Specialisation and Trade

Specialisation is when we concentrate on a product or task. Surplus products can then be exchanged and traded creating the potential for gains in welfare for all involved. Specialisation happens at all levels of an economy:

1. Within the family for example the specialization of tasks within extended families in many of the world's poorest countries
2. Within businesses and organizations
3. In a particular country – for example Bangladesh is a major producer and exporter of textiles; Norway is a leading oil exporter. And Ghana is one of the biggest producers of cocoa in the world.
4. In a region of a country – for example for many years the West Midlands has been a centre for motor car assembly.

The gains from specialization

By concentrating on what people and businesses do best rather than relying on self sufficiency:

- **Higher output**: The total level of production of goods and services is raised and quality can be improved.
- **Variety;** Consumers have access to a greater variety of higher quality products
- **A bigger market:** Specialisation and global trade increase the size of the market offering opportunities for economies of scale.
- **Competition and lower prices:** Increased competition acts as an incentive to minimise costs, keep prices down and therefore maintains low inflation

The Division of Labour

The **division of labour** occurs where production is broken down into many separate tasks. Division of labour raises **output per person** as people become proficient through constant repetition of a task – "**learning by doing**". This gain in productivity helps to lower cost per unit and ought to lead to lower prices for consumers.

Limitations of division of labour

Unrewarding, repetitive work that requires little skill lowers **motivation** and hits productivity. Workers begin to take less pride in their work and quality suffers, the result may be a problem of **diseconomies of scale**. We often see dissatisfied workers becoming less punctual at work and the rate of **absenteeism** increases.

Many people may choose to move to less boring jobs creating a problem of high worker turnover for businesses. According to figures for 2010, the overall employee turnover rate for the UK to be 13.5% per year. In other words, nearly one worker in seven changes jobs each year. The highest levels of labour turnover are found in retailing, hotels, catering and leisure, call centres and among other lower paid private sector services groups

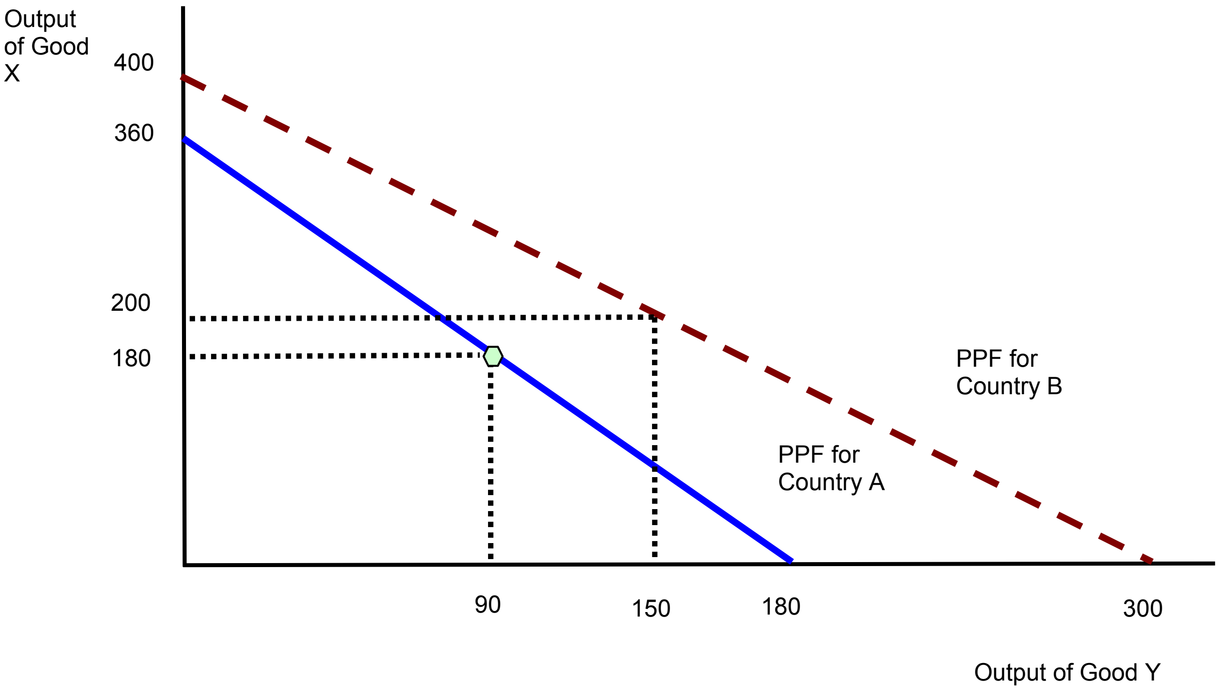
Some workers receive a little training and may not be able to find alternative jobs if they find themselves out of work (they may then suffer **structural unemployment**). Another disadvantage is that mass-produced standardized goods tend to lack variety for consumers

Comparative advantage

First introduced by **David Ricardo** in 1817, comparative advantage exists when a country has a **'margin of superiority'** in the supply of a product i.e. the cost of production is lower. Countries will usually specialise in and export products, which use intensively the factors inputs, which they are most abundantly **endowed**. So for example the Canadian economy which is rich in low cost land is able to exploit this by specializing in agricultural production. The dynamic Asian economies including China have focused their resources in exporting low-cost manufactured goods which take advantage of much **lower labour costs.**

In highly developed countries, the comparative advantage is shifting towards specializing in producing and then exporting **high-value and high-technology manufactured goods** and **high-knowledge services**.

The PPF and Specialisation



Two countries are producing two products (X and Y). With a given amount of resources:

	Output of X	Output of Y
Country A	180	90
Country B	200	150

In this example, country B has an absolute advantage in both products. Absolute advantage occurs when a country or region can create more of a product with the same factor inputs. But Country A has a comparative advantage in the production of good X. It is 9/10ths as efficient at producing good X but it is only 3/5ths as efficient at producing good Y.

Comparative advantage exists when a country has lower opportunity cost, i.e., it gives up less of one product to obtain more of another product. In our example above, for country A, every extra unit of good Y produced involves an opportunity cost of 2 unit of good X. For country B, an additional unit of good Y involves a sacrifice of only 4.3 units of good X.

There are gains to be had from country A specializing in the supply of good X and country B allocating more of their resources into the production of good Y.

Another example of comparative advantage

Consider two countries producing two products – digital cameras and vacuum cleaners.

Pre-specialisation	Digital Cameras	Vacuum Cleaners
UK	600	600
United States	2400	1000
Total	3000	1600

Were the UK to shift more resources into higher output of vacuum cleaners, the opportunity cost of each cleaner is one digital television. For the United States the same decision has an opportunity cost of 2.4 digital cameras. Therefore, the UK has a comparative advantage in vacuum cleaners.

If the UK chose to **reallocate resources** to digital cameras the opportunity cost of one extra camera is still one vacuum cleaner. But for the United States the opportunity cost is only 5/12ths of a vacuum cleaner. Thus the United States has a comparative advantage in producing digital cameras.

	Digital Cameras	Vacuum Cleaners
UK	0 (-600)	1200 (+600)
United States	3360 (+960)	600 (-400)
Total	3000	1600
	3360	**1800**

- The UK specializes totally in producing vacuum cleaners – doubling its output to 1200.
- The United States partly specializes in digital cameras increasing output by 960 having given up 400 units of vacuum cleaners.
- Output of both products has increased - representing a gain in economic welfare.

For mutually beneficial trade to take place, the two nations have to agree an **acceptable rate of exchange** of one product for another. There are gains from trade between the two countries. If the two countries trade at a rate of exchange of 2 digital cameras for one vacuum cleaner, the post-trade position will be as follows:

- The UK exports 420 vacuum cleaners to the USA and receives 840 digital cameras
- The USA exports 840 digital cameras and imports 420 vacuum cleaners

	Digital Cameras	Vacuum Cleaners
UK	840	780
United States	2520	1020

Total	**3360**	**1800**

Compared with the pre-specialisation output levels, consumers in both countries now have an increased supply of both goods to choose from.

We have seen in this chapter how specialisation and trade based on the idea of comparative advantage can lead to an improvement in welfare.