Theory of Absolute Cost Advantage:

Adam Smith, the father of economics, thought that the basis of international trade was absolute cost advantage. According to his theory, trade between two countries would be mutually beneficial if one country could produce one commodity at absolute advantage (over the other commodity) and the other countries could, in turn, produce another commodity at an absolute advantage over the first.

In other words , the principle of **absolute advantage** refers to the ability of a party (an individual, or firm, or country) to produce a greater quantity of a good, product, or service than competitors, using the same amount of resources. Adam Smith first described the principle of absolute advantage in the context of international trade, using labor as the only input. Since absolute advantage is determined by a simple comparison of labor productiveness, it is possible for a party to have no absolute advantage in anything; in that case, according to the theory of absolute advantage, no trade will occur with the other party. It can be contrasted with the concept of comparative advantage which refers to the ability to produce specific goods at a lower opportunity cost.

Origin of the theory

The main concept of absolute advantage is generally attributed to Adam Smith for his 1776 publication *An Inquiry into the Nature and Causes of the Wealth of Nations* in which he countered mercantilist ideas. Smith argued that it was impossible for all nations to become rich simultaneously by following mercantilism because the export of one nation is another nation's import and instead stated that all nations would gain simultaneously if they practiced free trade and specialized in accordance with their absolute advantage. Smith also stated that the wealth of nations depends upon the goods and services available to their citizens, rather than their gold reserves. While there are possible gains from trade with absolute advantage, the gains may not be mutually beneficial. Comparative advantage focuses on the range of possible mutually beneficial exchanges.

Assumptions of the Absolute Advantage Theory:

- Trade between the two countries.
- He took into consideration a two-country and two-commodity framework for his analysis.
- There is no transportation cost.
- Smith assumed that the costs of the commodities were computed by the relative amounts of labour required in their respective production processes.
- He assumed that labour was mobile within a country but immobile between countries.
- He implicitly assumed that any trade between the two countries considered would take place if each of the two countries has an absolutely lower cost in the production of one of the commodities.

Figure-1.Hours of work necessary to produce one unit

Country	Cloth	Wine
England	80	100
Portugal	120	90

Figure-2. Hours of work commit after specialization

Country	**Cloth**	**Wine**
England	80+100	0
Portugal	0	90+120

According to Figure 1, England commits 80 hours of labour to produce one unit of cloth, which is fewer than Portugal's hours of work necessary to produce one unit of cloth. England is able to produce one unit of cloth with fewer hours of labour; therefore England has an absolute advantage in the production of cloth. On the other hand, Portugal commits 90 hours to produce one unit of wine, which are fewer than England's hours of work necessary to produce one unit of wine. Therefore, Portugal has an absolute advantage in the production of wine.

If the two countries specialize in producing the good for which they have the absolute advantage, and if they exchange part of the good with each other, both of the two countries can end up with more of each good than they would have in the absence of trade. In the absence of trade, each country produces one unit of cloth and one unit of wine. Here, if England commits all of its labour (80+100) for the production of cloth for which England has the absolute advantage, England produces (80+100)÷80=2.25 units of cloth. On the other hand, if Portugal commits all of its labour (90+120) for the production of wine, Portugal produces (90+120)÷90=2.33 Units of wine. By exchanging the 2.25 units of cloth and the 2.33 Units of wine, both of the two countries can end up with more of each good than they would have in the absence of trade.

Achieving an Absolute Advantage

An absolute advantage is achieved through low-cost production. In other words, an absolute advantage refers to an individual, company, or country that can produce at a lower marginal cost. An absolute advantage is established when (compared to competitors):

- Fewer materials are used to produce a product
- Cheaper materials (thus a lower cost) are used to produce a product
- Fewer hours are needed to produce a product

- Cheaper workers are (in terms of hourly wage) used to produce a product

Advantages of Absolute Advantage

Absolute Cost Advantage

Absolute cost advantage results from the specialization of labour proposed by Smith in his theory. Specialization of labour, or division of labour, results in a significantly higher productivity per unit of labour, and in turn, a lower cost of production. Smith also used the concept of "Economies of Scale" to explain the lowering of production costs, as a higher output due to labour diversification would significantly reduce production cost.

Criticisms:

Adam Smith, theory has certain weaknesses.

Firstly, this theory assumes that each exporting country has an absolute cast advantage in the production of a specific commodity. This assumption may not hold true, when a country has no specific line of production in which it has an absolute superiority. In this context Ellsworth says "Smith's argument is not very convincing as it assumed without argument that international trade required a producer of exports to have an absolute advantage, that is, an exporting country must be able to produce with a given amount of capital and labour a larger output than any rival. But what if a country has no line of production in which it was clearly superior."

Most of the backward countries with inefficient labour and machinery may not be enjoying absolute advantage in any line of activity. So the principle of absolute cost advantage cannot provide complete and satisfactory explanation of the basis on which trade proceeds among the different countries.

Secondly, Adam Smith simply indicated the fundamental basis on which international trade rests. The absolute cost advantage had failed to explore in any comprehensive manner the factors influencing trade between two or more countries.

Thirdly, the 'Vent for Surplus' doctrine of Adam Smith is not completely satisfactory. This doctrine can have serious adverse repercussions on the growth process of the backward countries. These countries do not sell their surplus produce in foreign markets but are constrained to export despite domestic shortages for the reasons of neutralising their balance of payments deficit.