# The global economy

IB DP Economics Unit 4: trade, protection, integration, exchange rates, balance of payments, development

# From Shenzhen to the world

> How does trade cause growth, who loses, and why do some countries still struggle?

- Unit 4: trade, protection, blocs, exchange rates, the **balance of payments**, development.
- The trade examples use $Qd = 140 - 2P$ and $Qs = 20 + 4P$ at a world price of 12.

# Why countries trade

> Bigger markets, more competition, new ideas.

- Consumers get lower prices and more choice.
- Trade spreads technology and ideas.

# Absolute and comparative advantage

## Absolute advantage

Makes more of a good with the same resources.

## Comparative advantage

Makes a good at a lower **opportunity cost**.

# Who should make cloth?

| Country | Wheat | Cloth | Cost of 1 cloth |
|---|---|---|---|
| A | 4 | 2 | 2 wheat |
| B | 1 | 1 | 1 wheat |

# Both consume beyond their PPC

At 1.5 wheat per cloth, both countries consume outside their own curve.

- 100 workers each; trade 120 wheat for 80 cloth.
- A ends with 280 wheat and 80 cloth; alone it could have 240.

# Limits, and the WTO

## The theory assumes

No transport costs.

Constant opportunity costs.

Workers move easily between industries.

## The WTO

Sets rules for world trade.

Runs talks to lower barriers.

Settles disputes between members.

# Types of protection

Five tools: tariffs, quotas, two kinds of subsidy, and red tape.

- Protection limits imports to help domestic producers.
- Most tools make foreign goods dearer or scarcer.

# The effects of a tariff

Imports halve from 48 to 24; the **tariff** raises revenue and wastes two triangles.

- $Qd = 140 - 2P$ and $Qs = 20 + 4P$; world price 12.
- A tariff of 4 raises the domestic price to 16.

# Counting the tariff

1. **Revenue** $4 \times 24 = 96$
2. **Production loss** $\frac{1}{2} \times 4 \times (84 - 68) = 32$
3. **Consumption loss** $\frac{1}{2} \times 4 \times (116 - 108) = 16$

## Decision

Deadweight loss $32 + 16 = 48$.

# Who gains and who loses

| **Group** | **Effect of the tariff** |
|---|---|
| consumers | lose: pay more, buy less |
| domestic producers | gain: sell more at a higher price |
| government | gains **tariff** revenue |
| foreign producers | lose sales |
| society | loses the deadweight loss |

# Arguments about protection

## For

Infant industries.

Jobs facing cheap imports.

Stop **dumping**; national security.

## Against

Higher prices, less choice.

Retaliation and trade wars.

Protected firms stay inefficient.

# Stages of integration

**Free trade area**, **customs union**, **common market**, monetary union.

- Bilateral: two countries. Multilateral: many.
- Each stage adds to the one before.

# Creation or diversion?

## Trade creation

Buy from a lower-cost partner instead of high-cost home firms: efficiency rises.

## Trade diversion

Buy from a higher-cost partner instead of a cheaper outsider: efficiency falls.

# The market for yuan

More demand for Chinese exports: the yuan appreciates from 14 to 15 cents.

- Demand for yuan: foreigners buying Chinese exports, tourists, investors.
- Supply of yuan: Chinese buyers of imports, travellers, investors abroad.

# What moves a currency

| Change | Effect on the currency |
|---|---|
| more demand for exports | appreciates |
| higher interest rates | **hot money** in: appreciates |
| higher inflation than rivals | depreciates |
| speculation | moves the way investors bet |
| central bank buys it | appreciates |

# A phone priced in yuan

1. **At 7.00 yuan per dollar** $2{,}100 \div 7.00 = 300$ dollars
2. **At 6.00 yuan per dollar** $2{,}100 \div 6.00 = 350$ dollars

**Decision**

The yuan appreciates, so the same phone costs Americans 50 dollars more.

# Floating, fixed and managed

| System | How it works | Example |
|---|---|---|
| floating | demand and supply set it | most major currencies |
| fixed | the bank holds one value | HK dollar since 1983 |
| managed | floats within a band | the yuan |

# The balance of payments

| Account | What it records |
|---|---|
| current | goods, services, income, transfers |
| capital | debt forgiveness, sales of patents |
| financial | FDI, shares and bonds, reserves |

# Correcting a deficit

> Switch spending, reduce spending, or make exports more competitive.

- A small deficit for imported machines can be harmless.
- A persistent surplus brings a rising currency and disputes.

# The J-curve

> After a **depreciation** the **current account** gets worse before it gets better.

- Marshall–Lerner: a depreciation helps if PEDx + PEDm is above 1.
- In the short run, demand is inelastic.

# The terms of trade

1. **Indices** exports 128.9, imports 117.1
2. **Terms of trade** $128.9 \div 117.1 \times 100 \approx 110.1$

**Decision**

Each unit of exports now buys about 10% more imports.

# Development, not just growth

> Less poverty, better health and education, more freedom: sustainably.

- **Sustainable development** meets today's needs without harming the future.
- The UN agreed 17 **Sustainable Development Goals** for 2030.

# Measuring development

| **Type** | **Example** | **Limit** |
|---|---|---|
| single | GNI per capita at PPP | one side only |
| composite | HDI: income, health, schooling | hides inequality |
| adjusted | IHDI, **Gender Inequality Index** | poor data |

# The poverty trap

> Low income, low saving, low investment, low productivity: and round again.

- Aid, FDI, **microfinance**, education and healthcare can break a link.
- Each link keeps the next one weak.

# Barriers to development

Economic, trade, geographic, political and social barriers.

- **Capital flight** and unsustainable debt drain resources.
- When girls cannot go to school, half the talent is wasted.

# Strategies for development

| Strategy | Helps by | Problem |
|---|---|---|
| **export promotion** | using **comparative advantage** | world demand |
| **import substitution** | protecting new industry | inefficient firms |
| FDI | capital, jobs, skills | profits leave |
| foreign aid | health, schools, crises | dependency |
| microfinance | loans banks refuse | high interest |

# Check yourself

