Absolute Cost Advantage

- Absolute advantage is a concept was first introduced by economist Adam Smith in his seminal work, "The Wealth of Nations," published in 1776.
- It developed in reaction of the restrictive and protectionist mercantilist views on international trade.

- Meaning: -
- A country has an absolute advantage if it can produce more output using fewer inputs than another country in the production of a particular product.
- It refers to a situation where a country can produce a certain good or service more efficiently and with lower resource inputs compared to another country.
- When one nation is more efficient than (or has an absolute advantage over) another in the production of one commodity but is less efficient than (or has an absolute disadvantage with respect to) the other nation in producing a second commodity, then both nations can gain by each specializing in the production of the commodity of its absolute advantage and exchanging part of its output with the other nation for the commodity of its absolute disadvantage.

Example

Before Trade

TABLE 2.1. Absolute Cost Differences in Two Countries

Country	Units of Labour (Man-days)	Commodities X	Y	Ratio of Exchange
A	1	20	10	1 Unit of X = 0·5 Unit of Y
B	1	10	20	1 Unit of X = 2 Units of Y

After International Tarde

TABLE 2.2. Gain From Trade

Country	Before Trade		After Trade		Gain from Trade	
	X	Y	X	Y	X	Y
A	20	10	40	–	+20	–10
B	10	20	–	40	–10	+20
World Production	30	30	40	40	+10	+10

- Before trade, Country A produces 20 units of X and 10 units of Y. After trade, as it specializes in the production of X commodity, the total output of 40 units of X is turned out by A and it produces no unit of Y.
- Country B produces 10 units of X and 20 units of Y before trade. After trade it specializes in Y and produces 40 units of Y and no unit of X.
- The gain is production of X and Y commodity each is of 10 units. The gain from trade for country A is +20 units of X and -10 units of Y so that net gain to it from trade is +10 units of X. Similarly net gain to country B is +10 units of Y.
- World production increased from 30 unit of X and 30 Unit of Y to 40 Unit of X and 40 Unit of Y

Assumption: -

1. **Two Countries, Two Goods Model: -** The absolute advantage theory often starts with a simplified scenario involving two countries and two goods.
2. **Fixed Resources and Labor Mobility: -** The theory assumes that resources such as labour, capital, and technology are fixed within each country and cannot easily move between industries or countries.
3. **Full Specialization**: -Absolute advantage assumes that countries will specialize completely in producing the goods they are most efficient
4. **Constant Costs**: - The theory assumes constant costs of production, Average Cost remain constant.
5. **No Transportation Costs or Trade Barriers**
6. **Perfect Competition**: - The model assumes perfect competition, where there are many buyers and sellers, and no single entity has the power to influence prices.

Implication

- **Mutual Benefit**: (Gain from trade) When countries specialize in producing the goods in which they have an absolute advantage, they can trade with other countries that specialize in producing goods where they have an absolute advantage.
- **Increased Output**: Specialization and trade based on absolute advantage allow countries to collectively produce more goods and services overall.
- **Resource Efficiency**: Absolute advantage is based on the idea that different countries have varying levels of efficiency in utilizing their resources,

Limitations and Real-World Factors

- Absolute advantage is a simplified concept that assumes that resources can move freely between industries, and that production efficiency remains constant regardless of scale.

- In reality, many factors can influence production efficiency, including technological advancements, economies of scale, government policies, and trade barriers.