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**.

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.

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

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.

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

