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

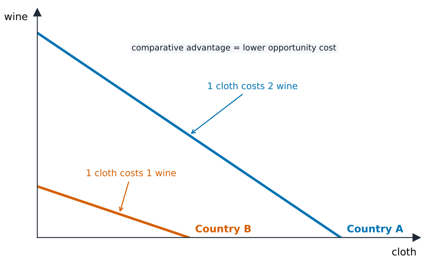
1 Trade

Comparative advantage

A country has **comparative advantage** 比较优势 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



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

Protectionism

tariff 关税 tax on imports	quota 配额 import limit	subsidy 补贴 help home firms	embargo 禁运 total ban	admin 行政壁垒 red tape

> **For**: **infant industry** 幼稚产业, jobs, stop **dumping** 倾销. **Against**: higher prices, inefficiency, **retaliation** 报复.

The protection tools, and the arguments for them

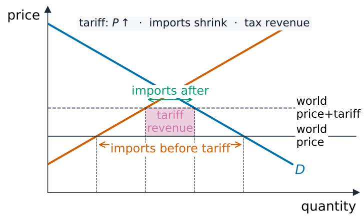
tariff	a tax on imports – raises their price and earns revenue
quota	a limit on the quantity imported – no revenue, and it hands the higher price to the importer
subsidy	paid to domestic producers so they can undercut imports
administrative barriers 行政壁垒	extra paperwork and tough standards that make importing hard *without* an announced tariff
the arguments for	protecting an **infant industry** 幼稚产业 until it can compete, saving jobs, and stopping **dumping** 倾销
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 利益相关者** differently: home producers gain, the government gains tariff revenue, but consumers lose (higher prices.

How a tariff works



A **tariff** 关税 raises the price to "world price + tariff":

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

Producers & government gain; consumers lose.

2 Balance of payments and exchange rates

The balance of payments

the current account
- trade in **goods** (physical exports & imports)
- trade in **services** (tourism, banking)
- **primary income** (wages, profit, interest)
- **secondary income** (transfers, aid)

The **current account** 经常账户 adds up four flows: trade in goods & services, plus **primary income** 初次收入 (work & investment) and **secondary income** 二次收入 (transfers). A **deficit** 经常账户赤字: 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 二次收入	transfers with nothing given back, such as foreign aid and remittances
a deficit 经常账户赤字	the country buys more from abroad than it sells
a surplus 经常账户盈余	the reverse – and one country's surplus is another's deficit

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

Exchange rate systems

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

- **floating** 浮动汇率 – set by demand & supply
- **fixed** 固定汇率 – held by the central bank
- **managed** 管理浮动汇率 – 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** 固定汇率 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** 管理浮动汇率 mostly floats, with the central bank stepping in now and then to steady it.
Current account surplus	A **current account surplus** 经常账户盈余 is the opposite of a deficit: the country sells more abroad than it buys, and lends the difference to the rest of the world.

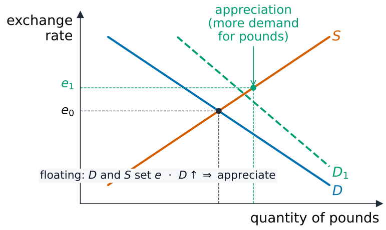
> **International trade** 国际贸易 lets countries buy and sell with each other – and every current-account balance is matched by a financial-account flow the other way.

Appreciation and depreciation

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

A depreciation can help the current account but raise inflation.

Appreciation and depreciation, in detail



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

Correcting a current account deficit

expenditure-reducing 支出减少 lower demand → fewer imports	**expenditure-switching 支出转换** tariff or weaker currency → home goods	**supply-side** raise **competitiveness** 竞争力 (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	**quota**	**subsidy**
a tax on imports (raises their price)	a limit on the quantity imported	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).

3 Recap

Worked example – terms of trade

Export prices rise $100 \to 110$; import prices rise $100 \to 105$. Find the new terms of trade.

- Terms of trade $= \dfrac{\text{export price index}}{\text{import price index}} \times 100$
- $= \dfrac{110}{105} \times 100 = 104.8$
- 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.

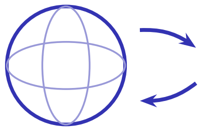
In the real world these do not fully hold, and specialising in one good is risky if its price falls.

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
4. **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