

Absolute advantage theory analysis



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Background of Adam Smith

Adam Smith was a Scottish moral philosopher and pioneer of political economy. Adam Smith is well known with his classic works such as *The Theory of Moral Sentiments* and *The Wealth of Nations*. Adam Smith was cited as the father of modern economics and is still the most influential economics thinkers. *The Wealth of Nations* is considering as Adam Smith's most popular classic work and it is a first modern work of economics. Adam Smith was born in Kirkcaldy, Fife, Scotland and he was the son of Margaret Douglas and Adam Smith. He attends to the Burgh School of Kirkcaldy which was one of the best secondary schools of Scotland from year 1729 until year 1737 where Adam Smith learns about Latin, Mathematics, History and writing. Adam Smith later entered the University of Glasgow when he was fourteen years old where he developed his passion for reasons, liberty and free speech. In year 1740, Adam Smith entered Balliol College, Oxford until year 1746. Adam Smith was awarded with professorship from the Glasgow University in year 1751 and granted the title of Doctor of Laws (LL. D.). *The Wealth of Nations* was published in year 1776 and it was well known until today. He died in the Edinburgh on 17 July 1790 and was buried in Canongate, Kirkyard. Adam Smith had contributed more effort to the modern economics until his rest of life.

Theoretical background

Absolute advantage theory is generally attributed to Adam Smith for his publication of *An Inquiry into the Nature and Causes of the Wealth of Nations* in years 1776. During the 17th and 18th centuries, mercantilist was

dominant economic which advocated restrictions on import and done aggressive some efforts to increase the export. Famous economist Adam Smith claims that all nations are impossible to become rich simultaneously if following the mercantilist prescriptions because the export of one nation is another nation's import. " If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry employed in a way in which we have some advantage. The general industry of the country, being always in proportion to the capital which employs it, will not thereby be diminished ... but only left to find out the way in which it can be employed with the greatest advantage."(Adam Smith, 1776). Adam Smith advocate countries should find out which of the goods and services that they able to produce more efficiently than other countries. For example let's say there are two countries: country A and country B, and they produce only two goods which are shoes and shirts by using same resources

Country	Shoes	Shirts
A	10	2
B	5	4

By using the same resources, the country A able to produce 10 units of shoes and 2 unit of shirts while country B able to produce 5 units of shoes and 4 units of shirt.

Table above shown that country A can produce more shoes than country B. Country A can produce 10 pairs of shoes and country B only can only produce 5 pairs of shoes. So, what we can say about these is country A has an absolute advantage over country B in producing shoes. On the other hand, country B can produce more shirts than country A. Country B can produce 4 shirts compare with country B only can produce 2 shirts. As the result, country B has an absolute advantage over country A in producing shirts.

In conclusion, absolute advantage means ability a country has an absolute advantage over another in producing a good, if it can produce those good using resources than another country.

Discussion and argument

Discussion

The absolute advantages theory that was introduced by Adam Smith defines as the ability of a country to produce more number of a goods or services than the competitors by using the same amount of resources.

For example:

Country	Production of bags(unit)	Production of shoes(unit)
A	50	20
B	20	50

By using the same resources, country A able to produce 50 units of bags and 20 units of shoes while country B able to produce 20 units of bags and 50 units of shoes.

Country A had absolute advantages in production of bags because country A able to produce more number of bags than country B. Because of that, country A will specialize on production of bags. The Country A will export the bags and import the shoes.

Country B had absolute advantages in production of shoes because country B able to produce more number of shoes than country A. Because of that, country B will specialize on production of shoes. The country B will export the shoes and import the bags.

Based on absolute advantages theory, the country will need specialize in the goods and services that they able to produce more than other competitor by using same amount of resources and efficiently. The trade between country A and country B will beneficial to the both country

Argument

Advantages of Absolute Advantages Theory

Save cost

The absolute advantages theory can help the country to save cost. Based on absolute advantage theory, the country will specialize on producing the goods and services which are lower cost and decreasing the production of the goods and services which are higher cost which will cause the production cost decrease. For example, Malaysia able to produce 20 unit of shoes and 50 unit of batik cloths while Thailand able to produce 50 unit of shoes and 20 unit of batik cloths. Malaysia will specialize on producing batik cloths while Thailand will specialize on producing shoes

Increase of International Trade

Trade is important to obtain certain goods and resources that were not produced in the country. The absolute advantages theory will make the country specialize on producing the goods and services which are lower cost and decrease the production cost which will decrease of the production cost and cause the price of goods and services falls. The country can export their own specialize goods and services to other countries and import other goods and services. This will benefit the both countries by increase the producer profit and country income.

Increase of foreign investment

The absolute advantages that increase international trade will cause a country foreign investment to increase. With increase of the international trade, the investor from other countries will invest more money on the production of goods and services that country specializes causing local

industry to evolve. The evolve of an industry will help increase the job opportunities.

Disadvantage of Absolute Advantage Theory

More factors of production

There are several factors of production were used to produce goods such as capital, land and different types of labor. Usually, goods cannot be ranked according to absolute advantage because the production of a country requires one or more input but in another country might need lesser input. These issues are analyze in the Heckscher-Ohlin (factor abundance) theory of international trade.

Intra- versus inter-industry trade

Many countries engage in intra-industry trade, they exchange of similar types of goods. For example, exporting and importing car parts at the same time). This type of trade is becoming important. It can be based on market power and economies of scale, as analyzed in new trade theory.

Absence of absolute advantage

Absolute advantage is determined by simple comparison or labour productivities. It is possible for a country do not have absolute advantage in anything. It is always has a argument about the developing countries may lack of the technology to gain an absolute advantage in the production of any good. Therefore, they have no chance to compete on the global market and gain benefit from free trade. But, as analyzed in the Ricardian model

(comparative advantage), this assumption was wrong. Since technologically disadvantaged countries can compete on the global market by paying lower wages. It turns out that absolute advantage is neither a necessary nor a sufficient condition for exporting a certain good and gain from international trade.

Conclusion

In conclusion, Adam Smith was known as father of modern economic and was still the most influential economic thinker until nowadays. He had published two books that is *The Theory of Moral Sentiments* in year of 1759 and *The Wealth of Nations* in the year of 1776. *The Wealth of Nations* was Adam Smith most popular books and had contributed more to the economic world.

The Absolute Advantages Theory had introduced in Adam Smith publication of *An Inquiry into the Nature and Causes of the Wealth of Nations*. The absolute advantages theory defines the ability of a country to produce more goods and services than other countries by using same amount of resources and the country will specialize on the goods and services that they can make by using the most efficient way.

By using the absolute advantages theory, the country able to save the production cost, increase foreign investment and increase of international trade. Although the absolute advantages theory is beneficial to country but there is disadvantages to country such as a lot of factors of production, Intra-versus inter-industry trade, Absence of absolute advantage.

The improvement for absolute advantages theory is to change it from using absolute advantages theory to comparative advantages theory. There is no mutually beneficial to both countries that use absolute advantages theory although there is possibly gain. By using comparative advantages theory, the country able to reduce opportunity cost and specialize on the goods and product that are more lower opportunity cost.

Improvement

The countries that use the absolute advantages theory should change to comparative advantages. This is because there is no mutually beneficial although there is the possible gain from trade with the absolute advantages theory. Comparative advantages defines as the advantage in the production of a product enjoyed by one country over another when that product can be produced at lower opportunities cost. For example

Country	Computer	Cars
A	1600	1000
B	900	1800
Total Production	2500	2800

	Computer	Opportunity cost Cars	Opportunity cost
A	1600	$(1000/1600)= 0.100$	$(1600/1000)=$

		625	0	1.6
B	900	$(1800/900)= 2$	180	$(900/1800)= 0.5$
			0	5
Total			280	
production	2500		0	

Country A has lower opportunity cost in producing computer than country B so country A should specialize in producing computer while country B had lower opportunity cost in producing cars than country A so country B should specialize in production of cars. The production of Computer and Cars will increased after using comparative advantages theory and help the country to save more production cost.

Country	Computer	Cars
B	$(1000/0.625)+1600 = 3200$	0
A	0	$(900/0.5)+1800$
Total	3200	3600
Production		