Edexcel A - A Level Economics

Theme 4 – A global perspective

4.1 International economics

Revision Notes

Contents

Hey there! 👋

We're **Tutor Packs**, and our mission is simple: making learning easy, stress-free, and actually enjoyable. ✨📚

We've got FREE revision notes and worked examples for loads of subjects, perfect for smashing those exams. 💪🤓

Want to see what we're all about and show support please visit our social media pages: https://www.tutorpacks.com/links

4.1.1 Globalisation

Characteristics of globalisation

Globalisation means that countries around the world are becoming **more connected and dependent on each other**. It's all about **how fast things change**, from technology to trade, and how deeply linked our economies and lives have become.

Globalisation is the way **business activities are spread across the world**. This includes things like:

- Doing **research and development** in one country (like the US),
- **Sourcing materials** in another (say, lithium from Chile),
- **Manufacturing products** in another (maybe Vietnam), and
- **Selling and distributing** them all over the world.

It also includes businesses **working together across borders,** for example, when Toyota and BMW work on engine tech together. These are called **joint ventures**.

Globalisation also means more freedom in how things move:

- **Free trade** in goods and services (Countries trade without huge taxes or limits. Example: German cars sold in Japan or Netflix streaming worldwide),
- **Free movement of people and tech** (People work abroad more easily, and new tech spreads fast. Example: Doctors from the Philippines working in the UK; TikTok (a Chinese app) used globally),
- **Capital (money)** flowing between countries easily (A UK investor can buy shares in a US tech company online in minutes),
- **More foreign ownership** like companies from one country own businesses in another (Tata (an Indian company) owns Jaguar Land Rover in the UK.),
- And the **sharing of knowledge and ideas**, including intellectual property (like global access to COVID vaccine research).

4.1.1 Globalisation

Factors contributing to globalisation

Globalisation isn't just happening by chance, there are reasons behind it. Below are the key drivers that are helping the world become more connected than ever.

1. Better Transport = Cheaper, Faster Global Trade

- **Transport infrastructure** includes things like ports, airports, roads, and railways. Thanks to big improvements, goods can now be moved quickly and cheaply around the world.
- Thanks to **container shipping**, goods can now be packed into standard-sized boxes and loaded quickly onto ships, trains, and trucks.
- This has made transport **cheaper, faster, and more efficient**.
- When businesses produce more at a lower cost per unit, it's called **economies of scale**.
- **Example:** A juice company can send thousands of bottles to Europe in one big container instead of several small deliveries, saving time and money.

2. Tech and Communication Make It Easy to Work Globally

- Modern **IT (Information Technology)** and communication tools like Zoom, email, and cloud storage mean businesses can manage teams, customers, and suppliers in different countries, all from a laptop.
- Companies can also now **market themselves**, hold meetings, or even run customer service from another country.
- This makes it easy to **promote your brand internationally** without opening a physical store.
- **Example:** A clothing brand in Bali can sell hoodies to customers in London through Instagram and Shopify.

tutorpacks.com

Factors contributing to globalisation

🌐 3. The WTO and Free Trade Deals

- The **World Trade Organization (WTO)** helps countries make trade agreements and lower trade barriers.
- **Free trade (trade liberalisation)** means fewer taxes (tariffs) on imports and exports, making it easier for businesses to operate globally.
- This encourages **specialisation.** Countries focus on what they do best and trade for the rest.
  🧀 Example: France exports cheese; Japan exports electronics, both win.

🏢 4. Big Companies Taking Over the World (Literally)

- **TNCs (Transnational Corporations)** are huge companies that operate in more than one country, like Apple, Coca-Cola, or Amazon. They manufacture, sell, and even advertise globally.
- These companies often move production to **low-cost countries** to save money, and they're powerful enough to **influence government decisions** in their favour.
- 🛒 **Example:** Your phone might be designed in California, assembled in China, and sold to you online all handled by one global company.

💰 5. Financial Markets That Work Across Borders

- **International financial markets** make it easy to invest and move money between countries. This is vital for global businesses that need funding or want to expand abroad.
- 🏦 **Example:** A UK-based company can get a loan from a bank in Singapore or invest in a factory in Mexico, all through global finance systems.

4.1.1 Globalisation

Impacts of globalisation

Globalisation affects pretty much everyone, countries, governments, companies, workers, consumers, and even the planet itself. Some of these impacts are amazing... others? Not so much.

📈 Economic Growth

The Good:

- **Boost in trade** – Countries grow faster when they specialise and trade efficiently.
- **More investment** – TNCs bring **foreign direct investment (FDI)** into countries, helping to build roads, factories, and jobs.
- **Better management and tech** – Global firms bring high standards and modern technology, helping local industries grow.

The Not-So-Good:

- **Unstable advantages** – If a country loses its **cost advantage**, companies may leave, causing unemployment and loss of growth.
- **Political instability** – TNCs may support dodgy governments that help them, even if they're corrupt.

🏭 Producers (Businesses and Firms)

The Good:

- **Efficient production** – Big businesses enjoy **economies of scale**, meaning they produce more at lower costs, which is usually leads to lower prices for consumers.
- **Lower costs** – They can also produce goods in cheaper countries by using **comparative advantage** (doing what they're best at).
- **Access to global markets** – Firms can sell worldwide, reaching more customers.
- **Reduced risk** – If one market collapses, they can rely on others.

The Not-So-Good:

- **Big companies, big power** – Some global giants (called **multinational corporations**) become so powerful they can influence laws, dodge taxes, or outcompete smaller local businesses.

tutorpacks.com

4.1.1 Globalisation

Impacts of globalisation

Consumers (People Who Buy Stuff)

The Good:

- **Lower prices** – Companies produce goods in countries with **lower labour costs** (like Bangladesh or Vietnam), meaning you pay less at the checkout.
- **More choice** – You can now buy clothes from China, phones from Korea, and coffee from Colombia, all on the same high street.

The Not-So-Good:

- **Loss of culture** – Local products and traditions can be lost in favour of global brands like McDonald's or Netflix.
- **Prices can rise** – As incomes increase globally, so does **demand**, which pushes prices up.

Workers (The People Doing the Jobs)

The Good:

- **More jobs, higher pay** – Thanks to global trade and investment, incomes have risen in many countries, especially where new industries have taken off.
- **Training and upskilling** – Multinational companies (called **TNCs**) often provide training and better job opportunities.
- **Easier movement of people and money** – Workers can migrate for jobs, and companies can invest across borders. This is called **capital and labour mobility**.

The Not-So-Good:

- **Structural unemployment** – This happens when jobs in old industries disappear (like coal mining) and workers can't easily move into new ones (like tech). Some governments haven't done enough to help people retrain. That's **structural unemployment,** long-term job loss due to economic shifts.
- **Inequality grows** – The gap between rich and poor can widen. Some people (especially in cities) gain from global jobs, while rural or low-skilled workers may get left behind.
- **Poor conditions** – In places like **sweatshops**, workers may face long hours and low pay.

4.1.1 Globalisation

Impacts of globalisation

Governments

The Good:

- **Higher tax revenue** – TNCs and their employees pay tax, boosting national budgets.
- **Global cooperation** – Countries can work together to solve big issues like climate change.

The Not-So-Good:

- **Policy struggles** – If governments don't plan well, they might fail to protect local jobs or industries.
- **Tax avoidance** – Global companies often use tricks like **transfer pricing** (moving profits to low-tax countries) to avoid paying fair taxes. It's legal, but many say it's unfair..
- **Corruption** – TNCs might use their power to **bribe or lobby** governments.

Environment

The Good:

- **Global teamwork** – Countries can share ideas and tech to fight climate change.

The Not-So-Good:

- **Environmental harm** – More factories = more **pollution**, **global warming**, **deforestation**, and **overuse of natural resources**. For example, mass palm oil production has led to huge deforestation in Indonesia.

tutorpacks.com

4.1.2 Specialisation and trade

Absolute and comparative advantage

The Basics

International trade makes stuff cheaper and gives us more to choose from, which means we enjoy a higher standard of living (yes to avocados all year round).

What Are They?

Absolute Advantage: When a country can produce **more of a good** than another country using the same amount of resources.
Example: If Germany makes 100 cars in a day and Spain can only make 80, Germany has the absolute advantage in car production.

Comparative Advantage: When a country can produce a good at a **lower opportunity cost** than another. This is where real trade benefits come from.

Opportunity cost is what you give up to do/make something else.

Example: If the UK gives up 2 loaves of bread to make 1 bottle of juice, and France gives up 3 loaves for the same bottle; the UK has the comparative advantage in juice.

Key Idea: Specialisation Makes Everyone Better Off

- If countries specialise in what they're **comparatively best at**, total production increases. That means more stuff, lower prices, and a higher standard of living for all.

4.1.2 Specialisation and trade

Absolute and comparative advantage

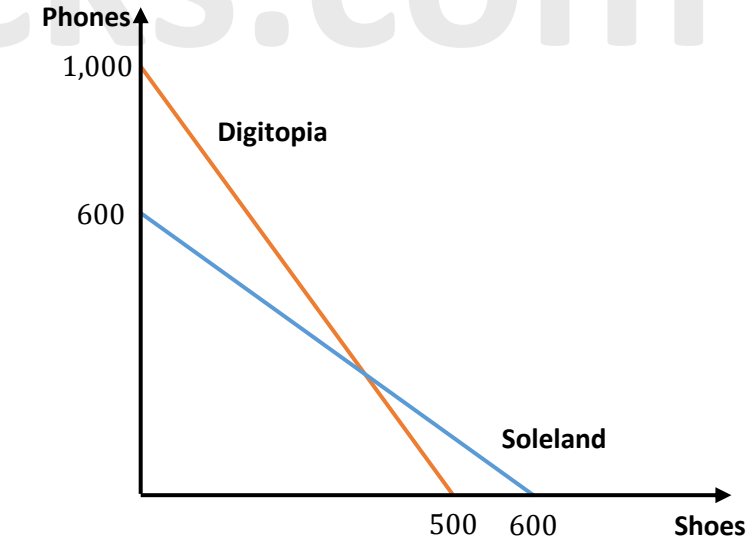
Let's imagine two countries, **Digitopia** and **Soleland**. Both of them produce **Phones** and **Shoes**.

Take a look at their production capabilities:

Country	Max Phones	Max Shoes
Digitopia	1,000	500
Soleland	600	600

Diagrams: PPF Edition (Production Possibility Frontier)

Think of PPFs as graphs showing what a country can produce with its limited resources.



4.1.2 Specialisation and trade

Absolute and comparative advantage

Who has the absolute advantage?

Product	Who can make more? → Absolute advantage
Phones	Digitopia (1,000 vs 600)
Shoes	Soleland (600 vs 500)

So, **Digitopia** has the absolute advantage in **phones**, and **Soleland** in **shoes**.

The opportunity cost

- Let's calculate what each country gives up to make one unit of the other good.

🔧 **Digitopia:**

- 1,000 phones = 500 shoes → each **phone** costs **0.5 shoes**
- So, 1 **shoe** costs **2 phones**

👟 **Soleland:**

- 600 phones = 600 shoes → each **phone** costs **1 shoe**
- So, 1 **shoe** costs **1 phone**

4.1.2 Specialisation and trade

Absolute and comparative advantage

Who has the comparative advantage?

Product	Opportunity cost (Digitopia)	Opportunity cost (Soleland)	Comparative advantage
Phones	0.5 shoes	1 shoe	**Digitopia**
Shoes	2 phones	1 phone	**Soleland**

So:

- **Digitopia** should specialise in **phones**
- **Soleland** should specialise in **shoes**

Then they can trade for mutual benefit.

✨ **Why It Works**

If both countries split their resources (like in real life without specialisation), they'd each make fewer goods overall.

But if:

- Digitopia puts all its effort into phones (1,000)
- Soleland focuses only on shoes (600)

Then together they produce more **phones and shoes** than they would working alone or splitting their efforts.

- This extra output = the **gains from trade.**

tutorpacks.com

4.1.2 Specialisation and trade

Assumptions and limitations

The theory of comparative advantage works great in textbooks… but not always in the real world. Here's why:

- 🚚 **No transport costs**: The model assumes trade is free and easy, but in reality, shipping is expensive.
- 💸 **Constant costs**: The theory ignores things like economies of scale (where producing more makes it cheaper per unit).
- 📚 **Perfect knowledge**: In reality, buyers and sellers don't have all the info to make the best choices.
- 🔁 **Easy switching:** It assumes factories and workers can switch between making shoes and phones instantly. Good luck retraining a steelworker overnight.
- ⚖️ **Terms of trade**: Whether trade even happens depends on how much of one good a country is willing to exchange for another. If the trade deal isn't fair, no deal.
- 🍎 **Perfectly identical products (homogenous)**: Not true, a German car ≠ a Chinese car, even if both are "cars".
- 🌎 **Perfect mobility of resources**: It assumes workers, machines, and money can move freely between industries and countries, which they often can't.
- ⛽ **Over-dependence:** If you rely too much on one country (like Russia for gas), it becomes risky.
- 🌱 **Environmental damage:** Specialising may ignore pollution or resource overuse, harming the planet.

4.1.2 Specialisation and trade

Advantages and disadvantages of specialisation and trade

✅ **Benefits of Specialisation and Trade:**

1. **Higher World Output**
   When countries focus on producing what they're best at (known as *comparative advantage*), global production increases. Imagine Italy making shoes and Japan making electronics, they both get better at it, and there's more for everyone to enjoy.

2. **Lower Prices**
   Specialisation allows businesses to produce on a large scale, which leads to *economies of scale,* basically, lower costs per item. That means lower prices for consumers.

3. **More Choice for Consumers**
   You can buy mangoes in winter or wear Italian leather in Australia. Why? Because trade brings goods from all over the world straight to your local shops.

4. **Everyone Has Different Resources (aka Factors of Production)**
   Countries all have access to different *factors of production* (things like land, labour, and capital). For example, Saudi Arabia has oil, while Bangladesh has cheap labour. Trade lets each country get what they don't have.

5. **Better Quality Through Competition**
   When firms compete globally, they push to offer better products and services, or risk getting left behind.

6. **Boost to Economic Growth**
   More exports = more income = more growth. Trade pumps money into economies, helping them grow and create jobs.

7. **Higher Living Standards**
   With better access to goods, more jobs, and lower prices, people enjoy a better quality of life.

8. **Staying Isolated = Falling Behind**
   Countries that cut themselves off (like North Korea) often suffer stagnation (meaning their economies stop growing). Trade opens doors to progress.

tutorpacks.com

4.1.2 Specialisation and trade

Advantages and disadvantages of specialisation and trade

❌ **Disadvantages of Specialisation and Trade**

1. **Too Much of a Good Thing: Over-Dependence**
   If a country relies heavily on exporting one thing (say, copper or oil), a price drop can spell disaster. And if they rely on one country for imports (like gas from Russia), they're in trouble if relations sour.

2. **Global monopolies**
   Some huge companies like Amazon or Google become so dominant that they can control prices, markets, and even influence governments.

3. **Structural Unemployment**
   Structural unemployment happens when industries shut down because other countries can do it better or cheaper. If workers can't easily switch jobs or skills, they're left behind, for example, some UK towns struggled when traditional industries like shipbuilding declined.

4. **Exposure to global shocks**
   If something bad happens in one country, it can cause chaos elsewhere. For example, the war in Ukraine shook up global wheat and energy prices.

5. **The Environment Pays the Price**
   More trade means more transport and more production, which can lead to deforestation, pollution, and overuse of resources.

6. **Loss of Control (Sovereignty)**
   Signing up to international trade deals or organisations might mean a country loses some control over its policies. For instance, EU membership meant the UK had to follow certain EU rules, a hot topic in Brexit.

4.1.2 Specialisation and trade

Advantages and disadvantages of specialisation and trade

❌ **Disadvantages of Specialisation and Trade**

7. Trade deficits
Some countries (like the US or UK) import more than they export. This can lead to a **deficit** on the balance of payments, basically, they owe the world money.

8. Loss of Culture
With global trade comes global brands and trends. Traditional clothes, foods, and languages might fade as people adopt more international tastes. It's a cultural mash-up, great for variety, but tricky for tradition.

4.1.3 Pattern of trade

Factors influencing the pattern of trade

Trade between countries doesn't stay the same forever, it evolves based on loads of different factors. For example, in the early 2000s, **China wasn't a major trading partner for many Western nations**, but by 2020, it had become **one of the top export destinations for countries like Germany, Australia, and the USA**. Why? Cheaper production, growing demand, and a booming economy changed everything.

So, what causes these shifts in who trades with who and what they trade? Let's break it down...

1. Comparative Advantage

🔍 *Definition:* When a country can produce a good at a lower opportunity cost than others.

If one country is really good (or cheap!) at making something, firms will want to buy from there. For instance, Bangladesh produces clothes cheaply, so many companies outsource garment production there. Over time, countries naturally shift to exporting the things they're best at. This changes what countries trade and who they trade with.

🧵 *Example:* The UK no longer makes most of its clothes, they're made in countries like Vietnam and Bangladesh, which are more efficient at it.

4.1.3 Pattern of trade

Factors influencing the pattern of trade

2. Rise of Emerging Economies

🌎 *Emerging economies* like China, Indonesia, India and Vietnam are becoming major players in global trade. They offer low labour costs, growing industries, and are producing more goods at competitive prices.

This means they're taking up a *bigger share* of global exports, and as they grow, older trading relationships start to fade or shift.

🏭 *Example:* As China grew into a manufacturing powerhouse, some countries lost business they used to get, like the USA losing some textile and electronics production to Asia.

3. Trading Blocs and Bilateral Trading

🤝 *Trading blocs* are groups of countries that agree to trade more freely with each other (e.g. the EU or NAFTA/USMCA). *Bilateral agreements* are just trade deals between two countries.

These reduce tariffs (taxes on imports), making it cheaper and easier to trade. This can lead to:

- *Trade creation* – more trade between members.
- *Trade diversion* – less trade with countries outside the bloc.

🌎 *Example:* After Brexit, the UK left the EU's trading bloc, meaning new rules and costs for UK-EU trade, and it started forming its own deals (like with Australia or Japan).

tutorpacks.com

Factors influencing the pattern of trade

4. Exchange Rates

🎓 *Definition:* The exchange rate tells you how much your currency is worth compared to another.

If a country's currency *appreciates* (gets stronger), its goods become more expensive for other countries to buy, exports go down. But imports become cheaper, so people at home buy more from abroad.

If the currency *depreciates* (gets weaker), it works the opposite way, exports become cheaper and more competitive globally, boosting trade.

📉 *Example:* If the UK pound gets weaker compared to the US dollar, British-made products will seem cheaper to Americans, great news for UK exporters.

Summary

Factor	In Simple Words	Example
Comparative Advantage	Produce what you're best at	India = tech, Brazil = coffee
Emerging Economies	Rising stars join the trade game	Vietnam exporting electronics
Trading Blocs/Trade Deals	Agreements that make trade easier	EU, NAFTA, AfCFTA
Exchange Rates	Currency affects how cheap things are	Weak yen = more Japanese exports

4.1.3 Pattern of trade

Factors influencing the pattern of trade

Continue to the next page…

tutorpacks.com

Calculation of terms of trade

📊 What Are *Terms of Trade (ToT)*?

Terms of trade (ToT) measure how much a country earns from its exports compared to how much it spends on its imports. More specifically, it's the **ratio of the average price of exports** to the **average price of imports,** and it's expressed as an index or a percentage.

Think of it like this: if the UK exports cars and imports bananas, the terms of trade tells us how many bananas the UK can buy for each car it sells.

Why does this matter?

Because it affects a country's **standard of living**. If a country can sell its exports at higher prices and buy its imports more cheaply, it earns more and spends less.

- If a country exports **highly priced products** (like luxury cars or tech), it brings in **more income**.
- This income can then be used to buy cheaper goods from abroad (like raw materials or food).
- So, strong terms of trade = more bang for your buck.

4.1.4 Terms of trade

Calculation of terms of trade

💡 What Happens When Terms of Trade Change?

- If **export prices go up** or **import prices go down**, the country can get **more imports for the same exports**. This is called an **improvement** in terms of trade, a good thing. Economists call this a **favourable movement**.
- ✅ Example: Germany's car prices rise globally, so it can sell fewer cars but still afford lots of raw materials.
- If **export prices fall** or **import prices rise**, the country gets **fewer imports for the same exports**. That's a **deterioration** in terms of trade. This is an **unfavourable movement**.
- ❌ Example: Kenya's coffee prices drop while oil prices soar. It now needs to sell way more coffee to buy the same amount of oil.

🧮 How Do You Work It Out?

ToT is calculated as an **index**, like a score made from a huge list of prices. The formula is:

$$ToT = \left(\frac{Index\ of\ Average\ Export\ Prices}{Index\ of\ Average\ Import\ Prices}\right) \times 100$$

A value **above 100** means exports are relatively more expensive than imports (favourable), and a value **below 100** means the opposite (unfavourable).

👉 These price indexes are made using a **weighted basket** of goods, just like a **consumer price index**, but focused on traded goods instead of everyday items. So big items like **oil or wheat** (which are traded a lot) matter more than niche goods like **Rolls Royce cars** or luxury watches.

tutorpacks.com

4.1.4 Terms of trade

Calculation of terms of trade

Example

Year	Export Price Index	Import Price Index	ToT Calculation	ToT Value	Improve or Worsen?	What It Means
2015	100	100	$\left(\frac{100}{100}\right) \times 100$	**100**	Baseline year	Country Z could import 1 unit for every 1 unit exported.
2016	105	110	$\left(\frac{105}{110}\right) \times 100$	**95.5**	❌ Deterioration	Imports got more expensive; exports buy less.
2017	115	108	$\left(\frac{115}{108}\right) \times 100$	**106.5**	✅ Improvement	Country Z gets more imports per export; stronger buying power 💪
2018	112	115	$\left(\frac{112}{115}\right) \times 100$	**97.4**	❌ Deterioration	Weaker ToT again; importing costs more 😓

4.1.4 Terms of trade

Factors influencing terms of trade

1. 📈 Inflation Differences (Relative Inflation Rates)

Inflation is when prices go up over time. If prices in your country rise faster than in other countries, your goods become more expensive abroad.
So, what happens?

- If your exports are **price inelastic** (people buy them no matter the price, like medicine or oil), you can still sell them. This improves your terms of trade; each unit you sell buys more stuff from other countries. 💰
- But if your goods are **price elastic** (like luxury handbags, people only buy if it's a good deal), demand might drop. This worsens your ToT. 😬

✅ **Example:** If Japan exports rare computer chips and prices go up, but the world still needs them, Japan gains, and their ToT improves.

2. 💱 Changes in Exchange Rates

The **exchange rate** is how much your currency is worth compared to another (e.g. £1 = $1.30). When this changes, so do the prices of exports and imports.

- If your currency **appreciates** (gets stronger), your exports become **more expensive**, and imports **cheaper**.
- If it **depreciates** (gets weaker), the opposite happens.

This can swing the ToT either way depending on the direction of the change and how sensitive demand is.

🔄 **Example:** If the Brazilian Real weakens, Brazil's coffee becomes cheaper for foreign buyers, but buying tech from the U.S. becomes pricier.

Factors influencing terms of trade

3. ⚙️ Productivity Differences (Relative Productivity Rates)

Productivity is all about how much you can make with the same resources. If your workers or machines become super efficient, you can make more at a lower cost.

Sounds great, right? Well, sort of...

- If you pass on these savings as lower prices for exports, your goods become cheaper abroad.
- That means you need to sell **more exports** to buy the same amount of imports. So, your **ToT gets worse** (even though you're efficient).

❌ **Example:** If Vietnam boosts textile production and drops export prices, they earn less per shirt sold, even if they're making tons.

4. 📈 Demand and Supply Shocks

- If demand for your exports suddenly spikes (e.g. people really want your avocados), prices may rise, improving ToT.
- If supply of imports increases (like a flood of cheap electronics from another country), import prices drop, also improving ToT.

5. 💷 Changing Incomes:

- As people around the world earn more, they spend more, especially on tourism or fancy services.
- For example, if global income rises, a tourist hotspot like **Thailand** might see higher prices in hotels and tours, improving its ToT.

4.1.4 Terms of trade

Impacts of changes in terms of trade

🔄 1. It Depends on Elasticity

Price Elasticity of Demand (PED) measures how much people change their buying habits when prices change.

- If demand for exports or imports is **inelastic** (people buy it no matter the price), then an **improvement** in the terms of trade (like higher export prices) can help boost export earnings and **improve the balance of payments**.
- But if demand is **elastic** (people buy less when the price rises), then higher prices might lead to **fewer exports sold,** and the balance of payments can actually **worsen**.

📌 Think of it like this: if Country A raises the price of bananas and people still buy them, it earns more. But if people just switch to apples from Country B, then earnings fall.

📉 2. Not All Improvements Are "Good News"

An **improvement in the terms of trade** sounds great (you get more imports for your exports), but it can backfire:

- If prices of exports rise, but **demand falls**, exports may drop.
- If import prices fall, people might **import more**, reducing demand for domestic products.

Both cases can lead to:

- **Lower GDP** (less production),
- **Higher unemployment** (fewer jobs),
- And eventually a **drop in living standards**.

💬 In short: more imports and fewer exports = less income and fewer jobs.

⚠️ A **long-term deterioration** in the terms of trade (like consistently falling export prices) can be a warning sign of **economic struggles**, especially for countries that rely heavily on one or two products (e.g. copper or coffee).

tutorpacks.com

Impacts of changes in terms of trade

🚦 **Possible Effects on the Economy:**

- **Changes to the current account balance**: This is part of a country's Balance of Payments (basically its international bank statement). A deterioration (worse terms of trade) can lead to a **deficit**, meaning the country spends more on imports than it earns from exports.
- **Competitiveness**: If export prices rise too much, foreign buyers might turn elsewhere. This makes the country **less competitive** globally.
- **Disposable income**: If imports get pricier, consumers might spend more on foreign goods and have less to spend on other things at home.
- **Changes to GDP (Gross Domestic Product)**: GDP could shrink if falling export prices hurt national income. If a country earns less from exports, there's less money circulating in the economy.
- **Unemployment**: If export industries lose revenue, they might cut jobs. But if the economy benefits from strong exports, more jobs may be created.
- **Living standards**: Improved terms of trade can mean people afford more imported goods and services. But if things go south, living standards can drop.

4.1.4 Terms of trade

Impacts of changes in terms of trade

Continue to the next page…

tutorpacks.com

4.1.5 Trading blocs and the World Trade Organisation (WTO)

Types of trading blocs

🤝 **Types of Trading Blocs — Explained Simply**

A **trading bloc** is a group of countries that team up and make it easier and cheaper to trade with each other. They reduce or remove things like tariffs (taxes on imports), quotas (limits on imports), and other barriers that make trade expensive or difficult.

📈 **What's "Economic Integration"?**

Economic integration just means how closely countries work together economically. This can range from:

- **Low integration**, like a basic agreement between two countries to trade a few goods with fewer restrictions (called a **bilateral agreement**),
- To **high integration**, where countries use the same currency and follow shared economic rules, like the **Eurozone**, where countries share the euro 💶 and a central bank.

🌎 **What Is a Free Trade Area?**

A **Free Trade Area** is when a group of countries agree to **trade with each other without tariffs (taxes on imports) and trade barriers**.

But each country is still allowed to **set its own trade rules** with countries **outside the group**.

🧠 *Example:* The UK could trade freely with Canada and Mexico inside the trading bloc but still charge tariffs on goods from China.

4.1.5 Trading blocs and the World Trade Organisation (WTO)

Types of trading blocs

🚚 **What is a Customs Union?**

A **customs union** is a group of countries that agree to:

✅ **Trade freely** with each other — no tariffs (taxes on imports) on goods moving between them.

✅ **Set the same tariffs** on goods coming in from countries outside their group. That means they act like a team when dealing with outsiders.

🧠 **Easy Example: Southern African Customs Union (SACU)**

SACU includes countries like **South Africa, Botswana, Namibia, Eswatini, and Lesotho**.

- They don't charge tariffs on goods they trade with each other.
- But if a product comes from, say, China, they all charge **the same tariff**.

So, while Botswana and South Africa can trade bananas freely, they both charge the same import tax on electronics from Japan.

🌎 **What's a Common Market?**

A **common market** is like a customs union but with extra perks.

✅ Countries **trade goods and services freely** with no tariffs (just like a customs union).

✅ But they also allow the **free movement of the four factors of production**:

1. **Labour** (people/workers)
2. **Capital** (money/investment)
3. **Land** (resources)
4. **Enterprise** (business ideas)

This means a worker from Country A can easily get a job in Country B, or businesses can invest across borders with fewer rules in the way.

4.1.5 Trading blocs and the World Trade Organisation (WTO)

Types of trading blocs

🔄 **Why?**

The aim is to make the economy more **efficient**. By letting workers, money, and ideas flow freely, countries can:

- Use their resources better
- Lower production costs
- Boost growth and job opportunities

Think of it like a team project: each country does what it's best at, and everyone benefits.

💰 **What's a Monetary Union?**

A **monetary union** is a group of countries that agree to:

- Trade freely with each other (no tariffs or trade barriers),
- Let people, money, and businesses move easily between them,
- Use **one shared currency** (like the West African CFA franc),
- And have **one central bank** that manages interest rates and money supply for everyone.

🧠 *Example:* France and Germany both use the Euro. They don't have to worry about exchange rates when trading with each other.

4.1.5 Trading blocs and the World Trade Organisation (WTO)

Types of trading blocs

🔑 **What Do You Need for a Monetary Union to Actually Work?**

1. Free Flow of Money

Capital (money and investment) should move freely. Wages and prices also need to adjust depending on how each country's economy is doing.
💷 For example, if the economy slows in **Benin**, wages should be able to fall slightly to keep people employed but that only works if markets are flexible.

2. Financial Support Between Members

If one country gets hit hard by a crisis (like a drought or a recession) the others need to help.
🏢 Example: In a perfect system, if **Togo** is struggling, countries like **Ivory Coast** could transfer funds to help balance things out. But in practice, this rarely happens and can cause arguments.

3. Similar Economic Patterns

If one country is booming and another is crashing, it's hard to set one interest rate that works for both.
📊 Example: If **Senegal** is growing quickly but **Guinea-Bissau** is in a slowdown, they may need different monetary policies, which isn't possible with one shared currency.

4. Free Movement of People (Labour)

Workers need to be able to move from country to country to find jobs, just like moving between cities.
🌍 Example: In the **East Caribbean Currency Union**, someone from St. Lucia should be able to work in Antigua without needing complicated paperwork.

tutorpacks.com

4.1.5 Trading blocs and the World Trade Organisation (WTO)

Types of trading blocs

⚠️ **What Happens Without These?**

If countries don't:

- Let labour or money move freely,
- Have similar economic cycles,
- Or help each other during tough times...

...then the union feels unfair. Some countries benefit more than others, and political tension builds.

4.1.5 Trading blocs and the World Trade Organisation (WTO)

Costs and benefits of regional trade agreement

🌍 **Benefits of Regional Trade Agreements**

- **Trade creation**
  When countries trade more efficiently with each other, everyone wins. They specialise in what they're best at and buy what they need more cheaply from their partners.
  👉 *For example, Kenya might buy affordable electronics from South Africa instead of further afield, saving money and boosting incomes.*

- **Bigger Market = Bigger Opportunities**
  Businesses can now sell to a larger group of countries without extra costs. Think of a Kenyan farmer selling easily to Rwanda, Uganda, and Tanzania thanks to the East African Community (EAC).

- **No tariffs between members**
  Goods and services move freely across borders without added taxes (called tariffs). This lowers prices for consumers and makes trade quicker and easier.

- **Shared tariffs for outsiders**
  Member countries agree to charge the same tariffs to non-members, which makes external trade simpler and fairer.

- **Easier trading in monetary unions**
  If countries in a trade agreement share a single currency (like the euro), there's no need for exchange rate calculations or currency conversion. This reduces costs for businesses and makes pricing more transparent.

- **Access to better financial stability**
  Some member countries, especially smaller or developing ones, benefit from stronger economic policies and lower interest rates provided by the union's central bank. This can lead to more stable borrowing conditions.

tutorpacks.com

4.1.5 Trading blocs and the World Trade Organisation (WTO)

Costs and benefits of regional trade agreement

💥 Costs of Regional Trade Agreements

- **Trade diversion**
  Sometimes, countries stop trading with more efficient producers outside the bloc and switch to less efficient ones inside it. This is called **trade diversion**, and it can actually make global trade less efficient.
  👉 *Egypt might buy wheat from a trade partner instead of cheaper Australian wheat, not ideal.*

- **Structural unemployment**
  Some domestic industries might lose out because they can't compete with stronger industries from partner countries. This leads to job losses in certain sectors.
  👉 *A country's textile factories may shut down if another member produces clothes more cheaply.*

- **Environmental impact**
  More trade means more production, transport, and energy use, which can damage the environment through pollution and resource overuse.

- **Expensive and tricky transition to monetary unions**
  Joining a shared currency is a big step. It requires changing systems, prices, and policies, which can be costly and time-consuming for businesses, especially small ones.

- **Less control over national policies**
  Once a country joins a monetary union, it can't set its own interest rates or control how much money it prints. Decisions are made by the union's central authority.
  👉 *Imagine needing a loan, but someone else decides how much interest you'll pay.*

4.1.5 Trading blocs and the World Trade Organisation (WTO)

Costs and benefits of regional trade agreement

💥 Costs of Regional Trade Agreements

- **Loss of sovereignty**
  Being in a trade bloc means playing by shared rules. Sometimes countries must follow decisions they didn't fully agree with and that can be frustrating when local needs differ.

- **Not Everyone Wins Equally**
  Often, richer countries gain more. For instance, Germany may benefit more from the EU than Bulgaria, creating **inequality** across the region.

- **Loss of Independence**
  Governments can't always respond quickly to local issues (like changing interest rates or using different economic tools) because decisions are made jointly.

- **Hard to Form Full Trade Deals**
  Trade blocs can sometimes stop countries from signing better **bilateral agreements** (one-on-one deals) with others outside the bloc like the UK wanting a unique trade deal post-Brexit.

tutorpacks.com

4.1.5 Trading blocs and the World Trade Organisation (WTO)

Role of the WTO in trade liberalisation

🌐 What Does the WTO Actually Do?

The **World Trade Organization (WTO)** was created in 1995, replacing an older system called **GATT** (General Agreement on Tariffs and Trade). The WTO's job is basically to keep global trade running smoothly. It has two main goals:

1. **Trade liberalisation** – making it easier and cheaper for countries to trade by cutting tariffs (taxes on imports) and removing trade barriers.
2. Making sure countries **stick to the trade agreements** they've signed.

👉 The WTO believes that free trade helps boost living standards, creates jobs, and generally makes life better for people all around the world.

📝 What If a Country Breaks the Rules?

Let's say one country breaks the rules of a trade deal, another country can **file a complaint** with the WTO.

- The WTO first tries to fix things through talks.
- If that doesn't work, a group of expert's steps in and reviews the case.
- If the complaint is upheld, the country that "wins" the case can use **trade sanctions.** Basically, they're allowed to hit back with taxes or restrictions on the other country's exports.

🛢️ **Example**: In 2021, Australia filed a complaint against China after China placed high tariffs on Australian wine. The WTO began a formal investigation into whether this violated trade rules.

4.1.5 Trading blocs and the World Trade Organisation (WTO)

Role of the WTO in trade liberalisation

📆 What Are WTO 'Rounds'?

The WTO holds big global meetings called **rounds**. These are where countries come together and try to negotiate better trade terms for everyone.

🥣 The **Uruguay Round** (1986–1994), for example, led to the creation of the WTO itself. It tackled tough topics like agricultural subsidies and trade in services (like banking and insurance).

🌾 Another goal of these rounds is to support **developing countries;** helping them compete more fairly with larger economies.

😬 What's the Catch?

To get anything done, **all countries have to agree**. That's right, even one country can **veto** (block) a decision.

This can be tricky because countries sometimes use their veto for reasons that have nothing to do with trade, like making a political point. So, reaching a deal can be slow and difficult.

4.1.5 Trading blocs and the World Trade Organisation (WTO)

Possible conflicts between regional trade agreements and the WTO

There are hundreds of **regional trade agreements (RTAs)** in place, think of them like exclusive clubs where a group of countries agree to trade more freely with each other.

Sounds great, right? And for the members, it often is. RTAs can:

- Build stronger ties between neighbouring countries
- Increase trade within the group
- Lower tariffs and trade barriers (just like a group discount at your favourite store)

🎉 But here's the catch, these deals can **clash with what the WTO** is trying to do globally.

🤔 **So What's the Problem?**

The WTO wants to promote **free trade for everyone**, not just small cliques of countries. That's where things get messy. Here's how:

- **Trade gets redirected**
  Sometimes a regional trade deal moves trade away from a non-member country (that might be really efficient at making something; it has a **comparative advantage**) to a less efficient member country simply because it's in the club.
  - 🔄 Example: Imagine Vietnam is really good at producing electronics cheaply, but a country like Poland chooses to buy more expensive products from another EU country just to keep it "within the bloc." That's called **trade diversion**, and it's not efficient.
- **Common barriers = mini walls**
  Countries in these groups often put **trade barriers** (like tariffs or quotas) on non-members. That's the opposite of what the WTO is trying to do, which is to knock down those walls, not build them.

4.1.5 Trading blocs and the World Trade Organisation (WTO)

Possible conflicts between regional trade agreements and the WTO

💡 **Why It Matters**

- RTAs may help the members, but they can lead to **global inefficiency** by messing with the natural flow of trade.
- Goods might not come from the best producers anymore, just the ones inside the club.

That's why the **WTO pushes for free trade between all countries**, not just mini-groups.

🤝 **But It's Not All Bad...**

RTAs can still work alongside the WTO, kind of like neighbours who don't always get along but still help each other take out the bins.

The WTO encourages regional blocs to **keep trade flowing**, even with non-members. If done right, RTAs can make it easier for outsiders to trade with member countries, rather than shutting them out completely.

🐂 **Is the WTO Too Bossy?**

Some critics say the WTO has too much power or that it's unfair to poorer nations.

🌍 **Developing countries** (like Ethiopia or Bangladesh) often struggle to access big markets freely, even though the WTO's mission is equal trade opportunities. Richer countries don't always follow through, they might protect their own farmers or industries instead.

tutorpacks.com

4.1.6 Restrictions on free trade

Reasons for restrictions on free trade

Free trade is all about countries buying and selling without too many restrictions, based on the idea that everyone should focus on what they're best at; that's called *comparative advantage*. But sometimes, countries put up trade barriers. This is known as **protectionism;** protecting domestic businesses from too much international competition.

Protectionism can take many forms, like tariffs (taxes on imports), quotas (limits on how much can be imported), or rules that make importing tricky (known as administrative barriers).

Here's why countries do it:

1. Protecting New Businesses – Infant industries

If a country has just started producing electric cars, for example, it might struggle to compete with big firms in the USA or Japan. So, the government might protect it with tariffs until it's strong enough to stand on its own.

2. Protecting Jobs (Employment)

If lots of factories close because production moves overseas, thousands can lose their jobs. This is called **structural unemployment**. To prevent this, governments may block or tax imported goods to keep local factories running.

3. Keeping Key Sectors Safe

Certain sectors like food, water, energy, or defence are considered vital for a country's independence. For example, the UK may want to grow its own crops instead of relying entirely on food imports from Europe in case of future supply issues.

4. Dumping – Fighting unfair trade

Dumping is when a country floods another market with products at unfairly low prices (often below production cost), just to wipe out the competition. Think of it as economic sabotage, it's bad news for local businesses.

4.1.6 Restrictions on free trade

Reasons for restrictions on free trade

5. Supporting Declining Industries

Some industries are slowly fading away, like coal mining. Governments might help them with support or limit foreign competition to avoid sudden job losses and economic shock.

6. Fixing a Trade Imbalance (Current Account Deficit)

When a country buys way more than it sells (imports > exports), money flows out of the country faster than it flows in. Governments might restrict imports to fix this imbalance and give local businesses a boost.

7. Raising Standards

Some countries make products more cheaply by paying very low wages or ignoring environmental rules. Others might use protectionism to pressure them into better behaviour, like saying, "We won't buy your stuff unless you clean up your act."

8. Unfair Competition

Some countries have super low production costs, maybe because of poor health & safety laws or big government subsidies. That gives them an unfair edge over countries that follow higher standards.
🌍 Protectionism can level the playing field.

9. National Security & "Dangerous" Goods

Governments might block imports of things they think are unsafe like faulty electronics, drugs, or weapons. Or they may restrict certain goods if they feel too reliant on another nation.
🔒 This is often done in the name of **national security**.

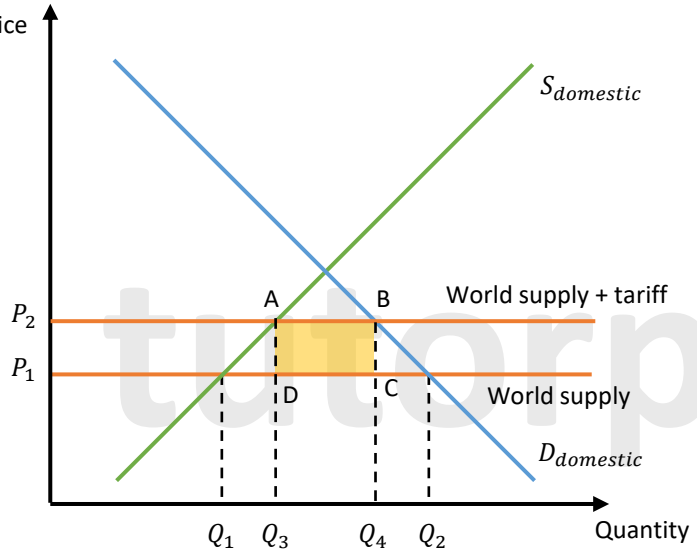
tutorpacks.com

4.1.6 Restrictions on free trade

Types of restrictions on trade

Tariffs

Tariffs are just taxes placed on goods that come from other countries aka **imports**. The main goal? To make imported items more expensive so that people are more likely to buy stuff made at home instead.



How It Works:

Let's say there's a product that costs **P_1** (thanks to world supply and demand). At that price:

- Local producers are only willing to supply $\boldsymbol{Q_1}$.
- But consumers want way more — they'll demand $\boldsymbol{Q_2}$.
- So, the gap between $\boldsymbol{Q_1}$ and $\boldsymbol{Q_2}$ is filled by **imports**.

In other words, the country buys the amount between $\boldsymbol{Q_1}$ **and** $\boldsymbol{Q_2}$ from abroad.

4.1.6 Restrictions on free trade

Types of restrictions on trade

Enter the Tariff...

Now imagine the government slaps a **tariff** on that imported good. That pushes the price up from $\boldsymbol{P_1}$ **to** $\boldsymbol{P_2}$. At this higher price:

- Local producers will now supply more — up to $\boldsymbol{Q_3}$.
- But consumers won't buy as much — demand falls to $\boldsymbol{Q_4}$.
- So now the country imports less — only the gap between $\boldsymbol{Q_3}$ **and** $\boldsymbol{Q_4}$.

That shaded box (**ABCD**) in the diagram? That's **government revenue** from the tariff.

What's the Impact?

- ✅ **Domestic producers** are happy, they get to sell more.
- ✅ **The government** earns money from the tariff.
- ✅ Maybe **local workers** (more production = more jobs)
- ❌ **Consumers** are worse off, they pay more and get less.
- ❌ **Foreign producers** are worse off, they sell less.
- ❌ **Overall efficiency decreases** because now less competitive firms are being protected.

tutorpacks.com

Types of restrictions on trade

Quotas

A **quota** is a cap on how much of a certain good a country allows to be imported. Think of it like saying, “Okay, we’ll let 10,000 foreign cars in this year but that’s it.”

When the limit is reached, people can’t buy more imports even if they want to, so they’re pushed to buy domestically-made products.

Why would a country do this?

- To protect local jobs and businesses (especially in industries like steel or agriculture).
- To give domestic firms a chance to sell more by reducing competition from cheaper imports.

What happens next?

- Prices usually go up, because cheap imported goods are harder to get.
- It might even lead to shortages if local firms can’t meet demand.
- But local businesses love it, they get more space in the market and might hire more people.

🧠 *Real-world vibe:* Instead of the UK and steel, imagine Australia putting a quota on imported clothes to protect local fashion brands.

Quotas can cause what economists call a **welfare loss**, which basically means some people lose out – they either pay more, or don’t get the product at all. Unlike tariffs (which earn money for the government), quotas often just benefit foreign exporters who manage to sell within the limit.

4.1.6 Restrictions on free trade

Types of restrictions on trade

Subsidies

A **subsidy** is money the government gives to local producers to make life easier for them. It’s like giving firms a leg up so they can sell their products more cheaply at home and abroad.

Why give a subsidy?

- To make their goods cheaper and more attractive both at home and abroad.
- To help firms' lower prices without losing profits.
- To boost exports by making products more competitive internationally.
- To help them grow and maybe hire more people.

Subsidies don’t always come in the form of cash. Sometimes, they’re **indirect**, like tax breaks, cheap loans, or help with research and development.

🎯 *Example:*
Imagine South Korea giving subsidies to tech companies to help them lead in AI development. That kind of support can help firms stay ahead in global markets.

tutorpacks.com

4.1.6 Restrictions on free trade

Types of restrictions on trade

Non-tariff barriers

Non-tariff barriers are rules and regulations that make it harder or more expensive to import goods, without actually slapping a tax (like a tariff) on them. They're less obvious, but they still restrict trade, just in a more subtle way.

Here are a few clever ways countries do this:

1. Health and Safety Rules

These are regulations meant to protect consumers, but they can also act like trade blockers.

Example:
Imagine a country bans imported soap unless it contains *zero* artificial scents. Great for sensitive skin but bad news for soap exporters from places like Indonesia, where natural-scented ingredients are part of traditional products. Suddenly, that unique jasmine bar can't be sold anymore.

2. Embargo

An embargo is a total ban on imports from a specific country or of a particular product.

Example:
A country might ban all imports from another country due to political conflict, like when trade is stopped during a diplomatic fallout.

3. Product Specifications

This means the product has to be made a certain way to be allowed in.

Example:
Japan once required imported juice cartons to be a non-standard shape to fit vending machines. Foreign juice companies had to completely redesign their packaging (a pricey change) or get shut out of the Japanese market.

4.1.6 Restrictions on free trade

Types of restrictions on trade

4. Environmental Rules

Some countries put eco-standards in place to protect the planet, but they can also block certain imports.

Example:
The EU restricts imports of leather goods that use heavy chemical dyes banned in Europe. If a shoe brand from India or Bangladesh uses those dyes in manufacturing, their products won't make it to European shelves even if they're cheaper or in demand.

5. Voluntary Export Restraints (VERs)

This is when two countries agree to limit how much one of them can export, voluntarily. It's usually done to avoid more aggressive protectionist measures.

Example:
Japan once agreed to limit how many cars it exported to the US to avoid a full-blown trade war. This gave US carmakers time to catch up.

6. Labelling Requirements

These demand that imports have specific information on their packaging. It might seem simple, but it can be expensive and complicated.

Example:
A company wants to sell pasta in a new country, but that country requires 3-language nutrition labels, allergen warnings, and eco-symbols. If that's too much effort or cost, the company might skip that market entirely.

tutorpacks.com

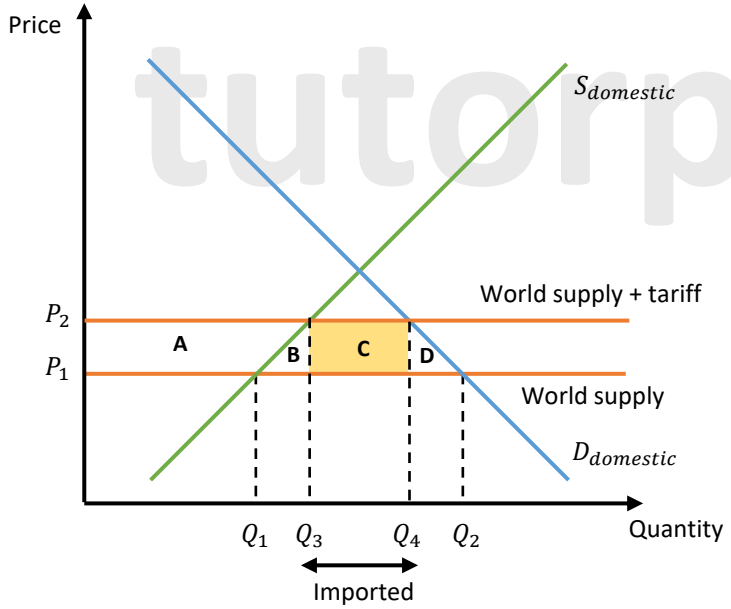
4.1.6 Restrictions on free trade

Impacts of protectionist policies

Protectionism is when a country tries to shield its domestic industries from foreign competition using tools like tariffs, quotas, subsidies, and non-tariff barriers. But what does this mean for everyday people, businesses, workers, and governments?

Tariffs

Tariffs are taxes placed on imported goods to make them more expensive. Why? To give an advantage to local producers and reduce how much we rely on foreign products.



4.1.6 Restrictions on free trade

Impacts of protectionist policies

Domestic Producers (Local Businesses)

Before the tariff:
Local firms were producing a smaller quantity (up to Q_1) and selling at a lower price (P_1). They weren't super competitive with the cheaper imports.

After the tariff:
Now that imports are more expensive (thanks to the tariff), local businesses can sell more (up to Q_3) and charge a higher price (P_2).
✅ **Good news**: Their revenue goes up and they gain what's called **producer surplus** (extra benefit), this is shown by the area marked B in the diagram.

Domestic Consumers (Shoppers Like Us)

Before the tariff:
We were buying more stuff (Q_2) at the lower world price (P_1). Life was good.

After the tariff:
Now everything costs more (P_2), and we end up buying less (only Q_4).
🚫 **Bad news**: Our choice goes down, and we have to pay more, this means **consumer surplus** (our benefit) falls; we lose areas A, B, C, and D from the diagram.

Government

After the tariff:
The government earns money from each imported product sold; this is the **tax revenue**. This is the area labelled **C** in the diagram.

Standards of Living

Tariffs affect different groups in different ways:

- **For consumers**, living standards fall because their **real income** (what their money can buy) drops due to higher prices.
- **For workers in protected industries**, life may get better because more production means **more jobs** and possibly **better wages**.

So, it's a mixed bag: More security for some, but higher prices for most.

4.1.6 Restrictions on free trade

Impacts of protectionist policies

Impacts of quotas, subsidies, and non-tariff barriers on different stakeholders.

Consumers:

- Quotas often mean fewer imported goods and less competition, which drives prices up. So, consumers get less choice and have to pay more.
- Subsidies, on the other hand, can be great for consumers. Since they reduce production costs, goods can be sold at lower prices. That means your paycheck stretches further.
- Non-tariff barriers are a mixed bag. They might limit what's available, reducing choice. But they also make sure what you're buying is safe, well-labelled, and environmentally friendly so they can improve the quality of life too.

Governments:

- Quotas don't bring in tariff money directly, but if domestic firms earn more, the government might collect more in taxes like corporation tax later.
- Subsidies cost the government money, so there's always an opportunity cost, basically, that money could've been used for something else like healthcare or education.
- Non-tariff barriers might look "cleaner" than taxes, but they can annoy other countries and get the government into arguments with trade bodies like the WTO. Plus, enforcing those rules takes effort and money.

4.1.6 Restrictions on free trade

Impacts of protectionist policies

Domestic Producers:

- Quotas (which limit the amount of imports allowed in) are like giving home producers more space to shine. With fewer competitors, they can sell more stuff, raise prices a bit, and enjoy higher profits.
- Subsidies (which are basically government financial help) lower the costs for local firms. This makes them stronger players in international markets and helps them produce more at lower prices.
- Non-tariff barriers (like strict product standards or health rules) protect them from international rivals. Less competition = more comfort. They might even be able to charge higher prices if they're the only ones meeting those rules.

Foreign Producers:

- Quotas hurt foreign sellers. They can only sell limited amounts, and those who do manage may get a higher price but still sell less.
- Subsidies in one country make it harder for firms in another country to compete, especially if they aren't getting the same support back home.
- Non-tariff barriers can feel like invisible walls. Things like complex labelling, safety standards, or eco-rules make it costly or impossible to enter the market. So, some foreign businesses just give up trying.

tutorpacks.com

Impacts of protectionist policies

📈 **Standards of Living:**

- Quotas usually mean higher prices and fewer options, that's bad news for consumers, especially those with lower incomes. It chips away at their purchasing power.
- Subsidies, by cutting costs and boosting production, often lead to lower prices, which helps consumers buy more with the same amount of money.
- Non-tariff barriers can go both ways. They might mean fewer choices and higher prices, but they also ensure safer, more informed purchases. For example, better labelling helps you make smarter decisions, which can improve your overall quality of life.

⚖️ **Equality:**

- Protectionist measures can help balance the scales between struggling local businesses and giant foreign competitors. For domestic firms, this feels fairer. But for foreign producers, it can seem like the game is rigged.
- Subsidies especially can help level the playing field letting smaller domestic firms compete with bigger, richer ones abroad.
- Non-tariff barriers, like green rules or safety laws, might also promote fairness. If everyone has to meet the same standards, it evens out the playing field in terms of production costs.

4.1.6 Restrictions on free trade

Impacts of protectionist policies

Continue to the next page…

tutorpacks.com

4.1.7 Balance of payments

Components of the balance of payments

Think of a country's **balance of payments** like its international bank statement; it keeps track of all the money flowing in and out as it trades, invests, and transfers money with the rest of the world.

📜 **The Two Big Parts of the Balance of Payments:**

1️⃣ **The Current Account**

This is the day-to-day stuff. It's all about trading goods, services, income, and transfers.
It includes:

- **Trade in goods** (e.g. cars, bananas, electronics)
- **Trade in services** (e.g. tourism, banking, Netflix subscriptions)
- **Primary income** (e.g. wages earned abroad or interest from overseas investments)
- **Secondary income** (e.g. foreign aid, remittances (when someone sends money back home))

2️⃣ **The Capital and Financial Accounts**

💼 **Capital Account:**

This part is kind of the sidekick; it tracks smaller things like:

- People bringing money into or out of the country (e.g. immigrants sending money home)
- Government transfers like **debt forgiveness** (when richer countries write off loans for poorer ones)

4.1.7 Balance of payments

Components of the balance of payments

💰 **Financial Account:**

Now this one's a big deal. It covers the movement of money related to investments and includes:

- **Foreign Direct Investment (FDI)**: Long-term investment in foreign businesses. For example, if Apple buys a 20% stake in an Indian software company; that's FDI.
- **Portfolio Investment**: Buying foreign shares or bonds but owning less than 10% (not enough to have control).
- **Financial Derivatives:** Fancy investment tools used to make a profit from future price changes, like options or futures.
- **Reserve Assets:** Gold, foreign currencies or special reserves held by the country's central bank to manage the economy.
- **Other Investments**: Things like loans to foreign governments, currency exchanges, or bank deposits overseas.

⚖️ **How It All Balances**

In theory, the total money flowing **in** (credits) and **out** (debits) should match up. If not, the statisticians use something called a **balancing item** to fill in the gaps, basically a plug for errors or unrecorded transactions.

🔍 **Quick Example - Japan (2022):**
Japan exported more goods than it imported, so it had a **trade surplus in goods** (think cars, electronics, and machinery).

However, it imported a lot of energy and raw materials, and it also had **net income outflows** (e.g. profits being sent back overseas by foreign companies operating in Japan).

Overall, Japan's **current account showed a surplus**, meaning more money flowed into the country than out. This helped strengthen its economy and keep the yen relatively stable.

tutorpacks.com

Causes of deficits and surpluses on the current account

In an ideal world, a country's **current account** (which tracks the value of its exports minus imports, plus income and transfers) should be balanced by its **capital and financial account** (which tracks investment flows like buying stocks, businesses, or bonds). If one is in deficit, the other must be in surplus. It's like a giant international seesaw of money. But why would a current account go into deficit?

🕒 **Short-Term Causes**

💸 **1. High Consumer Demand**

When people in a country get richer quickly, they tend to buy more stuff, often from abroad. That's because their own country might not produce enough (or the right kind of) goods fast enough.

Example: If Australians suddenly earn more and demand more iPhones and German cars, imports skyrocket. But exports stay the same. Boom, trade deficit.

- This is linked to **high income elasticity of demand for imports,** meaning that as income goes up, spending on foreign goods rises fast.

🔥 **2. High Relative Inflation**

If prices rise faster in your country than abroad, your goods become more expensive and less attractive to international buyers.

Example: If Turkish goods suddenly become 20% more expensive, but alternatives from Malaysia stay cheap, buyers will ditch Turkey reducing its exports.

4.1.7 Balance of payments

Causes of deficits and surpluses on the current account

💱 **3. Strong Exchange Rate**

When your currency is strong (e.g. the British pound or Swiss franc), it buys more foreign currency. This makes imports cheaper and exports more expensive to other countries.

Example: If the pound is strong, UK shoppers buy more U.S. tech, but Americans might avoid pricier British products, hurting exports.

📆 **Medium-Term Causes**

💼 **4. Loss of Comparative Advantage**

Comparative advantage means being good at producing something more efficiently than others. If a country loses that edge, people buy elsewhere.

Example: If Thailand becomes better at making furniture than Italy (cheaper, same quality), Italy may lose customers and face a deficit.

📜 **5. Rise in Cheap Imports**

If another country (say, Vietnam) offers cheaper clothes than what's made locally, people switch, imports rise, local producers suffer.

tutorpacks.com

Causes of deficits and surpluses on the current account

Long-Term Causes (Structural Issues)

These are deep-rooted and harder to fix:

6. Deindustrialisation

This means the economy moves away from factories and making stuff, and focuses more on services (like finance or tourism), which are harder to export.

Example: The UK has shifted heavily to services, which limits export potential.

7. Lack of Investment

If businesses don't invest in better machines, training, or technology, they fall behind in efficiency producing less for higher cost. That hurts exports.

Example: India may fall behind if it doesn't upgrade its textile machinery while competitors do.

8. International Competitiveness

Some countries are just really good at making things, high productivity, great quality, or strong brand image.

Example: Germany exports loads of high-end cars because of its productivity and brand reputation.

4.1.7 Balance of payments

Reduce a country's imbalance on the current account

When a country is importing way more than it's exporting, it runs into something called a **current account deficit**. Think of it like spending more money than you're earning, not sustainable for long. Luckily, governments have a few tools to fix this.

1. Do Nothing (Let the Market Fix It)

What is it?

Just sit back and let exchange rates do their thing. If a country keeps importing too much, its currency will weaken (depreciate). That makes imports more expensive and exports cheaper helping the situation fix itself naturally.

Benefits? It's free and automatic. Over time, higher import bills should cause the currency to drop. Weaker currency = cheaper exports, which boosts export sales.

Downside? It takes time and struggling local businesses might shut down before anything improves. Global events (like oil shocks or war) can mess with the currency, preventing that natural correction.

2. Demand-Side Policies

These policies focus on reducing how much people are spending overall especially on imports.

- **What's used?** Monetary policy (changing interest rates) or fiscal policy (changing government spending and taxes) to cut **aggregate demand** (the total demand for goods and services in an economy).
- **Why?** If people have less income to splash around, they'll buy fewer imports.
- **Fun Fact:** This works best when a country has **high income elasticity of demand** for imports (meaning when people earn more, they tend to import a lot more too).

Downside? This is only a **short-term fix**. It might also slow economic growth and reduce living standards because people are spending less overall.

tutorpacks.com

Reduce a country's imbalance on the current account

🏭 3. Supply-Side Policies

These aim to make domestic industries stronger and more competitive, so they can export more and rely less on imports.

- **How?**
  - Improving education and training (better workers = better productivity).
  - Investing in infrastructure like roads and internet.
  - Boosting innovation through grants or tax breaks.
  - Supporting industries with a **comparative advantage** (ones that a country is especially good at like Germany and car manufacturing).

Bonus: Encouraging industries to export more to places like the Middle East or Asia, wherever there's demand.

Reality check: These policies take **longer to work**, and closing uncompetitive industries could lead to job losses at first. But long term? It's usually worth it.

4.1.7 Balance of payments

Reduce a country's imbalance on the current account

🔄 4. Expenditure Switching Policies

What is it?
These are policies that encourage people to stop buying foreign goods and start buying home-made ones instead. Think tariffs, quotas, or promoting local products through marketing.

Example:
Tariffs on imported clothes make foreign brands more expensive. You end up buying that locally made hoodie instead.

Benefits: Shifts consumer habits back toward domestic producers. Boosts local businesses.

Downsides? Other countries might retaliate slapping tariffs on your exports. Could spark a trade war, reducing total exports and hurting global trade relationships.

👇 5. Expenditure Reducing Policies

What is it?
This means making people (and businesses) spend less overall especially on imports. It's usually done by raising taxes or cutting public spending (known as **deflationary fiscal policy**).

Benefits: Less income = fewer shopping sprees on foreign goods = fewer imports. Helps to narrow the deficit.

Costs: It can lead to slower economic growth. Less spending also means fewer jobs and a risk of recession.

tutorpacks.com

Significance of global trade imbalances

Global trade is a bit like a see-saw. The total value of exports across the world has to equal the total value of imports. One country's **trade surplus** (exporting more than it imports) has to be balanced by another country's **trade deficit** (importing more than it exports).

But big or long-lasting imbalances can cause problems for both sides.

❗ **What Happens If a Country Keeps Running a Trade Deficit?**

A **trade deficit** means a country is spending more on goods and services from abroad than it's earning from exports. To plug the gap, it usually has to:

- Borrow from other countries or international lenders
- Sell off national assets like companies, land, or infrastructure
- Rely on foreign investors to buy government bonds

💥 **Example:** Sri Lanka faced a serious economic crisis in 2022 after running trade deficits for years. It borrowed heavily and sold assets to stay afloat. But when foreign reserves dried up and it couldn't pay for basic imports like fuel or medicine, the country experienced protests, blackouts, and inflation.

Over time, too much reliance on outside money can mean losing control especially if lenders get nervous and want their money back fast.

📉 **Is a Current Account Deficit Always Bad?**

Not necessarily. Just look at the US and the UK. They've been running current account deficits for years without major issues. Why? Because global investors have confidence in their economies and are happy to lend money or invest there.

A current account deficit isn't always a red flag as long as it's balanced by a **capital and financial account surplus**. That means foreign money is flowing in through things like buying property, government bonds, or investing in local businesses.

4.1.7 Balance of payments

Significance of global trade imbalances

👉 Example: If the UK is importing a lot but also getting loads of foreign investment in its housing market or tech firms, the books still balance.

But... the 2008 Global Financial Crisis was a wake-up call. Suddenly, the flow of money around the world slowed, and investors pulled out fast. That made deficits harder to fund.

❗ **What If a Country Always Runs a Surplus?**

A **trade surplus** might sound like a good thing, you're earning more than you spend, right? But it's not always great.

Here's what can go wrong when a country over-focuses on exports:

- Its economy becomes geared toward satisfying **foreign buyers**, not local needs
- Domestic demand (what local people want) gets ignored
- If the country stops its currency from rising (to keep exports cheap), it distorts **foreign exchange markets**

💡 **Example:** Germany often runs a large trade surplus. It exports cars, machinery, and more. But critics (like the IMF) argue that Germany should invest more at home (in public services and infrastructure) to raise living standards for its own citizens. Otherwise, Germans are saving too much and spending too little domestically.

🧠 Another case: Singapore attracts foreign wealth due to its constant surpluses, but that's also led to high housing prices and income inequality as much of that capital flows into real estate rather than benefiting the average person.

tutorpacks.com

4.1.8 Exchange rates

Exchange rate systems

An **exchange rate** is just the price of one currency in terms of another. For example, £1 might be worth $1.33.

These rates are set in the **foreign exchange market (forex)** where currencies are traded like products.

But how a country manages its exchange rate depends on its **exchange rate system**, and there are three main types:

🌊 **1. Floating Exchange Rate**

This system works just like a regular market, **supply and demand** decide the price.

- If lots of people want your currency (high demand), its value goes up. This is called **appreciation**.
- If your currency is being sold off (high supply), its value goes down. That's **depreciation**.

🧠 **Example:** The British pound floats freely. If investors think the UK economy is strong, demand for pounds goes up and so does its value.

🖇️ **2. Fixed Exchange Rate**

Here, the government or central bank **"fixes"** its currency to another (usually the US dollar or euro) at a set value.

The **central bank** steps in whenever necessary to keep the currency at that fixed level.

- **Revaluation** happens when a government decides to make its currency **stronger** compared to the one it's pegged to.
  👉 This means you now get more foreign currency for your money.
  💡 **Example:** If the Saudi riyal was fixed at 3.75 to $1, and the government changes it to 3.50, that's a revaluation, the riyal has gotten stronger.

4.1.8 Exchange rates

Exchange rate systems

Devaluation is the opposite, it's when a country **lowers the value** of its currency against the one it's pegged to.
👉 Now you need more of your currency to buy the same amount of the foreign one.
💡 **Example:** If Egypt pegs its currency to the US dollar and changes the peg from 15 EGP = $1 to 18 EGP = $1, that's a devaluation, the Egyptian pound has lost value.

🧠 **Another example: Denmark** pegs its currency, the **Danish krone (DKK)**, to the **euro**. The central bank keeps the exchange rate close to **7.46 DKK = €1**, using interest rates and currency market interventions to maintain this stability. This helps Denmark stay aligned with its major trading partner (the Eurozone) while still keeping its own currency.

🌀 **3. Managed Exchange Rate (aka "Dirty Float")**

This one is a mix. The currency mostly floats, but the central bank keeps an eye on it and steps in when needed.

- If the value rises too much, the central bank **sells its currency** to bring the value down.
- If it drops too much, the bank **buys its currency** to strengthen it.
- They might also change **interest rates** to influence foreign investment.
  - Raising rates makes your currency more attractive to investors (stronger currency).
  - Lowering rates does the opposite (weaker currency).

🧠 **Example: Vietnam** uses a managed exchange rate. The Vietnamese dong mostly moves with market forces, but the central bank intervenes to prevent big swings and keep trade predictable.

4.1.8 Exchange rates

Factors influencing floating exchange rates

Floating exchange rates are like prices in any market; they move based on supply and demand. The more people want a currency, the more it's worth (appreciation). If fewer people want it, the value drops (depreciation). Here's what affects that:

🔼 **What Makes People Want a Currency? (Demand)**

The **demand** for a currency (like British pounds) goes up when:

- Foreigners want to buy British goods and services (like cars, clothes, or football match tickets!)
- People want to **invest** in the UK, maybe in UK property, businesses, or on the London Stock Exchange
- Tourists want to visit the UK (think Buckingham Palace, Premier League matches, and Stonehenge!)
- People or businesses want to **save** money in UK banks
- Traders/speculators think the pound will go up in value and want to make a profit

💡 **Example:** If the UK launches a hot new electric car brand and everyone abroad wants to buy it, demand for pounds will rise because customers need pounds to pay UK suppliers.

4.1.8 Exchange rates

Factors influencing floating exchange rates

🔽 **What Affects the Supply of a Currency?**

The **supply** of a currency increases when more of it is being sold, which can happen when:

- UK residents want to buy foreign goods (like iPhones or French wine)
- UK businesses invest overseas (maybe a British fashion brand opens stores in Japan)
- Brits go abroad on holiday (say, skiing in Switzerland)
- People move their savings to foreign banks
- Traders/speculators sell pounds because they think it'll drop in value

💡 **Example:** If lots of Brits decide to holiday in Thailand, they'll exchange pounds for Thai baht, increasing the supply of pounds in the market.

📈 **So What Moves the Currency in the Short Term?**

One word: **speculation**. This is when traders guess what might happen. If big investors think the pound will fall, they'll sell it now, which actually causes it to drop faster.

💥 **Think of it like this:** Rumours that the UK economy is shaky = traders sell = pound falls.

tutorpacks.com

Factors influencing floating exchange rates

And What About the Long Term?

1. Inflation Rates

Inflation means prices are rising.

- If Brazil's inflation is higher than other countries, its exports become expensive.
- Foreigners may stop buying Brazilian products, so demand for the real (currency) drops; the real depreciates.

Lower inflation = more competitive exports = stronger currency.

2. Interest Rates

Interest rates are how much return you get on savings and investments.

- If a country like India raises its interest rates, investors from abroad want to buy rupees to earn better returns. More demand = rupee appreciates.
- If the interest rate falls, investors might switch to another currency offering better returns. Less demand = rupee depreciates.

This is often called a flow of **hot money,** fast-moving funds chasing the best returns.

3. Net Investment

Foreign Direct Investment (FDI) is when money is used to build or buy businesses abroad.

- If Toyota opens a new factory in Mexico, it brings yen to convert to pesos. More demand = peso appreciates.
- If a Mexican company invests abroad, it needs to exchange pesos into foreign currency. Supply increases = peso depreciates.

4.1.8 Exchange rates

Factors influencing floating exchange rates

4. The Current Account

This includes exports, imports, and income from abroad.

- If Canada exports more than it imports (a trade surplus), more people want Canadian dollars, it appreciates.
- If it imports more (a trade deficit), there's more supply of CAD in forex markets, it depreciates.

5 Quantitative Easing (QE)

QE is when a central bank prints more money to buy government bonds and boost the economy.

- For example, if the Bank of Japan prints more yen and uses it to buy back bonds, the supply of yen increases.
- More supply = lower value = yen depreciates.

If foreign investors hold those bonds, they'll swap yen for their home currency, adding to the fall.

tutorpacks.com

4.1.8 Exchange rates

Government intervention in currency markets

Governments (or more specifically, their central banks) have two main tools they can use to influence the value of their country's currency in the world market.

💸 **1. Interest Rates – Turning the Money Magnet On (or Off)**

If the government wants to make their currency stronger (called **appreciation**), they can **increase interest rates**. Higher interest rates make it more attractive for people and investors from other countries to put their money in that country's banks, since they'll earn more interest.

📈 Example: If the UK raises interest rates, investors might swap their euros or dollars for pounds to take advantage which increases demand for pounds and pushes up its value.

If the government **lowers interest rates**, it becomes less attractive to save in that currency, so demand falls, and the currency **weakens** (this is **depreciation**).

💰 **2. Using Gold and Foreign Currency Reserves – Buying & Selling Power**

Governments also have a stash of **foreign currencies** (like US dollars or euros) and sometimes **gold;** this is called their **foreign currency reserves**. They can use these reserves to help manage their currency value.

- To **depreciate** the currency: If the pound is too strong, and the government wants to weaken it (make it cheaper), they can use pounds to **buy foreign currency or gold**. This increases the **supply of pounds** in the market, which pushes the value down. 🔁 Example: To weaken the peso, Mexico's central bank might sell pesos and buy US dollars.

- To **appreciate** the currency: If the pound is too weak and they want to strengthen it, they can **sell their foreign currency** to **buy pounds,** increasing demand for pounds, which pushes the value up. ✅ Example: If Japan wants to strengthen the yen, it could use dollars from its reserves to buy yen.

4.1.8 Exchange rates

Government intervention in currency markets

🎯 This method is useful in the short run but doesn't always work well long term. Currency values are mostly driven by **market confidence and economic fundamentals** (like inflation, growth, and investment). So even the best central bank can't control everything.

4.1.8 Exchange rates

Competitive devaluation/depreciation

Sometimes, a country **deliberately weakens its currency** to give its exports a boost. This is called **competitive devaluation** (under a fixed exchange rate) or **competitive depreciation** (under a floating rate).

🚀 **Why do this?**
A cheaper currency means your goods cost less in foreign markets. That makes them more attractive, so **exports go up**. At the same time, **imports become more expensive**, so people at home might buy less from abroad. This helps improve the country's **balance of payments** (which is basically how much money is coming in vs. going out of the country).

🧠 However, this only works if something called the **Marshall-Lerner condition** is met which means the demand for exports and imports needs to be **price elastic** (i.e. people respond to changes in price by buying more or less).

🧢 **But What Can Go Wrong?**

1. 💥 **Inflation risks -** If everything you import costs more now, that can push prices up at home. And if wages don't keep up? That's bad news for living standards.

2. ⚠️ **Reduced competitiveness over time -** If local businesses don't improve quality or efficiency, they might rely too much on the cheap currency trick. Eventually, that edge can fade and exports may fall again.

3. 🌎 **It can spark a currency war -** Other countries might fight back by weakening their currencies too. Everyone loses because prices just shift around but no one really gains more market share.

📌 **Example**: In the early 2010s, Japan's monetary policy led to a weaker yen, which helped Japanese exports (like cars and electronics). But it also sparked complaints from countries like South Korea, which worried about losing competitiveness.

4.1.8 Exchange rates

Impact of changes in exchange rates

When a country's currency changes value (either going up (appreciation) or down (depreciation)) it affects nearly everything: trade, jobs, inflation, and investment.

💸 **The current account of the balance of payments**

The **current account** is part of a country's balance of payments. It tracks exports and imports of goods and services, income from abroad, and transfers (like remittances or aid).

Depreciation (when the currency falls in value):

- Makes exports cheaper for foreign buyers
- Makes imports more expensive

🧠 But whether this helps the trade balance depends on **price elasticity**:

- If people change their buying habits a lot when prices shift = elastic
- If they don't = inelastic

📏 **The Marshall-Lerner Condition**

This says a weaker currency (devaluation) will help improve the trade balance *only* if the combined demand for imports and exports is responsive to price changes (i.e., elastic). In other words, the total responsiveness of exports and imports to price changes much be greater than 1 for depreciation to improve the current account. If people don't change their buying behaviour, it won't work.

📉 **The J-Curve Effect**

Right after a currency weakens, things can actually get worse before they get better. Why?

- It takes time for people to notice price changes.
- Import contracts are often fixed in the short term.
- Exporters may need time to find new buyers.

So, at first, the country's **trade deficit** might widen, then improve later once demand adjusts. That path looks like a letter "J" on a graph hence, the J-curve.

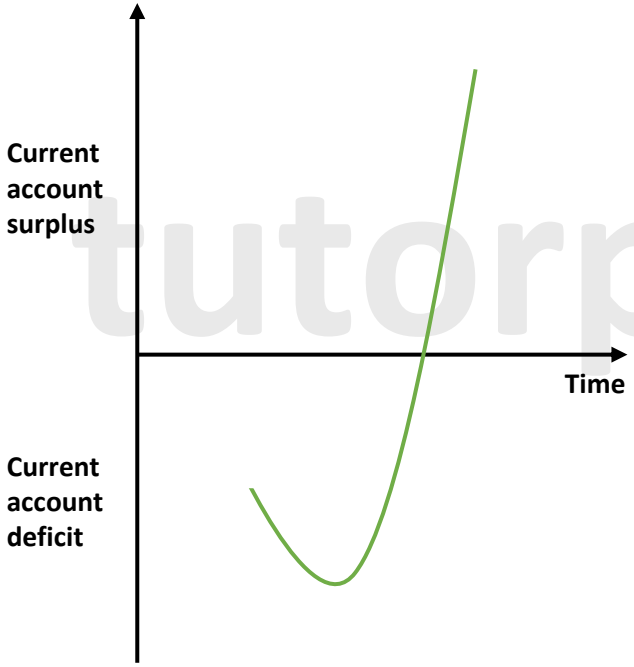
tutorpacks.com

4.1.8 Exchange rates

Impact of changes in exchange rates

The current account of the balance of payments

Example: A US company buying trainers from the UK might not switch right away even if French trainers become cheaper, relationships and contracts matter. But long-term? They'll probably switch.



The J-curve

4.1.8 Exchange rates

Impact of changes in exchange rates

Economic Growth & Jobs

When a currency weakens:

- Exports become cheaper for foreign buyers → demand goes up.
- Imports become more expensive → people buy more local goods.
- This boosts **aggregate demand (AD)**, helping the economy grow and creating jobs.

Unemployment

If depreciation boosts exports, then guess what?

- More goods sold abroad = more production = more workers needed

So, unemployment usually falls. But if the currency appreciates, exports fall, and unemployment can rise.

Inflation

A weaker currency makes **imports more expensive**, which can lead to rising prices at home (inflation). For example:

- Fuel, electronics, or food from abroad now costs more.
- Businesses pass on the cost to consumers → higher prices.

So, while exports go up, people might also feel the pain at the checkout.

Impact of changes in exchange rates

Foreign Direct Investment (FDI)

FDI = when companies from abroad invest in your country (e.g. build factories, buy real estate)

- If your currency is weak, foreign investors can get more bang for their buck and they're more likely to invest. BUT… if the currency keeps falling, it signals trouble. Investors might worry the economy is unstable and stay away.
- If the currency is strong, it's pricier for them to do business, so they may look elsewhere

Example: If the Indian rupee weakens, US firms might find it cheaper to open a new office in Mumbai than in London.

4.1.8 Exchange rates

Impact of changes in exchange rates

Continue to the next page…

tutorpacks.com

4.1.9 International competitiveness

Measures of international competitiveness

International competitiveness is all about how well a country's goods and services can compete with others in global markets. Think of it like this: if your country's products are cheaper, better quality, or more desirable, they're more likely to be snapped up by people abroad.

💡 And here's the deal:
The less competitive a country is, the more likely it is to run into problems like a **current account deficit** (this means it's buying more from the world than it's selling).

To stay competitive, countries need to offer:
✅ Good prices
✅ Quality and design
✅ Great customer service
✅ Smart marketing

🔍 **How Do We Measure It?**

To compare how competitive two countries are, we usually look at two key things:

1. 💼 Relative Unit Labour Costs

Definition: This tells us how much it costs in wages to make one unit of a product.

We calculate it like this:
Total wages paid in the country ÷ Total output produced

Once we have that number, we compare it with other countries. For example:

📊 If it costs less in the UK to make a car than in Germany, the UK is **more competitive.** It's cheaper to produce stuff there.

⚠️ But if wages rise without productivity rising, the cost per unit increases, and the UK becomes **less competitive**.

4.1.9 International competitiveness

Measures of international competitiveness

2. 📦 Relative Export Prices

This looks at how UK export prices change over time compared to other countries.

- If UK export prices are **rising** compared to others → the UK is becoming **less competitive** (people might buy cheaper goods from elsewhere)
- If UK export prices are **falling** → the UK is **more competitive** (hello bargains!)

🛍️ **Real-life example:**
Imagine the UK is exporting bikes. If those bikes become more expensive than ones from the Netherlands, foreign buyers might ditch British bikes for Dutch ones and UK sales drop.

tutorpacks.com

4.1.9 International competitiveness

Factors influencing international competitiveness

Let's look at the key things that make a country's products more (or less) attractive in international markets:

📉 1. Inflation

If prices in your country rise faster than elsewhere, your products become more expensive overseas.
Low, stable inflation helps maintain competitive prices.
💷 *A UK-made jacket becomes harder to sell abroad if the price keeps climbing.*

💱 2. Exchange Rates

When a country's currency (like the pound) increases in value, its goods become more expensive for foreigners. That can make exports less appealing.
🧠 *Think of it like this: if your favourite pizza shop doubles its prices, you're less likely to buy there.*

📋 3. Regulation

Heavy rules and red tape can slow companies down and make them spend more on compliance.
Too many regulations can limit a business's ability to respond quickly and keep prices low.
🖇️ *Imagine trying to open a lemonade stand and needing 10 different permits... you'd give up.*

💰 4. Taxation

High taxes can scare off investment and reduce business profits.
It also discourages risk-taking and innovation — the stuff that makes businesses competitive.
💡 *If you're taxed heavily on every new idea, you might stop bothering to invent.*

4.1.9 International competitiveness

Factors influencing international competitiveness

🧱 5. Economic Stability

Investors and businesses like predictability. If a country is politically or financially unstable, firms won't want to set up shop there.

🌐 6. Openness to Trade

If a country has low tariffs (import taxes) and few restrictions, it's easier for businesses to trade internationally.
It also means they can get cheaper supplies from abroad.
📠 *No trade barriers = easier exporting and less red tape = happier businesses.*

🏷️ 7. Relative Unit Labour Costs

This tells us how much it costs, on average, to pay workers to produce each item.

- If UK workers are more productive (say, making more widgets per hour) the **cost per item** goes down. That makes UK goods cheaper and more attractive overseas. ✅
- If productivity stays the same or drops, the cost per item stays high and that hurts competitiveness. ❌

🪛 **Example:** If a German car factory produces 10 cars per worker per week, and a UK factory produces 8, Germany has the edge unless the UK lowers its costs.

💰 8. Relative Wages and Non-Wage Costs

It's not just what you pay workers — it's also the **extras** like pension contributions and employer-paid social security taxes.

- If the UK pays more than other countries for the same job, it bumps up the **cost of production**, making goods more expensive to export. 🚫
- If wages and extra costs go down, goods become more affordable and attractive globally. ✅

🛠️ **Example:** If a UK firm has to pay more in health insurance and pensions than a similar firm in Poland, the UK-made product may cost more.

tutorpacks.com

4.1.9 International competitiveness

Significance of international competitiveness

✅ **Benefits of being internationally competitive**

1. 💰 **Current Account Surpluses**
   If your country sells more goods and services to the world than it buys (exports > imports), you get a **current account surplus**. This means more money coming in, which the government and businesses can use to invest abroad and earn extra income through interest, profits, or dividends. 🧠 Think of it like earning more than you spend so you can save, invest, and grow your wealth.

2. 🌍 **More Foreign Investment**
   A strong, competitive economy attracts **foreign direct investment (FDI)** (that's when overseas companies build factories or buy businesses in your country). This creates jobs, brings in new ideas and technology, and helps the economy level up. 🏗️ Example: A tech company from the US sets up shop in Vietnam, training local workers and sharing advanced skills.

3. 👷 **More Jobs + Higher Wages**
   Competitive countries make more stuff (for both locals and the global market) which means more jobs. As businesses grow, they hire more workers. More demand for workers = higher wages.

4. **Better Living Standards**
   When people have good jobs and growing wages, they can buy more. This boosts their **purchasing power,** and they get access to more and better products, from tech to healthcare.

4.1.9 International competitiveness

Significance of international competitiveness

⚠️ **Problems of being internationally uncompetitive**

In many cases, the downsides of being uncompetitive are simply the opposite of the benefits listed opposite. However, two key issue stands out:

1. 🚨 **Government Struggles to Fix It**
   If a country isn't selling much abroad and runs a **current account deficit** (buying more from others than it sells), the government has to act. That usually means spending more on **supply-side policies** (like training workers or investing in technology) to help businesses improve.

💡 But this comes with **opportunity costs** which means every pound spent here is a pound not spent on schools, hospitals, or pensions.

📉 *Example:* If the UK spends billions helping factories modernise, it might have to delay new hospital upgrades.

2. 🌐 **Overdependence on Others**
   If your economy becomes too focused on selling to other countries, you're vulnerable if something goes wrong globally. A worldwide recession means fewer people buying your stuff, and that can hurt.

📦 Imagine you're a bakery that only sells to cafes. If cafes close down, you've got a problem. Same with countries relying heavily on exports.

tutorpacks.com

Please see the '4.1 International Economics Worked Examples' pack for exam style questions.

For more FREE revision notes, tutorials, worked examples and help visit www.tutorpacks.com

tutorpacks.com