Theory of International Trade

Comparative Cost Advantage Theory

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I. Introduction:

- English Political economist – David Ricardo
- Book – "On the Principles of political Economy and Taxation" in 1817.
- Likely originated in James Mill's (Ricardo's mentor) analysis.
- Every country (World) engaged in trade will benefit if they trade on the basis of comparative cost advantage or disadvantage basis.

Comparative Cost Advantage Theory

- **What is comparative Advantage**: an economic term that refers to a country's ability to produce a goods and services at relatively lower opportunity cost than its trading partners.
- Reasons for international trade is difference in comparative advantage (efficiency) in the production (specialization) of different commodities.

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II. Assumptions:

1. There are two countries producing two goods.
2. Labour is the only factor of production.
3. Ricardo in his model ignores existence of money and considered cost of production in real terms i.e. in terms of labour (labour cost principle).
4. Free trade, complete absence of tariff, quota and free mobility of goods between the countries..

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5. There is perfect mobility of factors (labour) within the country but factor (labour) is immobile between the countries.
6. Constant returns to scale in bothe countries.
7. Full employment in both the countries.
8. No transportation cost.

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TO BE CONTINUED ....

THANK YOU