Comparative Advantage

	Wage Rates	Return on Capital
United States	+	1
Mexico	1	+

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Lectures in Macroeconomics- Charles W. Upton

Comparative Advantage

- Comparative Advantage makes the world (or at least international trade) go round.
- Everyone has a comparative advantage
- But what determines comparative advantage?

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Comparative Advantage

Factors Determining Comparative Advantage

- · Specialization
- · Climate
- Natural Resources
- · Economies of Scale
- · Investment Decisions
- · Capital Intensity

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Comparative Advantage

Some Definitions

- · Capital Abundant Nation
 - A higher level of capital per worker in one country relative to another, a high capital labor ratio. (US vs. Indonesia).



Comparative Advantage

Some Definitions

- Capital Abundant Nation
- Labor Abundant Nation
 - A lower level of capital per worker in one country relative to another, a low capital labor ratio. (Indonesia vs. US).



Comparative Advantage

Some Definitions

- · Capital Abundant Nation
- · Labor Abundant Nation
- Capital Intensive Production
 - Production that uses a relatively high level of capital per worker. (Electricity)



Comparative Advantage

Some Definitions

- · Capital Abundant Nation
- · Labor Abundant Nation
- Capital Intensive Production
- Labor Intensive Production
 - Production that uses a relatively low level of capital per worker. (Handcrafts)



Comparative Advantage

The Heckscher-Ohlin Theorem

- Capital abundant countries have a comparative advantage in commodities requiring capital intensity.
- Labor abundant countries have a comparative advantage in commodities requiring labor intensity.



Comparative Advantage

Factor Price Equalization

	Wage Rates	Return on Capital
Capital Abundant Nation	ļ	1
Labor Abundant Nation		



Comparative Advantage

Factor Price Equalization

	Wage Rates	Return on Capital
Capital Abundant Nation	1	1
Labor Abundant Nation	1	Ţ

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Comparative Advantage

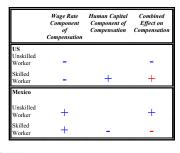
Factor Price Equalization

	Wage Rates	Return on Capital
United States	1	1
Mexico	1	Ţ

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Comparative Advantage

Human Capital



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Comparative Advantage

The Politics of Free Trade

- College graduates gain from free trade.
 - They support it
 - Also tend to be Republican
- HS graduates tend to lose from free trade
 - Tend not to support it
 - Also tend to be Democratic

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Comparative Advantage

End

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Comparative Advantage