**W2 V2 Abs and CA**

0:10  
In this video, we're going to define absolute and comparative advantage.

0:14  
These are probably the two most misunderstood terms in this concept and we're going to use it a lot in the next video.

0:21  
So let's make sure we define and understand it carefully here.

0:25  
OK, so when I'm calculating costs, I need to know potentially the answer to two questions.

0:30  
One is who's the best overall at producing a particular good?

0:34  
So focusing just on one good, Who's the best at it?

0:37  
And then a second question is who should specialize in me in meal production or in producing tables?

0:45  
I want to be a little bit careful here about thinking about the word specialized.

0:48  
Sometimes students over interpret this to mean that someone should only produce one thing.

0:54  
Not necessarily.

0:55  
Sometimes this could mean partial specialization, right?

0:58  
So you are good at producing this good, and you should be producing more of this good and less of the other.

1:04  
OK, and I'll become more precise when we get there.

1:06  
I just wanted to flag this up here.

1:10  
OK, so when we're asking who is the best at producing something, overall, the concept we use will be absolute advantage when we're asking who should specialize?

1:20  
Who should produce more of a certain good?

1:23  
That concept that we're looking for?

1:24  
There is comparative advantage.

1:27  
Now, sometimes students think that this is where they can stop, so they can just throw in the word comparative advantage and they're done with this, determining trade patterns.

1:34  
It's not going to be enough.

1:35  
We're going to need you to use and to explain why comparative advantage.

1:39  
So dig deeper and make sure you understand why we use the concept of comparative advantage in order to determine specialization, even if it's partial.

1:49  
OK, so absolute advantage.

1:51  
Here I want you to think about the person in your high school who is the best at everything, right?

1:57  
What does that mean here?

1:58  
Basically, an individual from country doesn't matter who you're looking at, they can do the best with what they have.

2:05  
In the sense that if a firm has the same inputs, for example, that's the firm that's going to give you the most output with the same inputs, right?

2:14  
Same resources.

2:15  
They're the ones who are going to give you the most with the same resources.

2:18  
Make sense that those would be the most productive people.

2:22  
You can flip it around, right, and say who can get the same output, who can reach the same finish line the fastest, or in this case, would be with the fewest inputs.

2:33  
Both of those are focusing on one good at a time and asking you to figure out who's the most productive.

2:41  
OK, now let's look at this with numbers, right?

2:44  
So we've got this information with Ann and Bill, and what we do have is with one hour with the same resource working, they produce.

2:52  
Now if you're looking at them separately, so if I'm just going to focus on tables, it means that I'm ignoring everything else.

2:59  
I'm not looking at meals, I'm just focusing on tables.

3:01  
I'm looking across everybody who's producing tables and it seems like with the same resource which is one hour and can produce more tables and OK, so absolute Advantage focuses on one good and ignores everything else so we can flip it around and say who uses the least amount of resource to produce one extra good.

3:23  
So here I'm thinking about one extra table.

3:26  
I'm ignoring meals, I don't care about what's happening in meal production and I'm going to see that Anne uses less time, fewer resources in order to achieve the same output which is 1 good.

3:40  
So either way, no matter how the data is given to us, we can see that Anne is more productive in table production.

3:46  
You can also flip it around and ask for meal production.

3:48  
Who's the most productive?

3:49  
They can be absolute advantage in just one good.

3:52  
Absolute advantage in both goods doesn't matter because what we're doing is examining each one separately.

3:59  
Now, does this mean that Anne should produce everything?

4:02  
Right?

4:03  
And that's going to be a question that we're going to have to think carefully about because students mostly stop at this and say, oh, this person is the best at everything.

4:09  
They should just do everything.

4:11  
But guess what, They have a limited amount of time, right?

4:12  
So we've got to actually think about what everybody else can do in the most efficient allocation possible.

4:19  
OK.

4:21  
So comparative advantage now thinks about shifting resources allocation.

4:26  
So already you should be primed to think, OK, they're good.

4:28  
This is better for economics, right, Because it's moving things around here.

4:31  
It's thinking about how I can produce one good at the lowest cost because I have the lowest opportunity cost, the lowest cost of the other good given up when I want an additional unit of this and it's the lowest cost producer, opportunity cost producer for that good compared to everybody else.

4:54  
Let's look at this with numbers.

4:55  
It may help to think about this in a better way.

4:59  
OK, so I'm going to do the same thing in here is if you're going to ask me about table production, sure.

5:03  
I'm going to ignore meals and I'm just going to focus on tables and I'm going to look at Ann and Bill and you're going to say, oh, it's the same thing as you did before?

5:10  
Not really.

5:11  
Because when I'm looking at opportunity cost, implicitly I'm already including table production in here because I'm noticing that one extra table means that I'm giving up one extra meal, right.

5:23  
It's the cost in terms of the other good given up.

5:26  
It's a trade off that I'm using.

5:28  
OK, so comparative advantage is looking at the lowest cost producer, but it's the lowest opportunity cost producer.

5:35  
OK, so you ignore one side.

5:37  
You look at tables if you want the cheapest table producer and you find the one with the cheapest cost of production.

5:44  
In this case, we're going to have and be the lowest opportunity cost producer for tables.

5:51  
So she should be the one producing more tables, OK.

5:54  
Bill, on the other hand, it doesn't mean that he doesn't have anything to produce because if you focus just on meals, you're going to see that Bill is the lowest cost producer of meals.

6:04  
Is that surprising?

6:05  
What kind of not?

6:07  
Because remember, the opportunity cost of each good is just the inverse of the other.

6:12  
So if Bill has a really high opportunity cost here, then the inverse is going to be lower, right?

6:18  
So while Anne may be the best at doing everything, she's relatively the best at producing meals, which means a Bill is relatively the best at producing tables.

6:28  
OK, pay attention to this.

6:31  
You may see this pattern sometimes.

6:32  
It's unintuitive, but this is at the heart of determining who should produce what.

6:36  
OK.

6:37  
Now no difference in opportunity cost.

6:40  
Well, you can still trade, but there's not going to be any benefits in trade because nobody's relatively the best at producing anything.

6:46  
Pay attention to this with the numbers.

6:47  
Sometimes this can be surprising to some students.

6:51  
OK, So here's what we've talked about, opportunity cost and absolute advantage, sorry, comparative advantage and absolute advantage.

7:01  
Both of these terms are looking for the lowest cost producer, OK.

7:06  
The difference in how they're framed is the comparative advantage is looking at the lowest opportunity cost producer?

7:13  
OK, the one who can produce an extra table by giving up the least amount of the other resource?

7:20  
OK, absolute advantage is also lowest cost, but it's ignoring the other thing or the other good altogether.

7:29  
It's like don't worry about meals just in table production, who uses the least amount of resource to produce one unit or the other way around.

7:36  
We are going to use who should produce what allocation decisions based on comparative advantage.

7:43  
Again, no surprise in there, because we've already kind of told you how important opportunity cost is for economists.