

## Biography

- David Ricardo was born in April 1772
- Started working at the age of 14 at the London Stock Exchange, made a fortune and worked in the banking business
- Developed an interest in economics and wrote books regarding his ideas
  - His interests led to his critiques of how the Bank of England was lending so much (1810) and how the government acted with tariffing corn (1815)
- He would buy a seat in parliament as a Whig in 1819 and would retire in 1823
- He would die in 1824 due to an illness

## Absolute and Comparative Advantage

- Absolute Advantage: A country can produce more units of a good with fewer resources.
- Comparative Advantage: A country can produce more units of a good with a lower opportunity cost.

For this graph, assume both countries are using the same amount of resources

Country	Units of Rice	Opportunity Cost of 1 Unit of Rice	Units of Video Games	Opportunity Cost of 1 Unit of Video Game
Country A	5	2/5 units of video games	2	5/2 units of video games
Country B	3	1/3 units of video games	1	3 units of video games

- Country A has the absolute advantage in both the production of rice and video games ( $5 > 3$ ,  $2 > 1$ )
- Country A has the comparative advantage in producing video games ( $5/2 < 3$ ), and Country B has the comparative advantage in producing rice ( $1/3 < 2/5$ )
- If there is no difference in opportunity cost, there is no gain from trading
  - However, if there is a difference, then within this model, each country will have its own comparative advantage in producing its own good
- By looking through the lens of comparative advantage, Ricardo argues that countries should specialize in what they have a comparative advantage in
  - Then, they should engage in global trade, exporting excess amounts of their advantaged goods while importing goods that they cannot produce well

## Importance of Comparative Advantage:

- Helps explain why countries participate in global trade and it argues for free trade
  - An argument for specialization in the face of greater output and efficiency

### **Limitations and Criticisms of Comparative Advantage:**

- The comparative advantage model is very simplified and does not consider phenomena in the real world
  - It assumes perfect information and competition
  - It assumes no trade barriers or no transport costs
  - The graph assumes that the PPF is straight (factors of production are not all equally suitable for production) and factor is mobile
  - Limited to two countries and two goods (although the theory can apply to more than two)
- Static comparative advantage ignores the dynamic nature of factors of production (workers can migrate)
- Arguments against the theory and the usefulness of comparative advantage are also similar to arguments against free trade
  - E.g. Overspecialization, the need to develop domestic industries for national security

### **Labour Theory of Value:**

- While inquiring about the relative prices between goods, he concluded that the value of a good is derived from the labour time that went into it (a natural price)
  - Salary would be irrelevant to this perception of value
  - E.g. If it took 5 hours to hunt and "produce" a fox and 10 hours to hunt and "produce" a deer, a fox would be worth twice as much as a deer
  - He argued that while market forces can temporarily affect the price in the short run, in the long run, the market price of a good will adjust back to its natural price
- Ricardo's work on this theory was an expansion of Adam Smith's original findings, and eventually, his own work would be incredibly influential on and expanded by Karl Marx

### **Limitations and Criticisms of the Labour Theory of Value:**

- People can spend a lot of time creating something of little to no value
  - E.g. Would the twenty minutes of our class creating "widgets" be worth the same as twenty minutes of flipping burgers?
- Sometimes products that have similar labor times have completely different market prices
- Eventually replaced with the subjectivist theory
  - People would only spend time producing a good if that good utility

