A-LEVEL ECONOMICS • EXERCISE SHEET

11.1 Policies to correct disequilibrium in the balance of payments

Name: _____ Class: _____ Date: _____ **Total: 24 marks**

KEY WORDS expenditure-switching 支出转换 • marshall–lerner condition 马歇尔勒纳条件 • expenditure-reducing 支
• j-curve effect J 曲线效应 • current account 经常账户

Objective

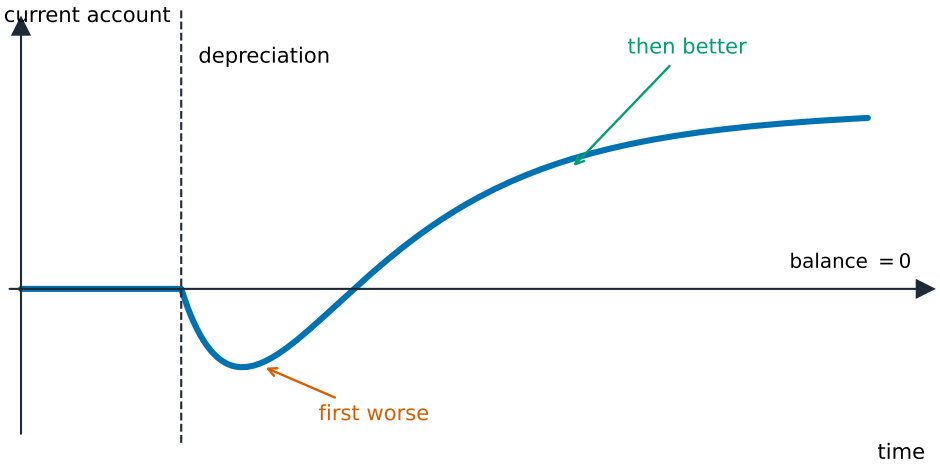
Build the skills to answer exam questions on **policies to correct a balance of payments disequilibrium** 纠正国际收支失衡 — **expenditure-reducing and expenditure-switching** 支出减少与支出转换 policies, the **Marshall–Lerner condition** 马歇尔勒纳条件, and the **J-curve** J 曲线.

You must be able to:

- describe expenditure-reducing and expenditure-switching policies
- state the Marshall–Lerner condition
- explain the J-curve effect

1 Worked examples

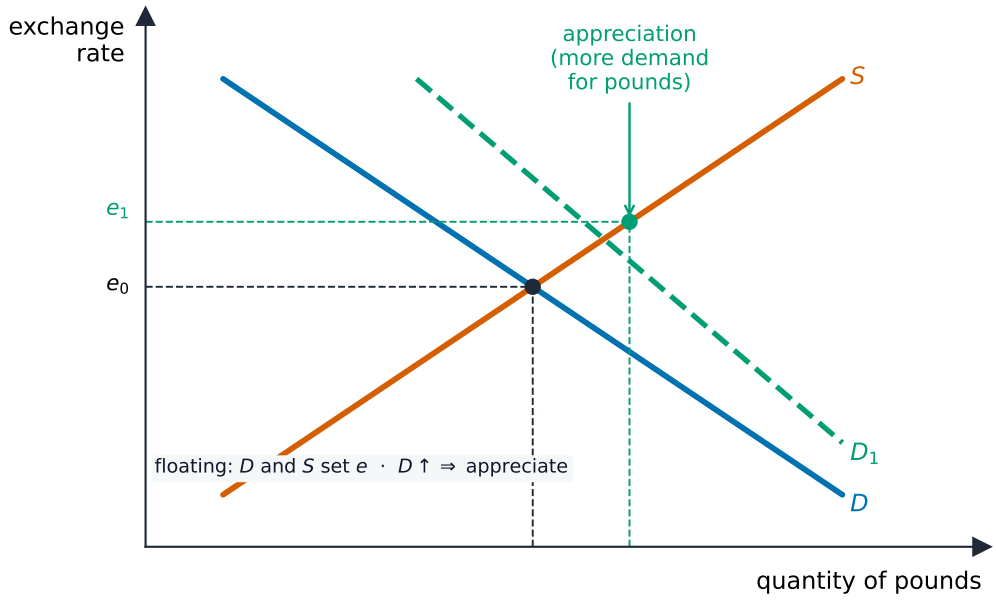
■ Why a depreciation takes time to work



J-curve: after depreciation, CA first worse then better

Imports cost more at once, but trade volumes adjust only slowly

- **Expenditure-reducing** 支出减少: higher taxes/interest rates cut imports — but slow growth.
- **Expenditure-switching** 支出转换: a lower exchange rate (**depreciation** 贬值 / **devaluation** 法定贬值) makes exports cheaper, imports dearer.
- **Marshall–Lerner:** a lower rate helps only if $PED_{\text{exports}} + PED_{\text{imports}} > 1$.



Expenditure-switching works through the exchange rate — a lower rate makes exports cheaper

- **J-curve:** the current account first **worsens**, then improves as volumes adjust.

Answer shapes: AO1 + AO2 + AO3 (analysis) + AO4 (a supported judgement *in*

context).

2 Practice

2.1 Define the term *expenditure-switching policy*. [2]

2.2 State the Marshall–Lerner condition. [2]

2.3 State what the J-curve shows happens just after a depreciation. [1]

3 Exam-style questions

3.1 A depreciation will improve the current account only if: [1]

- **A** the sum of the price elasticities of demand for exports and imports is less than 1
- **B** the sum of the price elasticities of demand for exports and imports is greater than 1
- **C** demand for both is perfectly inelastic
- **D** the exchange rate is fixed

3.2 Explain the J-curve effect of a depreciation on the current account. [6]

3.3 Discuss whether a depreciation of the currency is the best way to correct a current account deficit. [12]

Solutions

Economics answers are marked by **level of response** against the assessment objectives: award **AO1** knowledge, **AO2** application, **AO3** analysis and **AO4** evaluation.

2.1 a policy that switches spending from imports to domestically produced goods, mainly by lowering the exchange rate (2 for a clear definition; 1 for a partial idea).

2.2 that the sum of the price elasticities of demand for exports and imports must be greater than one ($PED_X + PED_M > 1$) (2 for the condition; 1 for a partial idea).

2.3 the current account first gets worse (1).

3.1 B. The Marshall–Lerner condition requires the elasticities to sum to more than 1.

3.2 *[6]* AO1 1 + AO3 up to 5 — straight after a depreciation, import prices rise at once but trade volumes are slow to change (contracts, habits) → so the import bill rises and the current account first **worsens**; over time buyers switch to cheaper exports and away from dearer imports → volumes adjust → the current account improves, tracing a J.

3.3 *[12]* AO1/AO2/AO3 up to 8 + AO4 up to 4. **For:** a depreciation makes exports cheaper and imports dearer, improving the current account if Marshall–Lerner holds. **Against:** the J-curve means a short-run worsening, it can cause cost-push inflation (dearer imports), and it may invite retaliation. **Alternatives:** expenditure-reducing or supply-side policies. Judgement: a depreciation can work where demand is elastic, but only after a lag and at the cost of inflation — the best choice depends on elasticities and the cause of the deficit.