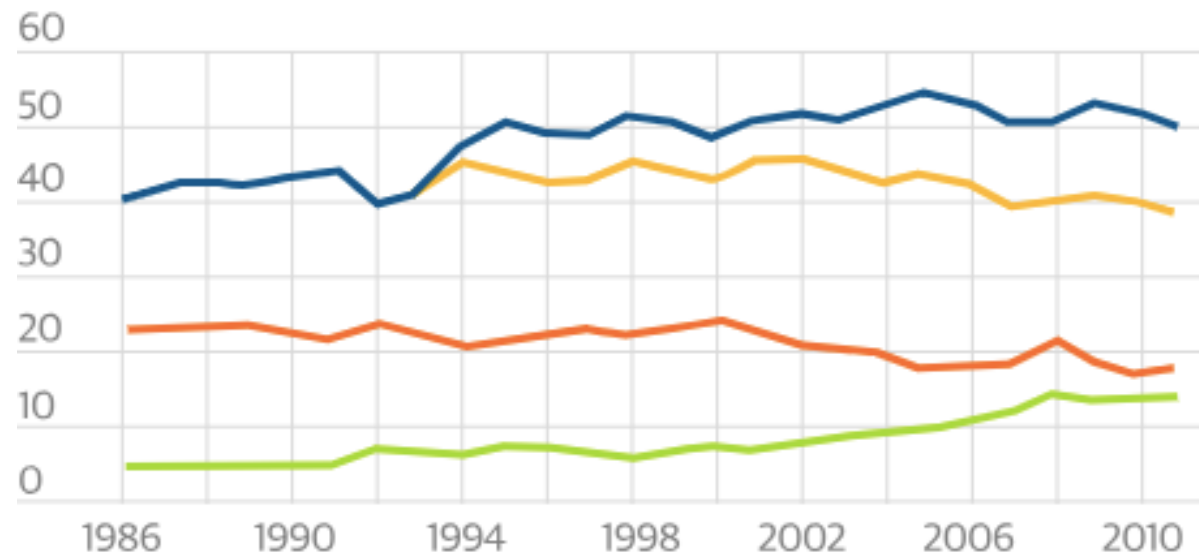
UK Trade with Emerging/EU Countries

UK trade

Per cent of total UK trade

EU (changing composition) | EU - 11

OECD non-EU | IMF emerging economies



Guardian graphic

Source: IMF

Impacts of Emerging Economies

- Emerging economies tend to over-specialise and become reliant on their export revenues. This leads to higher efficiency/trade integration but increased economic risk (E.g. Gulf area countries try to diversify away from oil export revenues)
- Developing countries can find it difficult to access developed markets due to protectionist measures including tariffs, regulation and other restrictions. (E.g. EU product regulations)
- Growth of emerging economies will ultimately make primary resources and foodstuffs costlier. This can have an inflationary impact on the world economy.

Trading Blocs

Have anyone heard of a trading blocs by any chance?



Trading Blocs

Trading blocs are groups of countries that have formed agreements between one another to reduce trade barriers amongst them (e.g. tariffs, quotas).

<https://www.youtube.com/watch?v=YDUq0DINhYk>

Let's watch this quick video and share what you have learnt.

Trading Blocs Are Good Right?

Trading blocs are often formed with neighboring countries due to lower cost in transporting goods between them. Their economies are also likely to be more compatible, making the agreement mutually beneficial.

Trading blocs encourage trade between member countries. This can lead to increased free trade between economies (trade creation).

However, customs unions can discourage trade with non-member countries due to common tariffs and trade barriers (trade diversion). This can lead to countries that are not in one being sidelined.

Trading Blocs Are Good Right?

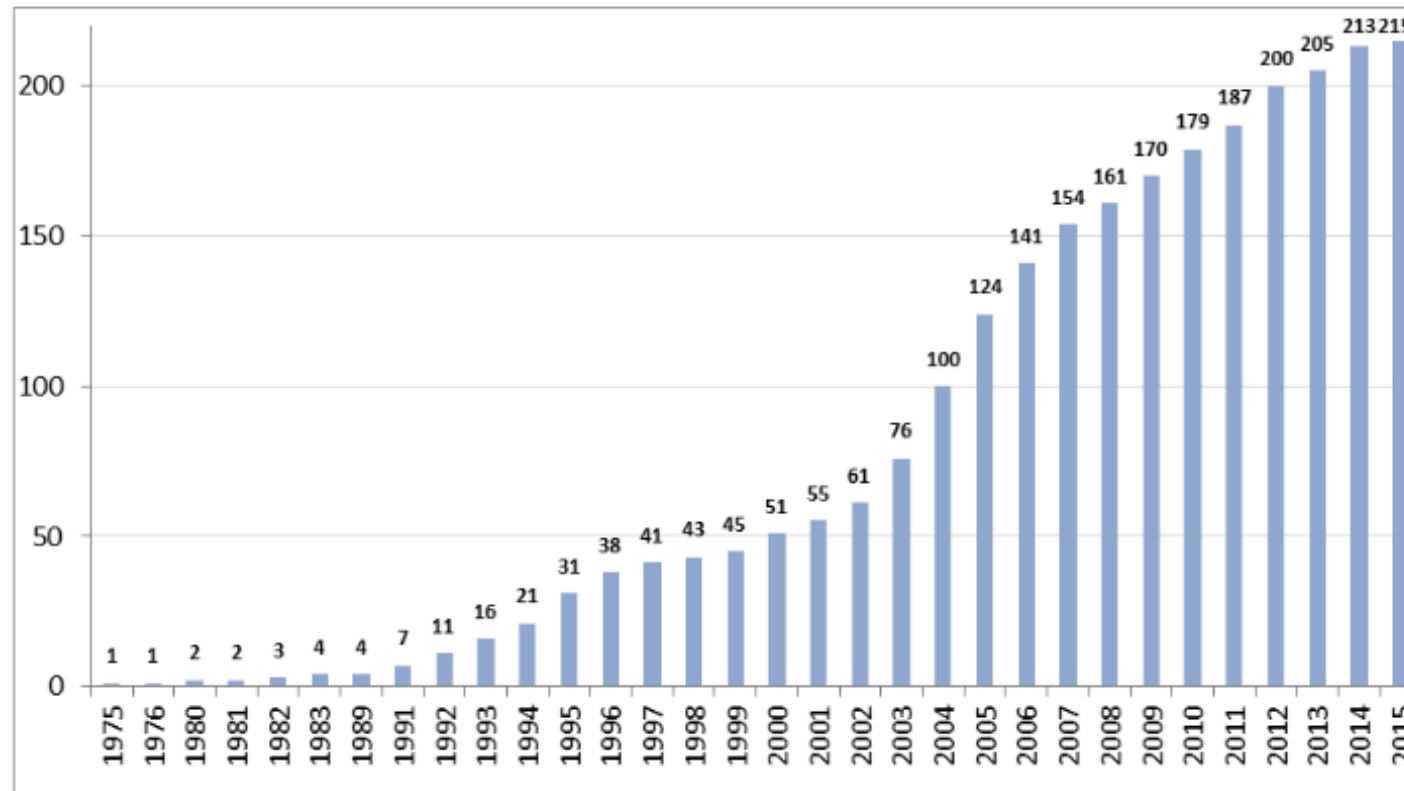
One advantage of UK leaving the EU is the ability for the UK to strike trade deals with other countries freely.

- We tried this with the US but would they risk their relationship with the EU (a significantly bigger market) by forming an agreement with us?



Global Number of Free Trade Areas

Figure 1: Total Number of FTAs (Cumulative)



Note: FTA count includes FTAs under negotiation, signed but not yet in effect and in force.

Source: ARIC FTA Database (Accessed 31 August 2015).