

Comparative Cost Advantage – Definition and Example

Definition:

The Comparative Cost Advantage theory was developed by **David Ricardo**. It explains that even if a country does not have an absolute advantage in producing any good, it can still gain from trade by **specializing in goods where it has a comparative (relative) cost advantage** — that is, where it has the **lowest opportunity cost** of production.

In simple words, a country should produce and export goods that it can make at a **lower opportunity cost**, and import goods that it produces at a **higher opportunity cost**.

Example:

Let's take two countries — India and Sri Lanka, and two goods — Tea and Rice.

Country	Tea (units per worker)	Rice (units per worker)
India	10	5
Sri Lanka	6	2

Opportunity Cost Calculation:

- **India:** 1 unit of Rice = 2 units of Tea ($10 \div 5 = 2$)
1 unit of Tea = 0.5 unit of Rice ($5 \div 10 = 0.5$)
- **Sri Lanka:** 1 unit of Rice = 3 units of Tea ($6 \div 2 = 3$)
1 unit of Tea = 0.33 unit of Rice ($2 \div 6 \approx 0.33$)

Analysis:

- India has a lower opportunity cost for producing **Rice** (2 vs 3). → Comparative advantage in Rice.
- Sri Lanka has a lower opportunity cost for producing **Tea** (0.33 vs 0.5). → Comparative advantage in Tea.

Conclusion:

- India should specialize in **Rice**.
- Sri Lanka should specialize in **Tea**.
- Both can trade and gain from specialization and exchange.

Key Point:

Comparative cost advantage shows that mutual trade benefits are possible even if one country is less efficient in producing all goods, as long as their opportunity costs differ.