

LECTURE 16: ABSOLUTE AND COMPARATIVE ADVANTAGE II

- I. Smith Vs Ricardo
 - a. Between the Adam Smith reading and last class, you should have a good idea why specialization leads to greater productivity. But note that Adam Smith and David Ricardo have two very different explanations as to why this occurs.
 - b. Smithian specialization focuses on experience. People are interchangeable: once you've allowed time for the individual to develop enough understanding to master the position (recall the three reasons Smith used to explain why specialization leads to more productivity are all experience-based), anyone would be equally good at all positions.
 - c. Ricardian specialization focuses on attributes. People are *not* interchangeable: some people (or cities or countries) are better at some tasks than others due to factors that can't be changed or in the short run when there's no time to change.
- II. Other applications
 - a. Comparative advantage is one of the social science's most counter-intuitive ideas and it has many applications beyond international trade.
 - b. *Work*. Good employees recognize the importance of comparative advantage, especially as a starting employee.
 - i. Starting employees get assigned tasks. It's tempting to ask endless detailed questions about what exactly should be done. You want to do a good job, after all, and doesn't your boss know how she wants the task completed?
 - ii. But even if your boss could complete the task faster than you and better than you, your boss has other thing to do that you can't or shouldn't. You have the comparative advantage in this task; by asking endless questions, you're likely to rob your boss of her valuable time. She'll get angry and annoyed with you; she wants you to handle it so she can focus on something else.
 - iii. This doesn't mean you should never ask questions but you should make sure you *have* to ask a question. It's best to try to figure out stuff on your own before you bother someone with more valuable time than you.

- c. *Firms*. New companies are best positioned when they minimize the number of tasks they do that's beyond their core business. Even if the founders are trained accountants or lawyers, it's better to pass that task off to someone else, sometimes another firm entirely, and focus on how the business brings in revenue.
- d. *Cities*. Just as countries should specialize, so should cities. It's no surprise that so many successful urban areas had a handful of industries they are known for. Specialization allows for a sizable pool of relevant talent and infrastructure; the city not only gets the comparative advantage but the absolute advantage, too.

III. Limits

- a. Specialization is a wonderful but it can lead to problems. If you've taken macroeconomics with me, you should see a big one: a lack of diversification.
 - i. The Venezuelan government focused the country's economy on oil production. When the price of oil collapsed in 2014, they didn't have enough money to buy all the things they import. As of 2017, the Venezuelan economy is still in shambles.
 - ii. Natural disasters, changing prices, and technological change are just some of the factors that can harm an overly-specialized economy.
- b. The extent of the market limits the effectiveness of specialization; there is only so much demand for any particular product. This is why large communities have a wider variety of products (ethnic grocery stores, masseurs, fertility clinics, kayaking clubs) while smaller communities don't have many services and other services are provided by the same person (e.g. the local doctor is also the county coroner).
- c. People who have specialized can also get bored; from a management perspective, it's not a bad idea to switch tasks around. What you lose in specialty gains, you can get in enthusiasm.