60 Second Adventures in Economics

4. The Principle of Comparative Advantage

60 Second Adventures in Economics – Number Four: The Principle of Comparative Advantage.

Whether you think economies work best if they're left alone or that governments need to do something to get them working, the one thing that can't be controlled is the rest of the world.

Fear of foreign competition once led countries to try and produce everything they needed, and impose heavy taxes to keep out foreign goods.

However, economist David Ricardo showed that international trade could actually make everyone better off, bringing in one of the first great economic models.

He pointed out that, even if a country can produce pretty much everything at the lowest possible cost, with what economists call an 'absolute advantage, it's still better to focus on the products it can make most efficiently – that sacrifice the least amount of other goods - and let the rest of the world do the same.

By specialising, they can then export these surpluses to each other and both end up better off.

This is the principle of comparative advantage – and it has persuaded many countries to sign up to free-trade agreements, but unfortunately, it can take a long time for countries to trade their way to prosperity.

And because it's now much easier to move to where the money is – it's increasingly not only goods that cross borders, but people - which has somewhat uprooted Ricardo's theory.