

Comparative Advantage

	Wage Rates	Return on Capital
United States	↓	↑
Mexico	↑	↓

Comparative Advantage

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

Factors Determining Comparative Advantage

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

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).

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).

Some Definitions

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

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)

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.

Factor Price Equalization

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Human Capital

	Wage Rate Component of Compensation	Human Capital Component of Compensation	Combined Effect on Compensation
US Unskilled Worker	-		-
US Skilled Worker	-	+	+
Mexico Unskilled Worker	+		+
Mexico Skilled Worker	+	-	-

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

End

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