Chapter 3: Interdependence and the Gains from Trade
Principles of Economics, 6th Edition
N. Gregory Mankiw
Page 1

1. A Parable for the Modern Economy
   a. People benefit from the opportunity to trade.
   b. Production possibilities
      i. Figure 1: The Production Possibilities Frontier. P. 51.
   a. Specialization and Trade
      i. Figure 2: How Trade Expands the Set of Consumption
         Opportunities. P. 53.
         (1) The rancher gives up three pounds of meat for one pound of
             potatoes.
         (2) The farmer gives up one pound of potatoes to get three
             pounds of meat.
         (3) The rancher shifts production to 24 units of meat and 2 units
             of potatoes, while the farmer produces 4 units of potatoes
             and no units of meat.
         (4) Through trade they are able to move outside their
             production possibility curves.

2. Comparative Advantage: The Driving Force of Specialization
   a. Absolute advantage is the comparison among producers of a good
      according to their productivity. P. 54
      i. Def: Opportunity cost is whatever must be given up to obtain some
         item. P. 54
   b. Opportunity Cost and Comparative Advantage
      i. Economists use the term comparative advantage when describing
         the opportunity cost of two producers with the producer who has the
         smaller opportunity cost having the comparative advantage in
         producing that good.
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Page 2

ii. Table 1: The Opportunity Cost of Meat and Potatoes. P. 55.

<table>
<thead>
<tr>
<th>Opportunity Cost of:</th>
<th>1 Ounce of Meat</th>
<th>1 Ounce of Potatoes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Farmer</td>
<td>4 oz potatoes</td>
<td>1/4 oz meat *</td>
</tr>
<tr>
<td>Rancher</td>
<td>2 oz potatoes *</td>
<td>1/2 oz meat½</td>
</tr>
</tbody>
</table>

c. Comparative advantage and trade
i. Def: Comparative advantage is the comparison among producers of
   a good according to their opportunity cost. P 55.

ii. FYI: The Legacy of Adam Smith and David Ricardo, P. 57.

iii. Trade can benefit everyone in society because it allows people to
     specialize in activities in which they have a comparative advantage.

iv. Another basis for trade is economies associated with larger scales of
    operations.

3. Applications of Comparative Advantage
a. Should Tom Brady mow his own lawn?
   i. In the News: The Changing Face of international Trade, P. 59.

b. Should the United States trade with other countries?
   i. International trade is not like war, which is a negative sum games,
      but is instead a positive sum game.
      (1) While country as a whole gains, certain individuals may lose
          and therein lies the resistance to free trade.
   ii. Def: Imports are goods produced abroad and sold domestically.
       P. 58
   iii. Def: Exports are goods produced domestically and sold abroad.
       P. 58

4. Conclusion

5. Summary