The production possibility curve is bowed because individuals specialize in the production of goods for which they have a comparative advantage and trade with others.

To produce on the production possibilities curve, individuals must produce those goods for which they have a comparative advantage.

Adam Smith argued that humankind’s proclivity to trade leads to individuals using their comparative advantage.
Markets, Specialization, and Growth

- The growth in per capita income in the past two millennia has been astonishing.
- This owes largely to the introduction of markets and democracy.

Markets, Specialization, and Growth

- Markets allow specialization, leading to trade and growth.

Markets, Specialization, and Growth

- As people are allowed to compete and specialize, they get better at what they do, develop new technologies, and the market grows ever larger.

Growth in the Past Two Millennia

- Per capita income (in 1990 international dollars)
- The graph shows a significant increase in per capita income from the 15th century onward.
The Benefits of Trade

- When people trade, both parties expect to benefit from the trade.
- Otherwise, why would they have traded in the first place?

The Benefits of Trade

- The argument for the benefits of trade underlies the general policy of laissez-faire.
  - Laissez-faire – an economic policy of leaving coordination of individuals’ actions to the market.

Production Possibilities without Trade

- Pakistan can produce 4,000 yards of textile per day or 1 ton of chocolate per day.
- Belgium can produce 1,000 yards of textile a day or 4 tons of chocolate per day.

Production Possibilities without Trade

- Pakistan has a comparative advantage in producing textiles.
- Belgium has a comparative advantage in chocolate.
Production Possibilities without Trade

- **Point A**: The combination of textile and chocolate chosen by Pakistan.

- **Point B**: The combination of textile and chocolate chosen by Belgium.

- **Point C**: The joint combination without trade.

**Pakistan's and Belgium's Individual Possibilities**

<table>
<thead>
<tr>
<th></th>
<th>Textile per day</th>
<th>Chocolate per day</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pakistan</td>
<td>2,000 yards</td>
<td>0.5 ton</td>
</tr>
<tr>
<td>Belgium</td>
<td>500 yards</td>
<td>2 tons</td>
</tr>
<tr>
<td>Total</td>
<td>2,500 yards</td>
<td>2.5 tons</td>
</tr>
</tbody>
</table>

Pakistan has chosen to produce 2,000 yards of textiles and 0.5 tons of chocolate.
Belgium has chosen to produce 500 yards of textile and 2 tons of chocolate.
Production Possibilities without Trade

- The two extreme combinations are both countries producing only textile (point D) and both producing only chocolate (point E).
- The combined production possibilities curve with no trade is drawn by connecting these two points.

Production Possibilities with Trade

- **Point F:** This is where each nation is focusing on that activity for which it has a comparative advantage.
  - Pakistan produces 4,000 yards of textile.
  - Belgium produces 4 tons of chocolate.
Production Possibilities with Trade

<table>
<thead>
<tr>
<th></th>
<th>No Trade</th>
<th>Specializing and Trade</th>
<th>Gains to Trade</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fabric</td>
<td>2,500 yards</td>
<td>4,000 yards</td>
<td>1,500 yards</td>
</tr>
<tr>
<td>Chocolate</td>
<td>2.5 Tons</td>
<td>4 tons</td>
<td>1.5 Tons</td>
</tr>
</tbody>
</table>

The combined PPC is bowed out because of Point F – comparative advantage and specialization.

U.S. Textile Production and Trade

- Two hundred years ago, the U.S had a comparative advantage in textile production.
- Now, countries with cheaper labor, such as Bangladesh have the comparative advantage in textile production.
U.S. Textile Production and Trade

- The gains from trade show up as higher pay for workers in Bangladesh and lower-priced cloth for U.S. consumers.