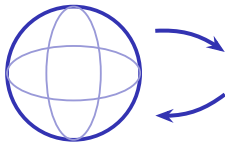


International Economic Issues

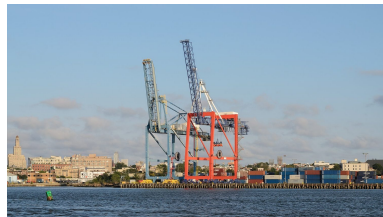
A-Level Economics ■ Topic 6

A-Level Economics



What we will cover

- 1 Comparative advantage
- 2 Protectionism
- 3 Tariffs
- 4 The balance of payments
- 5 Exchange rates
- 6 Correcting a deficit



trade moves goods worldwide

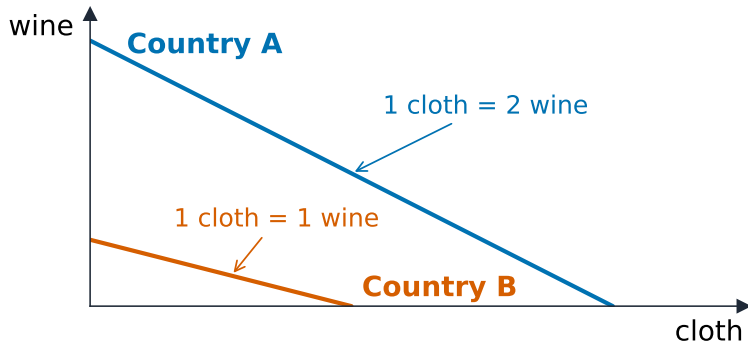


Comparative advantage

A country has **comparative advantage** in the good it can produce at **lower opportunity cost**. Both countries gain from trade if they specialise that way – even if one has absolute advantage in both.

Absolute advantage is who is better. Comparative advantage is who gives up less.

Comparative advantage, in detail



comparative advantage = lower opportunity cost

Country A can make more of both goods, but its PPC is steeper: it gives up 2 wine per cloth, while

Protectionism

tariff

tax on imports

quota

import limit

subsidy

help home firms

embargo

total ban

admin

red tape

For: infant industry , jobs, stop **dumping** . **Against:** higher prices, inefficiency, retaliation .

The protection tools, and the arguments for them

tariff

a tax on imports – raises their price and earns revenue

quota

a limit on the **quantity** imported – no revenue, and it hands the higher price to the importer

subsidy

paid to domestic producers so they can undercut imports

administrative barriers

extra paperwork and tough standards that make importing hard *without* an announced tariff

the arguments for

protecting an **infant industry** until it can compete, saving jobs, and stopping **dumping**

the arguments against

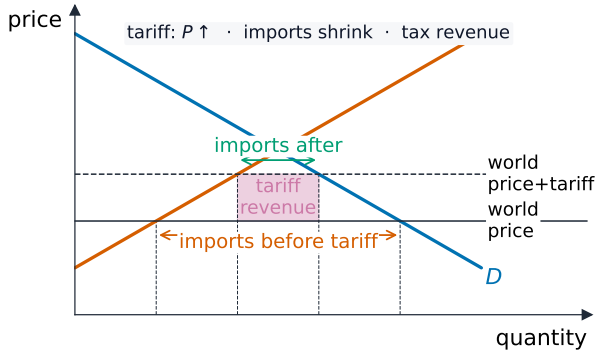
higher prices, retaliation, lost efficiency, and infant industries that never grow up

Every tool raises the domestic price. They differ in **who collects the difference** – the government, the importer, or the domestic producer.

Effects on stakeholders

A tariff affects each **stakeholder** differently: home producers gain, the government gains tariff revenue, but consumers lose (higher prices).

How a tariff works



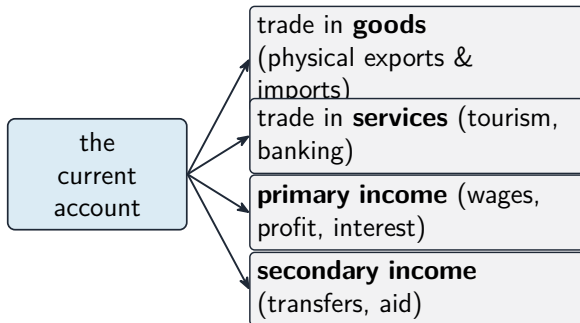
A **tariff** raises the price to “world price + tariff”:

- home supply rises, demand falls, imports shrink
- the box is government revenue

Producers & government gain;
consumers lose.



The balance of payments



The **current account** adds up four flows: trade in goods & services, plus **primary income** (work & investment) and **secondary income** (transfers). A **deficit** : buy more than you sell.

Reading the current account

trade in goods

visible exports minus visible imports

trade in services

invisibles – tourism, finance, shipping

primary income

income from assets held abroad – interest, profits, dividends

secondary income

transfers with **nothing given back**, such as foreign aid and remittances

a deficit

the country buys more from abroad than it sells

a surplus

the reverse – and one country's surplus is another's deficit

Correcting a deficit uses **expenditure-switching** policies (devaluation, tariffs) or **expenditure-reducing** ones (tighter fiscal and monetary policy). Name which.

Exchange rate systems



An **exchange rate** is the price of one currency in another.

- **floating** – set by demand & supply
- **fixed** – held by the central bank
- **managed** – floats, with occasional steering

Three systems, and what a surplus means

Floating

Set by demand for and supply of the currency; it adjusts on its own, and it can overshoot.

Fixed

A **fixed exchange rate** is held at a set value by the central bank, which buys and sells the currency to keep it there – and needs reserves to do it.

Managed

A **managed exchange rate** mostly floats, with the central bank stepping in now and then to steady it.

Current account surplus

A **current account surplus** is the opposite of a deficit: the country sells more abroad than it buys, and lends the difference to the rest of the world.

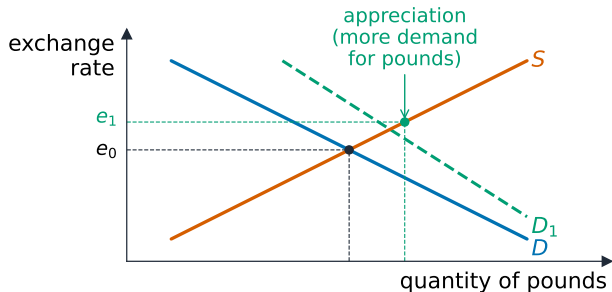
International trade lets countries buy and sell with each other – and every current-account balance is matched by a financial-account flow the other way.

Appreciation and depreciation

- **appreciation** – value rises: exports dearer, imports cheaper
- **depreciation** – value falls: exports cheaper, imports dearer

A depreciation can help the current account but raise **inflation**.

Appreciation and depreciation, in detail



floating: D and S set e · $D \uparrow \Rightarrow$ appreciate

A floating exchange rate is set where demand for the currency meets supply. More demand for pounds ($D \rightarrow D_1$) raises the rate – an appreciation.

Correcting a current account deficit

expenditure-reducing

lower demand
→ fewer imports

expenditure-switching

tariff or weaker
currency
→ home goods

supply-side

raise
competitiveness
(slow)

Correcting a current account deficit, continued



Trade flows at a container port: a current account deficit means imports of goods and services exceed exports

Correcting a current account deficit

Protectionism, continued

tariff

a tax on
imports
(raises
their price)

quota

a limit on the
quantity
imported

subsidy

help home
firms
sell more
cheaply

Three tools of protection: tariffs, quotas and subsidies

Exam tips

- Explain **comparative advantage** through opportunity cost (specialise where you give up least) and state its assumptions and limits.
- Evaluate **protectionism** (tariffs, quotas): it can protect jobs but raises prices and risks retaliation.
- Read the **balance of payments** (the current account covers trade, income and transfers).
- A **depreciation** makes exports cheaper and imports dearer, helping the current account only if demand is elastic enough (Marshall-Lerner).



Worked example – terms of trade

Export prices rise 100 → 110; import prices rise 100 → 105. Find the new terms of trade.

- Terms of trade = $\frac{\text{export price index}}{\text{import price index}} \times 100$
- $= \frac{110}{105} \times 100 = 104.8$
- Above 100 $\Rightarrow$ the terms of trade have **improved**: each export buys more imports.
- But an **improvement is not always good** – dearer exports may sell far fewer units.

“Improved” means only that the **ratio** rose. Whether the current account gains depends on **elasticity** – see Marshall-Lerner.

Limits of the theory

The gains are real, but the simple theory assumes no transport costs, no trade barriers, and that costs do not change with output.

In the real world these do not fully hold, and specialising in one good is risky if its price falls.

Topic 6 – key takeaways

1

Comparative adv.

specialise where opportunity cost is lowest

2

Protectionism

tariffs, quotas, subsidies – risk retaliation

3

Balance of payments

current account: goods, services, income

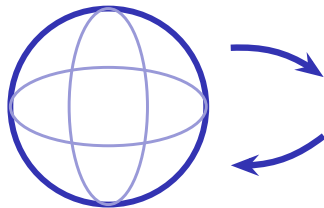
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Exchange rates

float/fix/manage; depreciation aids exports

Check yourself

- 1 Comparative advantage is about which cost?
- 2 A quota limits what?
- 3 Name a part of the current account.
- 4 Depreciation makes exports cheaper or dearer?



Answers 1. opportunity cost 2. the quantity imported 3. goods / services / primary / secondary income 4. cheaper