



AQA - A Level Economics

The national and international economy

14.1 The international economy

Revision Notes

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14.1.1 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).

14.1.1 Globalisation

The causes of 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.

14.1.1 Globalisation

The causes of 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.

14.1.1 Globalisation

The consequences 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 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.

14.1.1 Globalisation

The consequences 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.

14.1.1 Globalisation

The consequences 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.

14.1.1 Globalisation

The consequences of globalisation

Globalisation = the process where the world becomes more interconnected through trade, investment, technology, culture, and movement of people. Basically, it's why you can buy an iPhone in London, eat sushi in Paris 🍣, or watch a Bollywood movie in New York 🎬.

Globalisation affects **both richer (developed) countries** and **poorer (less developed) countries** in different ways 🖱️

✅ Consequences for More Developed Countries (like the UK, USA, Germany)

- **New markets = more sales** 📈
Firms can sell to booming economies (like India or Nigeria), where middle classes are growing fast. Think Apple or Netflix expanding into Asia.
- **Economies of scale** 📊
Producing for a bigger global market means making goods cheaper per unit. Example: Toyota can make millions of cars worldwide, spreading costs.
- **Shift away from manufacturing** 🔄
As poorer countries get better at making things cheaply, richer countries often move towards services (finance, IT, design) instead.
- **Outsourcing made easy** 🏢➡️🌐
Companies can move production to countries where wages are lower (e.g., making clothes in Bangladesh instead of Britain). This cuts costs but can hurt local factory jobs.
- **Bigger recruitment pool** 🌐👤
Companies can hire talent worldwide. But this can sometimes push down local wages if workers are brought in more cheaply.
- **Brain drain** 🧠✈️
Skilled workers may leave for opportunities abroad. For example, many UK doctors and engineers head to countries like Australia or the USA.
- **More competition** 😬
Local firms now face rivals from abroad who may produce goods more cheaply. Example: British steel has struggled against cheaper imports from China.

14.1.1 Globalisation

The consequences of globalisation

🌐 Consequences for Less Developed Countries (like Ethiopia, Bangladesh, Vietnam)

- **Global brands dominate** 🏪
Companies like McDonald's 🍔 and Nike 👟 often overpower local businesses. Sometimes they adapt products to fit local tastes (known as *glocalisation* — e.g., McSpicy Paneer Burger in India).
- **Policy pressure** 📁
To attract foreign investment (FDI = foreign companies building or investing locally), governments may adopt “free market” policies like cutting tariffs or relaxing labour laws.
- **Forced to open up** 🏢➡️🌐
Even if local businesses aren't ready, globalisation often pushes countries to allow foreign firms in, which can crush small local competitors.
- **Exploitation risk** ⚠️
Workers may face poor conditions or low pay in factories supplying big global firms. Think sweatshops in Bangladesh making clothes for Western brands.

14.1.1 Globalisation

The role of multinational corporations (MNCs in globalisation

Multinational Corporations (MNCs) = giant companies that operate in more than one country. Think McDonald's 🍔, Apple 🍏, or Nike 👟. Their size and global reach mean they have a **huge impact** on the world economy, so governments can't just ignore them.

✅ Benefits of MNCs

- **Jobs** 👤 MNCs often create employment in the countries they move to. For example, when Toyota builds a factory in the UK, thousands of people get jobs. This also boosts GDP (total income of the economy) and can have a *multiplier effect* (more jobs → more spending → more growth).
- **More tax revenue for governments** 💰 When MNCs make profits, pay wages, and people spend money, governments can collect taxes. This money can be used to fund schools, hospitals, or roads.
- **Higher wages (sometimes)** 💵 To attract the best workers, MNCs may pay higher wages than local firms. Example: Google paying above-average salaries in countries where it sets up offices.

❌ Drawbacks of MNCs

- **Low wages exploitation** 😞 If there's a large pool of unemployed workers, MNCs may pay the bare minimum. For example, garment workers in Bangladesh earning only a few dollars a day to make clothes for Western brands.
- **Not all jobs are high-skilled** 🔧 Many MNCs bring in skilled workers from developed countries and leave only low-skill, low-pay jobs for the local population.

14.1.1 Globalisation

The role of multinational corporations (MNCs in globalisation

- **Tax avoidance** 🏠✈️ MNCs can legally shift profits to countries with lower taxes (known as *tax avoidance*). For instance, a tech company might record profits in Ireland (where corporate tax is low) instead of the UK. This means governments don't always collect as much tax as expected. *(Important: tax avoidance is legal, though often seen as "unfair." Tax evasion [hiding profits or lying about earnings] is illegal 🚫).*
- **Unethical treatment of workers** 🗑️ In many poorer countries, workers lack strong legal protections. MNCs might take advantage by making employees work long hours, under unsafe conditions, or without benefits.
- **Environmental damage** 🌱👉 Regulations are often weaker in poorer countries. Some MNCs exploit this by cutting corners, e.g., polluting rivers, overusing natural resources, or failing to use clean technology.

🎯 Exam Tip

When writing about MNCs, don't get carried away by emotions ("it's unfair."). Instead, **focus on economic impacts** like jobs, tax revenue, growth, or inequality. That's what examiners want to see.

14.1.2 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.

14.1.2 Trade

Absolute and comparative advantage

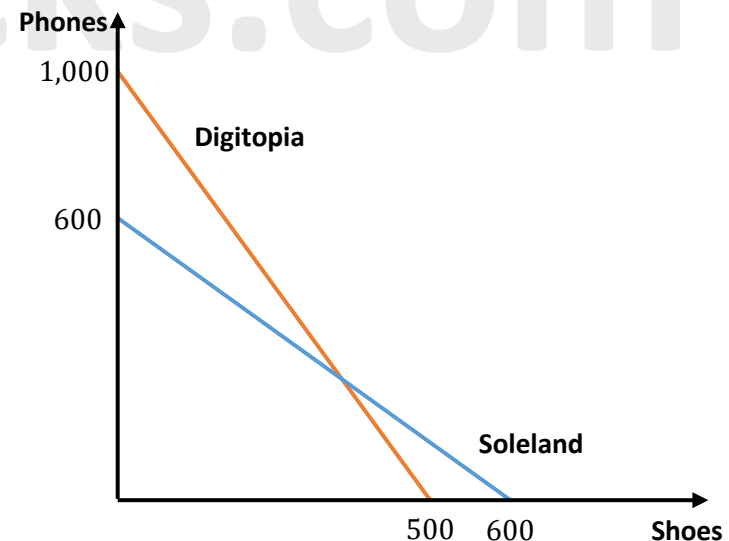
Let's imagine two countries, **Digitopia** and **Soleland**. Both of them produce **Phones** and **Shoes**.

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.



14.1.2 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**

14.1.2 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**.



14.1.2 Trade

The model of comparative advantage

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 $\neq$ 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.

14.1.2 Trade

The benefits of 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.

14.1.2 Trade

The costs of international 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.



14.1.2 Trade

The costs of international 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.

14.1.2 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.



14.1.2 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).

14.1.2 Trade

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



14.1.2 Trade

Factors influencing the pattern of trade

Continue to the next page...

14.1.2 Trade

The nature of protectionist policies

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.



14.1.2 Trade

The nature of protectionist policies

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.

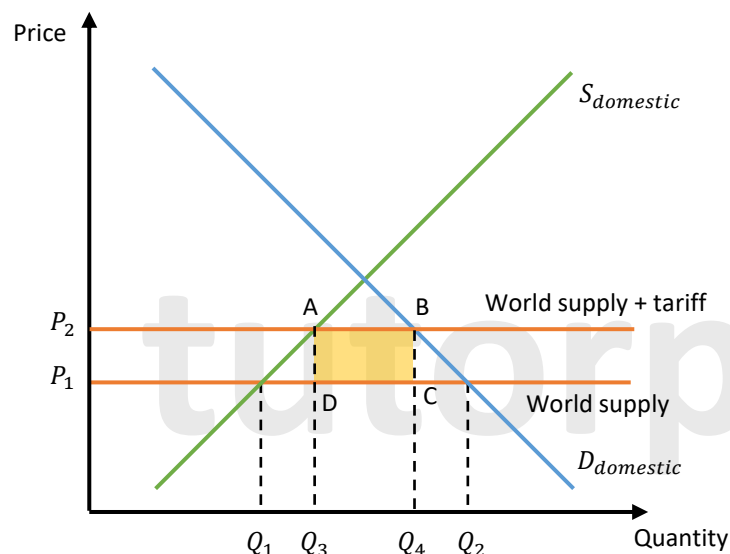
 This is often done in the name of **national security**.

14.1.2 Trade

The nature of protectionist policies

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 Q_1 .
- But consumers want way more — they'll demand Q_2 .
- So, the gap between Q_1 and Q_2 is filled by **imports**.

In other words, the country buys the amount between Q_1 and Q_2 from abroad.

14.1.2 Trade

The nature of protectionist policies

Enter the Tariff...

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

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

14.1.2 Trade

The nature of protectionist policies

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.



14.1.2 Trade

The nature of protectionist policies

Export 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.

14.1.2 Trade

The nature of protectionist policies

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.



14.1.2 Trade

The nature of protectionist policies

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.

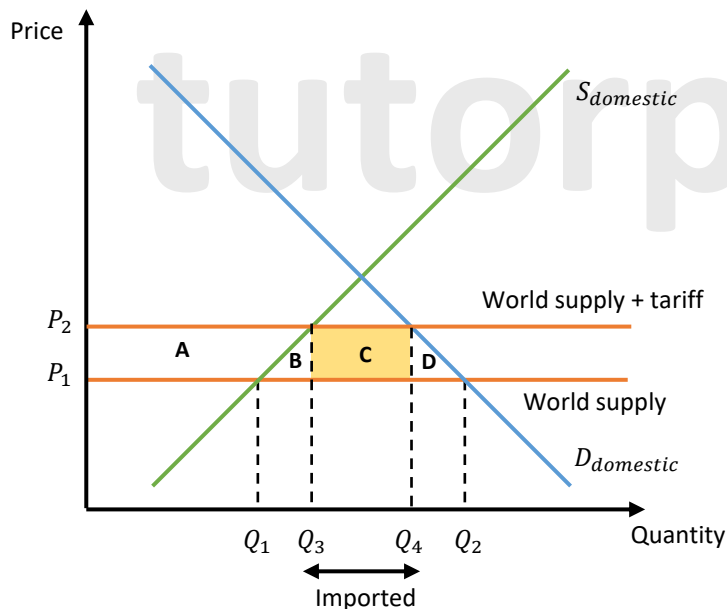
14.1.2 Trade

The causes and consequences of countries adopting 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.



14.1.2 Trade

The causes and consequences of countries adopting 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.

14.1.2 Trade

The causes and consequences of countries adopting 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.

14.1.2 Trade

The causes and consequences of countries adopting 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.

14.1.2 Trade

The causes and consequences of countries adopting 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.



14.1.2 Trade

The causes and consequences of countries adopting protectionist policies

Continue to the next page...

14.1.2 Trade

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.

14.1.2 Trade

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 (e.g. Single European Market [SEM])?

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.

14.1.2 Trade

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

For example, the Single European Market (SEM)

- Created in **1993**, giving **27 countries** access to a market of **500+ million people**. 
- It's a **customs union** (no tariffs between members + same tariffs on outsiders) and a **common market** (free movement of goods, people, services, and money).  
- Members get **EU funding**  for projects like better transport, retraining workers, and supporting poorer regions.

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.

14.1.2 Trade

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.

14.1.2 Trade

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.

14.1.2 Trade

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.



14.1.2 Trade

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.*



14.1.2 Trade

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.

14.1.2 Trade

Role of the World Trade Organisation (WTO)

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.

14.1.2 Trade

Role of the World Trade Organisation (WTO)

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.

14.1.2 Trade

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.

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14.1.2 Trade

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.

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14.1.3 The 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:

1 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))

2 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)

14.1.3 The 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.

14.1.3 The Balance of payments

Deficit and a surplus on the current account

The **Balance of Payments (BoP)** is like a country's financial scoreboard. It records all money flowing *in and out* through trade, investment, and financial activity.

In theory, the BoP should **balance to zero**, but in reality, it rarely does (so economists add a "net errors and omissions" line to tidy things up).

✓ Current Account Surplus

- A **current account** tracks trade in goods/services, investment income, and transfers (like aid or remittances).
- If exports > imports, the country earns more than it spends. This is a **surplus**.
- But then, the **financial account** (which records flows of money for assets like property, stocks, and bonds) must show a **deficit**.
- Example: If Germany sells loads of cars abroad (surplus), the extra euros they earn might be used to buy U.S. stocks or African infrastructure bonds (financial account deficit).

✗ Current Account Deficit

- If imports > exports, the country spends more than it earns. This is a **deficit**.
- To pay for this, money must flow *into* the financial account, usually through selling assets, borrowing, or attracting foreign investment.
- Example: If the UK imports loads of electronics from Asia (deficit), it might balance things by selling London property or government bonds to overseas investors (financial account surplus).



14.1.3 The Balance of payments

Deficit and a surplus on the current account

🌐 The See-Saw Effect

- Think of the **current account** and **financial account** like a seesaw: when one goes up, the other goes down.
- Surplus on one side = deficit on the other, and vice versa.

14.1.3 The Balance of payments

Factors that influences a country's current account balance

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 or a surplus?

1. Inflation

Inflation = the rate at which the general price of goods and services rises over time.

- **High inflation:** exports become expensive → foreigners buy less → imports seem cheaper to locals → trade deficit 
- **Low inflation (or deflation):** exports are cheaper → foreigners buy more → imports become pricey for locals → trade surplus 

Example:

If UK inflation is 10% but Germany's is 2%, UK cars (like Jaguars) will seem more expensive abroad, reducing exports.

2. Productivity

Productivity = how much output (goods/services) a worker can produce in a given time.

- If productivity rises, workers produce more per hour → goods become cheaper and better quality → exports increase 
- Governments can boost productivity using **supply-side policies** (e.g., tax breaks for training, better education, or investment in technology).

Example:

South Korea invested heavily in education and tech training → now it exports high-tech goods (like Samsung phones) worldwide.



14.1.3 The Balance of payments

Factors that influences a country's current account balance

3. Exchange Rates

Exchange rate = the value of one currency compared to another (e.g., £1 = \$1.25).

- **Stronger exchange rate (currency appreciates):**
 - Exports become more expensive → fewer sales abroad
 - Imports become cheaper → locals buy more foreign goods
 Good for holidaymakers abroad, bad for exporters
- **Weaker exchange rate (currency depreciates):**
 - Exports become cheaper → more foreign demand
 - Imports become more expensive → locals buy fewer foreign goods
 Good for exporters, bad if your country relies on imported food/energy

Example:

After Brexit, the pound (£) fell sharply → UK exports became cheaper abroad → tourism and some exports rose, but imports (like oil) became much more expensive.

In short:

- **Productivity** = more output, more exports
- **Inflation** = high is bad for exports, low helps exports
- **Exchange rates** = strong hurts exports, weak helps exports

14.1.3 The Balance of payments

The consequences of investment flows between countries

When money moves across borders in the form of **investment**, it affects not only businesses but also a country's **currency** and **exchange rate**.

What is the Financial Account?

The **financial account** is part of a country's balance of payments. It records the inflows (money coming in) and outflows (money going out) of **financial assets**.

This includes:

- **Foreign Direct Investment (FDI):** when a company sets up a factory, buys land, or takes control of a business in another country (e.g., Toyota building a car plant in the UK 🚗).
- **Portfolio Investment:** when investors buy financial assets like shares, bonds, or property abroad.

How Investments Affect the Exchange Rate

- **Inflow of investment (money coming in):**
Foreigners need the local currency to invest. This **increases demand** for that currency, which can lead to an **appreciation** (currency gets stronger).

Example: If US investors buy lots of UK government bonds, they need pounds (£), pushing up the value of the pound.

- **Outflow of investment (money leaving):**
Locals sell their currency to buy assets abroad. This **increases the supply** of the local currency in foreign markets, which can cause **depreciation** (currency gets weaker ).

Example: If UK pension funds heavily invest in US tech stocks, they sell pounds and buy dollars, which weakens the pound.



14.1.3 The Balance of payments

The consequences of investment flows between countries

Exchange Rates and Investment Attractiveness

- **Stronger exchange rate:**
Investing becomes **more expensive** for foreigners because they need more of their home currency to buy local assets. This can **reduce the appeal** of investing.

Example: If the pound is very strong, US investors find UK property pricey, so they might invest elsewhere.

- **Weaker exchange rate:**
Investing becomes **cheaper** for foreigners because their money stretches further. This can **increase the attractiveness** of investing.

Example: After the pound fell post-Brexit, UK property and companies suddenly looked like a “bargain” for overseas buyers.

14.1.3 The Balance of payments

Policies to correct a balance of payments deficit or surplus

A **current account deficit** happens when a country spends more on imports (goods/services bought from abroad) than it earns from exports (goods/services sold abroad). Governments don't like this imbalance because it can weaken the economy, so they use two main types of policies to fix it:

- **Expenditure reducing policies** – making people spend less (especially on imports).
- **Expenditure switching policies** – nudging people to buy more local goods instead of imports (like tariffs or devaluation).

1) Expenditure Reducing Policies 📦

These policies aim to cut back **consumer spending power** (how much people can buy). The idea is simple: if people spend less overall, they'll also spend less on imports.

Examples of tools the government can use:

- **Higher taxes** – People keep less of their income, so they spend less on goods (including foreign ones).
- **Higher interest rates** – Loans and mortgages become more expensive, so people save more and spend less.
- **Lower government spending** – Less money pumped into the economy means less overall demand.

Example: If UK households spend less on holidays in Spain because interest rates rise, imports (like airline tickets, hotels, etc.) fall.

Issues with This Policy

Sounds good on paper, but there are downsides:

- ❤️ **Slower economic growth** – Cutting spending reduces demand in the economy, which may lead to higher unemployment.
- 🔄 **Unintended consequences** – Higher interest rates may cause the UK pound to rise in value (appreciation). This makes UK exports more expensive abroad, reducing export sales; the exact opposite of what we want.
- 😞 **Unpopular with voters** – Nobody likes higher taxes or more expensive loans, as it lowers living standards.

14.1.3 The Balance of payments

Policies to correct a balance of payments deficit or surplus

2) Expenditure switching policies 🔄

These are government policies designed to **fix a current account deficit** (when imports > exports) by encouraging people to buy fewer imports and more domestically produced goods. They also aim to boost exports by making them cheaper for foreign buyers.

🏠 a) Devaluation

Devaluation = when a country deliberately lowers the value of its currency in relation to others.

👉 Example: If £1 used to equal \$2 but now £1 = \$1.50, the pound has been devalued.

Effects on the current account:

- Exports become **cheaper** for foreign buyers (their money now buys more of our currency), so exports should increase.
- Imports become **more expensive** for domestic consumers (we need more pounds to buy the same amount of foreign currency), so imports should fall.

Problem: The actual effect depends on how sensitive people are to price changes; this is called **price elasticity of demand (PED)**.

📊 Marshall–Lerner Condition

This rule tells us whether devaluation will actually improve the current account.

- If **PED for exports + PED for imports > 1**, devaluation works ✅
- If **PED for exports + PED for imports ≤ 1**, then devaluation won't make much difference ❌

In other words, if people don't really change their buying habits when prices change (inelastic demand), devaluation won't fix the deficit.

14.1.3 The Balance of payments

Policies to correct a balance of payments deficit or surplus

The J-Curve Effect

Imagine the current account balance line shaped like the letter J.

- **Short term:** Things get worse before they get better. Why?
 - Exports are cheaper, but foreign buyers don't react instantly (contracts, habits, lack of info).
 - Imports cost more, but domestic consumers may keep buying them anyway (inelastic demand).
- **Long term:** As time passes, buyers adjust. Exports rise because they're cheaper, and imports fall as people look for alternatives. The current account improves, climbing up the "J" curve.

Example: When the UK devalued the pound after Brexit, imports like petrol became more expensive right away, but exports like cars and financial services became more attractive over time.

b) Protectionist Policies

Protectionism = when a government puts up barriers (like tariffs, quotas, or bans) to limit imports and protect its own industries.

How it works:

By restricting imports, governments hope people will buy more **domestically produced goods** instead. This reduces the current account deficit (when imports > exports).

Problems with protectionism:

- Other countries may **retaliate** by putting barriers on our exports. For example, if the UK slaps tariffs on Chinese steel, China might retaliate by taxing British cars, reducing our export sales.
- Protectionism assumes people can easily switch to domestic alternatives. But what if we don't make that good at home? (E.g., coffee in the UK, we don't grow much of it, so tariffs just make it pricier with no local substitute).

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14.1.3 The Balance of payments

Policies to correct a balance of payments deficit or surplus

3) Supply-Side Policies

Supply-side policies = long-term strategies to make the economy more productive and competitive.

These include things like:

- Better education and training (so workers are more skilled )
- Investing in infrastructure like transport and broadband (so businesses can operate more efficiently).
- Keeping inflation under control, so our exports stay affordable abroad.

Why this helps:

If UK firms become more efficient and innovative, they can produce high-quality goods at lower costs. That means:

- Our exports become more competitive 
- Imports may fall because homegrown products are just as good (or better).

Example: If the UK invests in renewable energy technology, we could export green tech abroad, boosting exports and improving our current account balance in the long run.

Exam pointers

- Always state the main channel
reduce spending or switch spending
- Mention time lags and side effects on growth, jobs, inflation, and the exchange rate
- For devaluation, write the Marshall Lerner condition and the J curve
- For protection, mention retaliation and consumer prices
- For supply side, stress long term gains in productivity and quality

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14.1.3 The Balance of payments

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.

14.1.3 The 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.

14.1.3 The Balance of payments

Implications of current account imbalances

When countries try to “fix” their current account (e.g., reduce a deficit), their actions often affect other economies too.

How One Country's Fix Can Hurt Others

- If a big economy (like the USA or China) adopts policies to cut imports and improve its current account, other countries feel the shock.
- Why? Because less importing by one country means **less demand for exports** from others. This can cause job losses, lower incomes, and reduced growth abroad.

Example: If the USA introduces **protectionist policies** (like tariffs on EU goods), EU exporters sell fewer products in the US. Factories in Germany or France might produce less, leading to layoffs and weaker growth in Europe.

The “Beggar-Thy-Neighbour” Problem

These kinds of policies are often called “**beggar-thy-neighbour**” policies.

 Definition: This is when one country tries to help itself by making things worse for others.

The danger? Other countries usually retaliate with their own policies (like tariffs or quotas), and soon everyone is worse off — global trade shrinks, jobs are lost, and economies slow down.

Think of it like a trade “food fight”; once one country throws the first plate, others throw theirs back, and in the end, the whole room is a mess.



14.1.3 The Balance of payments

Implications of current account imbalances

Exam Tip

The importance of a current account balance depends on the country:

- **Advanced economies** (like the UK or USA) usually cope better with deficits since they can borrow easily.
- **Developing countries** (like Ghana or Bangladesh) often can't borrow as cheaply, so they need to pay closer attention to deficits. Otherwise, they risk debt crises.

14.1.4 Exchange rate systems

Exchange rate systems

An **exchange rate** is simply the price of one currency in terms of another. Think of it like the “conversion rate” when you swap money at the airport.

Example: If **£1 = €1.30**, it means one British pound can buy 1.30 euros. You could also flip it around: **€1 = £0.77** (that’s just the reciprocal — $1 \div 1.30$).

What does it mean when the exchange rate changes?

- **Higher exchange rate (appreciation):** Your currency gets stronger, so each pound buys *more* foreign currency. Great for holidays abroad (cheaper trips), but not so great for exporters since UK goods become more expensive for foreign buyers.
- **Lower exchange rate (depreciation):** Your currency weakens, so each pound buys *less* foreign currency. Tough luck for holidays abroad (your money doesn’t stretch as far), but exporters are happy because UK goods look cheaper to overseas buyers.

That’s why people often say a currency is “*strengthening*” (*strong*) or “*weakening*” (*weak*) depending on how it moves.

Typical Mistake

Always be clear which way you’re quoting the rate.

- Is it **euros per pound** (€ per £)?
- Or **pounds per euro** (£ per €)?

Mixing them up can lead to very wrong answers in exams.

14.1.4 Exchange rate systems

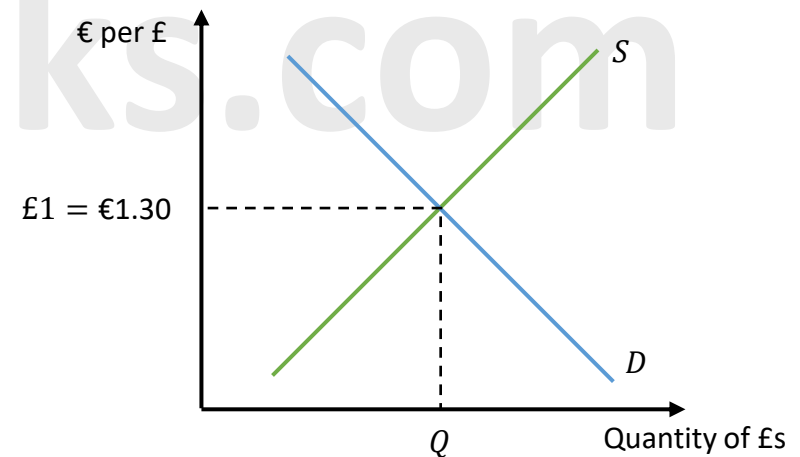
Exchange rate systems

What actually determines the exchange rate?

Like most things in economics, it comes down to **demand and supply**:

- If lots of people want pounds (say, foreign investors buying UK assets), demand for pounds rises → £ strengthens.
- If more pounds are being sold (say, Brits going on holiday abroad and buying foreign currency), supply of pounds rises → £ weakens.

At the point where demand and supply meet, you get the **equilibrium exchange rate**; the “settled” price of the pound.



14.1.4 Exchange rate systems

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.

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14.1.4 Exchange rate systems

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.

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14.1.4 Exchange rate systems

Factors influencing floating exchange rates

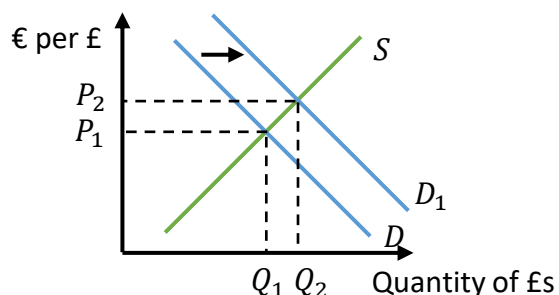
Floating exchange rates are like prices in any market; they move based on supply and demand. The more people want a currency, the more it's worth (appreciation). If fewer people want it, the value drops (depreciation). Here's what affects that:

▲ 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.



14.1.4 Exchange rate systems

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.



14.1.4 Exchange rate systems

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.

14.1.4 Exchange rate systems

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.

14.1.4 Exchange rate systems

Pros and cons of a floating exchange rate system

A **floating exchange rate** is when the value of a country's currency is determined by supply and demand in the foreign exchange market, without direct government control. In other words, the pound (£), dollar (\$), or euro (€) is allowed to "float" up and down depending on how much people want to buy or sell it.

The UK, for example, has let the pound float for over 20 years and there are some big benefits (but also drawbacks).

✓ Advantages of Floating Exchange Rates

- **No need for massive foreign reserves** 💰
Unlike fixed exchange rates, governments don't need to stockpile huge amounts of dollars, euros, or gold to keep the currency stable. That frees up resources for other things (like public services or investment).
- **Monetary sovereignty** 🏦
Governments can set **interest rates** based purely on their own economy (like tackling inflation or unemployment) rather than worrying about defending a fixed exchange rate.
Example: If the UK needs to cut interest rates during a recession, it can do so without worrying about pegging the pound to the dollar.
- **Automatic stabiliser** ⚖️
If a country has a big **current account deficit** (importing more than it exports), its currency will usually fall in value. A weaker currency makes exports cheaper abroad and imports more expensive at home; helping restore balance.
Example: If the UK imports loads of German cars and French wine, the pound may weaken, which in turn boosts British exports like financial services or machinery.

⚠️ Typical Mistake

It's easy to think that floating exchange rates automatically and smoothly fix deficits or surpluses. But in reality, it's messy due to speculation, politics, and global shocks (like oil price spikes) that can all mess with the process.



14.1.4 Exchange rate systems

Pros and cons of a floating exchange rate system

✗ Disadvantages of Floating Exchange Rates

- **Uncertainty for businesses** 📉
Companies trading across borders face risks when the currency swings wildly. For example, a British car exporter may set a price in dollars, but if the pound suddenly rises, their cars become more expensive abroad, cutting sales.
- **Overvalued or undervalued currency** 📈
Speculators (investors betting on currency movements) can push currencies too high or too low.
 - An **overvalued currency** (too strong) hurts exporters because their goods look expensive abroad.
 - An **undervalued currency** (too weak) may boost exports but can also trigger **cost-push inflation** (higher import prices make everything more expensive).
Example: If the pound falls sharply, UK holidays abroad get pricier, and imported goods like fuel or electronics shoot up in cost.

14.1.4 Exchange rate systems

Fixed exchange rates

A **fixed exchange rate** is when a government or central bank decides to “peg” its currency to another currency (like the US dollar or the euro) rather than letting it freely move in the market.

Think of it like a price tag glued onto your currency — no matter how much demand and supply shift, the government tries to keep the value steady within a narrow range.

How do governments keep it fixed?

- **Monetary policy** 🏠 — Changing interest rates to make holding the currency more or less attractive.
 - Example: If the UK wanted to keep the pound strong, it could raise interest rates, so investors want to hold pounds (to earn more return).
- **Open market operations** 🏦 — Buying and selling foreign reserves (like dollars, euros, yen) to control the supply and demand of the local currency.
- **Capital controls** 🚧 — Restricting how much money can enter or leave the economy (less common nowadays because most countries prefer open markets).

✅ Advantages of Fixed Exchange Rates

- **Easier for businesses to trade** 🌐 — Companies know what exchange rate they’ll get, which reduces uncertainty. Imagine exporting cars from Germany to France without worrying the euro will suddenly crash.
- **Monetary discipline** 📏 — By pegging your currency, you’re forced to keep interest rates and inflation stable, giving your economy credibility. It’s harder for governments to just “print money” or cut rates recklessly to win votes.

14.1.4 Exchange rate systems

Fixed exchange rates

❌ Disadvantages of Fixed Exchange Rates

- **No quick fix for trade problems** 📉 — If your exports are uncompetitive, you can’t just devalue your currency to make them cheaper.
- **Loss of independence** 😞 — You can’t always set interest rates to suit your own economy because you need to match the country you’re pegged to.
- **Costly foreign reserves** 💰 — Governments often need massive piles of foreign currency (like dollars) to defend the peg, which can run out quickly.
- **📌 Exam Tip**
 - Even with a “fixed” system, currencies aren’t frozen solid. They usually move within a very **narrow band** (often just 1–2%). So, it’s more like a tight leash than a padlock.

14.1.4 Exchange rate systems

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.



14.1.4 Exchange rate systems

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.

14.1.4 Exchange rate systems

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 must 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.

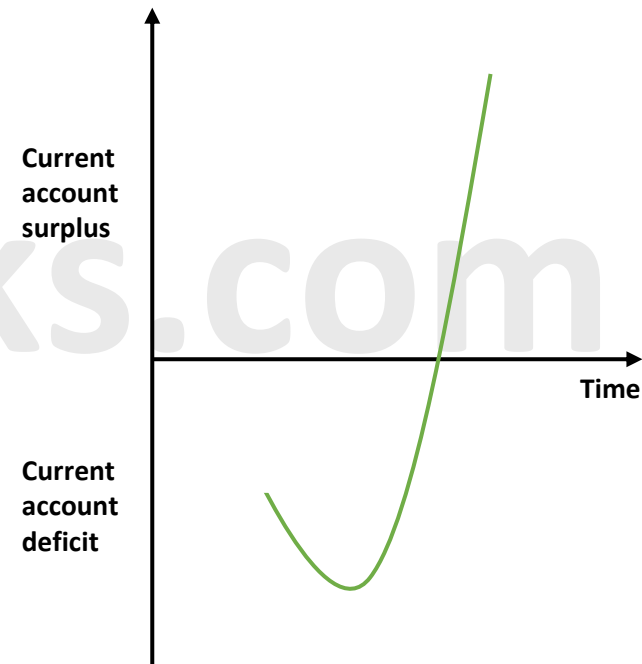
So, at first, the country's **trade deficit** might widen, then improve later once demand adjusts. That path looks like a letter "J" on a graph hence, the J-curve.

14.1.4 Exchange rate systems

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

14.1.4 Exchange rate systems

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.



14.1.4 Exchange rate systems

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.

14.1.4 Exchange rate systems

Custom unions

A **currency union** is when a group of countries share the same currency. For example, many EU countries use the **euro (€)** and together form what's called the **Eurozone**. The UK chose not to join, but it's a hot topic with pros and cons.

✓ Arguments in Favour of Joining a Currency Union

- **No exchange rate worries** ⚖️
No fear of your currency suddenly becoming "too strong" (hurting exports) or "too weak" (causing inflation) compared to other member countries. Everyone is on the same playing field.
- **No conversion costs** 💰
Businesses and travellers save money because there's no need to exchange currencies (and no fees). Imagine not paying extra every time you holiday in Spain, Italy, or Greece.
- **Certainty for businesses** 🏢
Companies trading with other member countries don't need to worry about fluctuating exchange rates. For instance, a French cheese seller can sell to Germany without worrying about the euro–franc conversion (since they both use the euro).
- **Price transparency** 🛒
Consumers can easily compare prices across countries. A phone priced at €500 in Portugal is €500 in Germany too, making it easier to spot good deals.

14.1.4 Exchange rate systems

Custom unions

✗ Arguments Against Joining a Currency Union

- **Fiscal policy pressure** 💰
Governments may have to use more taxes or spending cuts to manage imbalances, since they can't use exchange rate changes anymore. This is often unpopular with voters.
- **Loss of monetary policy independence** 🏦
A country can't set its own **interest rates** or use tools like money supply changes to fight inflation or unemployment. Instead, one central authority (like the European Central Bank) decides for everyone.
- **Business competitiveness issues** 📈
Countries with higher costs may struggle to compete with lower-cost producers in the union. For example, Greek farmers can't devalue their currency to make their goods cheaper compared to German ones.
- **Risk of bailouts** 🚒
If one country overspends and racks up huge government debt, other members may have to step in and help. The Eurozone debt crisis (where countries like Greece needed help from richer members like Germany) is a clear example.

14.1.5 Economic growth and development

Economic Growth vs Economic Development

- **Economic growth** means an increase in how much a country produces often measured by **real GDP** (Gross Domestic Product adjusted for inflation).
- **Economic development** means a country is getting better at meeting people's needs like longer life spans, access to clean water, better education, and higher incomes. It's not just about more money, but about **better lives**.

How Do We Measure It?

There are two main types of indicators:

Single Indicators – One Piece of the Puzzle

These focus on just **one aspect** of development, giving a limited snapshot.

For example:

- **Literacy rate** – What % of adults can read and write
- **Access to electricity** – How many people have reliable access to power
- **Average calorie intake per person** – Helps show whether people are getting enough food

Composite Indicators – A Bigger Picture

These combine **several indicators** into one score to give a more complete and balanced view of how developed a country is.

The most well-known is the **Human Development Index (HDI)**, which includes health, education, and income.

14.1.5 Economic growth and development

Human Development Index (HDI)

The Human Development Index (HDI)

The HDI was created by the **United Nations (UN)** to give a more balanced picture of how developed a country is, not just by how rich it is, but by how healthy, educated, and fairly wealthy its people are.

It's based on 3 key areas:

1. Health

Measured by **life expectancy at birth** (how long people are expected to live).

 **Example:** In 2021, life expectancy in **Japan** was around **84.8 years**, one of the highest in the world.
In **Sierra Leone**, it was around **60.6 years**.

2. Education

Measured using two things:

- The **average (mean)** years of schooling adults (age 25+) have completed
- The **expected years** a child entering school today is likely to complete

Example: A child in Germany might be expected to finish 14 years of schooling on average.

3. Income

Measured by **GNI (Gross National Income) per person**, adjusted for **purchasing power parity (PPP)**.

This tells us how much money people make on average, and what that money can actually buy in their country.

 **Example:** In **Qatar**, GNI per capita is high — over **\$55,000**.
In **Nepal**, it's much lower — closer to **\$4,000**.

14.1.5 Economic growth and development

Human Development Index (HDI)

How Is HDI Scored?

Each of the three categories (health, education, and income) gets **equal importance**.

Countries receive a score between **0 and 1**:

- **Closer to 1** = higher development
- **Closer to 0** = lower development

HDI Score	Development Level	Example Country
Below 0.550	Low	Chad – 0.394
0.550–0.699	Medium	India – 0.633
0.700–0.799	High	Brazil – 0.754
0.800 and above	Very High	Switzerland – 0.962

14.1.5 Economic growth and development

Pros and cons of using HDI

The **Human Development Index (HDI)** is a tool used to compare how developed different countries are. It uses three big indicators: health, education, and income.

Let's break down the pros and cons of using HDI to compare development:

Advantages of HDI

- **It's a composite indicator** – That means it combines several factors (not just income!), which gives a fuller picture than using one stat on its own.

 Example: Instead of just knowing how rich a country is, HDI tells us how healthy and educated its people are too.

- **It's used worldwide**, which means it's great for making **fair comparisons** between countries.

 Example: You can compare Canada, Kenya, and Cambodia using the same scale.

- **It helps governments set goals.** If a country scores low on education, for example, it shows the government where to focus its efforts.
- **It helps people understand their quality of life**, not just how much money is floating around in the economy.
- **It's fairly simple to calculate.** Governments already collect most of the data needed, like life expectancy or school enrolment.



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Pros and cons of using HDI

✗ Limitations of HDI

- **It doesn't show inequality.** HDI uses average income (GNI per capita), so if a country has a few billionaires and lots of people in poverty, it won't show that gap.
- ✎ Example: Two countries might have the same HDI, but one could have much worse income inequality.
- **It ignores poverty levels.** HDI doesn't tell us how many people are living in absolute poverty (struggling to afford basic needs) or in relative poverty (worse off than most others in their country).
- **Health scores don't show quality of life.** Just living longer doesn't always mean living better. Someone could live to 80 but in poor conditions or with bad healthcare access.
- **The data can be out of date.** Because it takes time to collect and report HDI data, it may not reflect **recent changes** like a new education policy or a health crisis.
- ✎ Example: A country's 2023 HDI score might still be based on 2020 data.
- **Education stats don't measure learning.** Years in school say nothing about how good that education was. Someone might go to school for 10 years and still not be fully literate if the schooling was poor.

14.1.5 Economic growth and development

Other indicators of development

◆ Other Composite Indicators

Composite indicators combine several indicators into one score, offering a more balanced view.

💡 IHDI – Inequality-Adjusted Human Development Index

The **IHDI** is like the regular HDI, but with a twist, it also looks at **inequality**. It adjusts a country's score based on how **fairly** health, education, and income are shared across the population.

- It uses something called the **Atkinson Index**, which reduces the HDI score if inequality is high.
- If **everyone is equal**, HDI and IHDI will be the same.
- But if there's a **big gap** between the rich and poor, IHDI will be **lower**.
- ✎ Example:
 - **Chile** has an HDI of **0.855**, but its IHDI drops to **0.731** once inequality is factored in, showing a **14.5% loss**.



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Other indicators of development

The Multidimensional Poverty Index (MPI)

The **MPI** measures the % of people who are **multidimensionally poor**, not just poor in income, but in **multiple aspects of life**.

It looks at **3 key dimensions** and **10 indicators**:

1. **Health** – child deaths, malnutrition
2. **Education** – years of school and whether kids are enrolled
3. **Living standards** – electricity, clean water, toilets, cooking fuel, flooring, and basic assets (like a fridge or bicycle)

 Example: In **Burkina Faso**, over **55%** of people are classed as multidimensionally poor meaning they lack essentials in at least 3 or more areas.

 Great for spotting regions within countries where poverty is worst — even if the country's overall income looks okay.

 But it can't be calculated for every country because **some data is missing**, and it **doesn't cover environmental issues**.

14.1.5 Economic growth and development

Other indicators of development

The Genuine Progress Indicator (GPI)

The **GPI** is all about **sustainable development** — making sure today's progress doesn't harm tomorrow's future.

It's based on **26 indicators** across three big areas:

1. Economic –

Looks at how much people spend, unemployment rates, and income inequality.

2. Environmental –

Tracks things like pollution, CO₂ emissions, destruction of forests, and the use of non-renewable resources.

3. Social –

Measures things like crime, time spent parenting, housework, and even the value of volunteering.

 Example: A country may have high GDP growth but also high CO₂ emissions, deforestation, and rising crime. GPI would reflect that negatively.

 Some critics say it's **anti-growth** because it often shows rich countries slowing down due to their environmental impact. Others say that proves growth isn't always sustainable.



14.1.5 Economic growth and development

Characteristics of less developed economies (LDCs)

Less developed economies (sometimes called **developing countries**) are nations that haven't yet reached the high-income, high-standard-of-living stage of developed countries. While they vary in culture, size, and geography, they often share common traits:

1. Low GDP per capita 💰

- **GDP per capita** = total value of goods/services produced ÷ population.
- In LDCs, this number is usually low, meaning people on average earn far less than in developed countries like the UK or Japan.
- Example: GDP per capita in Malawi is around a few hundred dollars per year, compared to over \$40,000 in Germany.

2. Dependence on primary products 🌱

- Many rely heavily on exporting raw materials (like cocoa, coffee, or oil).
- Problem? Prices of these goods can swing wildly. If coffee prices crash, so do national incomes.

3. Fast population growth & young population 🧒

- Populations often grow quickly, and the **median age** (the age where half the population is younger and half older) is very low.
- Example: In Niger, the median age is about 15. This can be a challenge (more schools, jobs needed) but also an opportunity (a young workforce in future).

14.1.5 Economic growth and development

Characteristics of less developed economies (LDCs)

4. Rural-based populations & agriculture-heavy jobs 🚜

- Many people live in the countryside and work in farming rather than industry or services.
- Example: In Ethiopia, agriculture employs around 65% of the workforce.

5. Large informal economy 🗑️

- The **informal economy** = unregulated, untaxed jobs like street vendors, small-scale traders, or cash-in-hand work.
- While it provides livelihoods, it reduces government tax revenue and often lacks worker protections.

6. Weak infrastructure 🏠

- Roads, electricity, clean water, and internet access are often limited.
- Example: Frequent power cuts in Nigeria make it harder for businesses to grow.

7. Poorly developed financial markets 🏦

- Banks and stock markets are often underdeveloped. This makes it harder for people and businesses to borrow money and invest.
- Imagine trying to start a business but no one will give you a loan; that's a big barrier to growth.



14.1.5 Economic growth and development

Factors that affect growth and development

For an economy to **develop**, it's not enough to just grow quickly; that growth has to be **sustainable** (able to continue into the future). Economists often explain this using the **PPC (Production Possibility Curve)**, which shows the maximum output an economy can produce with its resources. Development happens when the PPC shifts outward *and* when the benefits of growth actually improve people's lives.

Here are two of the biggest factors:

1 Investment 💰

- **Definition:** Investment means spending on things that will boost future production, like roads, schools, hospitals, or technology.
- This helps in the **short run** (creating jobs during construction, for example) and the **long run** (making businesses more efficient and improving living standards).
- Example: Building new transport links (like railways in India or new highways in Kenya) reduces costs for businesses and makes it easier for people to access jobs and markets.
- This kind of investment is usually *more useful for development* than, say, military spending, which doesn't directly raise productivity or improve living standards.



14.1.5 Economic growth and development

Factors that affect growth and development

2 Education and Training 🎓

- **Definition:** Education increases a country's **human capital**; the skills, knowledge, and abilities of its people.
- Training makes workers more **employable** (e.g. teaching digital skills so people can work in IT) and boosts **productivity** (workers produce more in the same time).
- Example: In South Korea, massive investments in education after the 1960s transformed the economy from being mostly agricultural to a global tech leader.
- This not only helps short-run growth (more skilled workers → more jobs filled) but also long-run growth (an economy with a smarter, more flexible workforce can adapt and innovate).

14.1.5 Economic growth and development

Barriers to growth and development

Even if a country invests in **education** 📖 and **infrastructure** 🏗️, it may still struggle to develop. Why? Because there are plenty of **barriers** (obstacles) that hold economies back.

1 Corruption 🕵️

- **Definition:** Corruption is the abuse of power for personal gain (like bribery).
- It makes a country unattractive for **FDI (Foreign Direct Investment)** because businesses can't rely on fair treatment.
- Example: If a company has to bribe officials just to get electricity connected, they may simply choose to invest elsewhere.

2 Poor Infrastructure

- **Definition:** Infrastructure means the basic systems needed for an economy to function like roads, electricity, internet, and ports.
- Without good infrastructure, businesses can't operate efficiently. Imagine trying to run an online company without reliable internet.
- Example: Some African countries face frequent power outages, which discourage investment from multinational corporations (MNCs).

3 Weak Human Capital

- **Definition:** Human capital = the skills, education, and health of the workforce.
- If people don't have proper education or training, they can't fill the jobs businesses need.
- Example: Tech companies might avoid countries without enough skilled software engineers.

14.1.5 Economic growth and development

Barriers to growth and development

4 Lack of Property Rights 🏠

- **Definition:** Property rights mean legal protection for ownership of land, assets, and ideas.
- Without strong property rights, investors fear their businesses or profits could be taken away.
- Example: In countries where land can be seized without fair compensation, farmers or businesses hesitate to invest.

5 Institutional Weakness

- **Definition:** Institutions are the “rules of the game”; stable governments, courts, healthcare, and education systems.
- Without them, development is nearly impossible.
- Example: War-torn countries often struggle to grow because there's no political stability to attract investors.

6 Undeveloped Financial System 🏦

- **Definition:** A financial system includes banks, stock markets, and credit institutions.
- If it's weak, businesses can't get loans to start or expand.
- Example: A farmer who wants to buy modern equipment may struggle if banks don't offer credit in rural areas.

7 Primary Product Dependency 🌾📦

- **Definition:** Relying heavily on one product (like oil, cocoa, or coffee) for exports.
- Problem? Commodity prices swing a lot; if prices drop, the whole economy suffers.
- Example: Venezuela relied heavily on oil. When oil prices collapsed, so did government revenues.

8 Volatile Commodity Earnings

- Exports like oil, copper, or coffee can fluctuate wildly in price. This makes it very hard for governments to plan budgets or provide stable public services.

14.1.5 Economic growth and development

Policies to promote economic growth and development - Market-orientated strategies

Market-oriented strategies are policies that let private individuals and businesses take the lead in growing the economy. The idea is to create the right conditions where people can trade, invest, produce, and compete, all with the goal of making profits and boosting growth.

Here are some key strategies:

1. Trade Liberalisation

This means opening up your country to international trade by removing things like tariffs (taxes on imports) or quotas (limits on how much you can import). It encourages countries to specialise in what they're good at (comparative advantage), and trade for the rest.

 *Example:* When Vietnam opened up to international trade, it became one of the world's top coffee exporters, lifting millions out of poverty.

2. Foreign Direct Investment (FDI)

FDI happens when a business from one country invests in a business in another. This could mean building a factory, buying a company, or forming a partnership.

FDI can create jobs, bring in new technology and skills and boost wages and incomes

 *Example:* Toyota's investment in car manufacturing in South Africa has helped boost jobs and industrial capacity.

BUT – there can be downsides:

- Profits are often sent back to the foreign company's home country (repatriation).
- Local businesses may struggle to compete.
- Jobs offered are often low-paid.

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Policies to promote economic growth and development - Market-orientated strategies

3. Removing Government Subsidies

Subsidies are government payments that make things like food or fuel cheaper. While they sound helpful, they can cause problems:

- They're expensive for governments.
- They often help everyone, not just those who need it.
- They can create inefficiencies if companies rely on them for too long.

Removing them encourages businesses to compete fairly and become more efficient. It can lead to better productivity and reduce government spending.

 *Example:* In 2015, India reduced its fuel subsidies to lower its budget deficit and encourage cleaner energy use.

4. Floating Exchange Rate Systems

This is when a country lets its currency value be decided by the market (supply and demand), rather than setting a fixed rate. This means:

- No need for government to use gold or foreign reserves to manage the exchange rate.
- It adjusts automatically to economic changes.

A strong currency can make imports cheaper, lowering production costs and raising income.

But it's not perfect:

- Exchange rates can be volatile (unstable).
- This can make it hard for exporters/importers to plan.

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Policies to promote economic growth and development - Market-orientated strategies

5. Microfinance

Microfinance gives small loans to people (especially women) who can't get traditional bank loans. It helps them start small businesses, invest in farming or trade and break the cycle of poverty

 *Example:* In Kenya, mobile banking like M-Pesa has helped farmers access small loans and improve their livelihoods.

 However, in places like **South Africa**, some people borrow to spend on daily needs rather than invest. This can lead to more debt and little real development.

6. Privatisation

Privatisation is when the government sells off state-owned businesses to private companies. The idea is that private companies are more efficient and profit-driven.

Privatisation can:

- Improve services
- Increase competition
- Raise money for governments

 *Example:* In the UK, the privatisation of British Airways made the airline more profitable and improved customer service.

14.1.5 Economic growth and development

Policies to promote economic growth and development - Market-orientated strategies

 Watch out:

- If a private company becomes a monopoly, competition disappears.
- There's a risk of corruption, for example, selling public companies to friends or for cheap prices.
- Jobs and services may suffer if the company only focuses on profits.



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Policies to promote economic growth and development - Interventionist strategies

Sometimes, the free market doesn't work perfectly, and governments have to step in. These strategies are called **interventionist strategies** where the goal is to boost economic growth, reduce inequality, and help citizens live better lives.

1. Development of Human Capital

Human capital refers to the skills, knowledge, and health people have, which help them to be more productive.

Governments can invest in human capital through:

- Better schools, colleges, and universities.
- Job training programmes.
- Vocational skills, like apprenticeships for plumbers or digital bootcamps for coders.

More skilled workers = more innovation, better quality products, and faster economic growth.

For example, **Vietnam** has invested a lot in education and technical training to become a tech and manufacturing hub.

It also helps countries move away from relying on just raw materials (like crops or minerals) and grow industries like manufacturing or services instead.

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Policies to promote economic growth and development - Interventionist strategies

2. Protectionism

This is when a country puts up barriers (like tariffs or quotas) to protect its local businesses from foreign competition.

- It helps **young industries** (called “infant industries”) survive and grow.
- Can create jobs locally in the short term.
- Protects wage levels and jobs. If not, cheap imports might force local businesses to close or slash wages.

But, if protection lasts too long, companies might become **lazy** (less efficient), prices go up, and other countries might retaliate by putting tariffs on your exports.

Example: In 2025, the U.S. put tariffs on steel imports to protect its local steel producers.

3. Managed Exchange Rates

Instead of letting the value of a country's currency float freely, governments sometimes **control the exchange rate**. They might fix the currency or buy/sell it to influence its value.

Why do this?

- A cheaper currency = cheaper exports, which boosts sales abroad.
- If a currency gets too strong, exports become more expensive, which can hurt businesses.
- A more stable currency = businesses find it easier to plan and trade.

But managing exchange rates can be tricky and lead to **black markets** or even **corruption** if not done transparently.



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Policies to promote economic growth and development - Interventionist strategies

4. Infrastructure Development

Infrastructure = all the basic physical systems needed for a country to work properly (e.g., roads, electricity, internet, schools, hospitals).

Good infrastructure:

- Attracts foreign investors.
- Makes it easier for people and goods to move around.
- Increases productivity.

Example: Ethiopia's investments in railways and power plants are helping it grow faster.

But infrastructure projects can be expensive and vulnerable to corruption. Some experts suggest using **intermediate technology** (like local materials and tools) instead of big flashy projects.

5. Joint Ventures with Global Companies

In some countries, foreign companies aren't allowed to fully own local businesses. So, they team up with local firms (called **joint ventures**) to get around this.

Joint ventures share profits and risks and can bring in new skills, tech, and jobs.

This way foreign companies can still invest (even if full ownership is banned), local workers get jobs and training and more of the profits stay in the country.

Example: Starbucks teamed up with India's Tata Group to open stores in India, a win-win.

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Policies to promote economic growth and development - Interventionist strategies

6. Buffer Stocks

A buffer stock scheme is when the government tries to keep the prices of essential goods stable by stepping in to buy or sell those goods at the right time. It's like having an emergency supply cupboard for the economy.

How It Works:

- The government sets a **minimum price** and a **maximum price** for a product (usually a **commodity** like rice, coffee, or cocoa).
- If there's too much supply (and prices fall), the government **buys the extra stock** to stop prices crashing.
- If there's a shortage (and prices rise too high), the government **sells from its stockpile** to bring prices down.
- This helps keep prices within a "safe zone", not too high, not too low.

The idea is that the scheme should be **self-financing** meaning the money the government makes from selling stock when prices are high is used to buy more stock when prices fall.

Why Use It?

- It **stabilises prices**, which is super helpful for farmers and producers who rely on predictable income.
- It prevents sharp drops in price, which could push small producers into **poverty**.
- It protects consumers from soaring prices, which helps make food and essential items **more affordable**.

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Policies to promote economic growth and development - Interventionist strategies

6. Buffer Stocks

- It also encourages investment because producers can plan for the long term.
- It's a useful tool for countries that rely heavily on selling raw materials (this is called **primary product dependency**).

The Challenges:

- Prices must go up and down to work. If they only fall or only rise, the system breaks.
- It can be **expensive to run**. You need money to buy stock, storage space to keep it, and systems to manage it all.
- If lots of countries benefit from price stability but don't take part in the scheme, they're called **free riders** and this can make some governments less willing to join.
- If the government sets the **minimum price too high**, farmers might overproduce, knowing the government will buy everything. This leads to **waste and inefficiency**.



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Policies to promote economic growth and development - Interventionist strategies

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14.1.5 Economic growth and development

The role of aid and trade

For poorer countries (often called **less developed economies**), finding money to build roads, schools, hospitals, and businesses is tough. Two big ways they can get support are through **trade** and **aid**. But which is better? Economists are divided.

Trade

Definition: Trade means countries exchanging goods and services with each other.

- If countries specialise in industries where they have a **comparative advantage** (i.e. they're relatively more efficient at producing something compared to others), everyone can benefit.
- Example: Ethiopia specialises in coffee ☕, while Germany focuses on cars 🚗. If they trade, both countries win.

But here's the catch:

- Developed countries sometimes protect their own industries (e.g. through tariffs or subsidies).
- Example: The EU has been criticised for subsidising its farmers, making it harder for African farmers to compete with their cheaper products.

Aid

Definition: Aid is money, goods, or services given by rich (developed) countries to poor (developing) countries, usually to help with growth or emergencies.

Types of Aid:

- **Money** 💰: Can be unconditional (a free gift) or conditional (must be used in a certain way).
 - Example: A "soft loan"; a loan with very low interest.
- **Goods and services** 📦: Often for emergencies, like food during famine, medicine during a pandemic, or tents during a natural disaster.

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The role of aid and trade

Benefits of Aid:

- Can build roads, schools, or hospitals.
- Can support social programmes like education and health.

Problems with Aid 🚩

- Money can be stolen by corrupt governments and never reach the people who need it.
- Countries may spend aid poorly like building "white elephant" projects (flashy airports or roads that nobody uses).
- Sometimes, aid doesn't match local needs. For example, sending wheat to a rice-eating country might not help much.
- Aid might come with strings attached, e.g. "You can have this money, but you must buy our country's products with it."

Conclusion

The truth? Both aid *and* trade can help but they work best when:

- Aid is given with few conditions, so governments can use it for what's really needed.
- Trade focuses on goods that are in demand (and less price-sensitive), so developing countries can actually compete globally.

Debt relief (cancelling or restructuring debt repayments) can also help poor countries breathe easier. But critics warn it may let corrupt governments off the hook, allowing them to stay in power without fixing deeper problems.

In short: aid is useful, trade is powerful, and the best results usually come from a mix of both.

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The role of debt relief

6. Debt Relief

Debt relief means cancelling or reducing the money a country owes often because it just can't afford to pay it back without harming its economy and people.

Why is this important?

- Many developing countries owe huge sums of money and pay **high interest** on those loans. That means a big chunk of their budgets goes to debt repayments instead of vital things like schools, hospitals, and clean water.
 -  *For example, in the early 2000s, debt repayments took up around 30% of government spending in countries like Mozambique.*
- Cancelling some of this debt means **governments can finally invest** in public services and infrastructure that improve people's lives.

Benefits:

- **More money for development** – Without the weight of debt, countries can spend more on building roads, paying teachers, and providing clean water.
- **Improves stability** – Less financial stress can make governments stronger and more effective.



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The role of debt relief

But there's a catch: Moral Hazard

Moral hazard happens when someone behaves recklessly because they know they'll be bailed out. In this case, if countries believe their debt will just be written off, they might:

- Keep borrowing irresponsibly
- Avoid making tough reforms (like fixing corruption or improving tax collection)
- Depend on aid and not take responsibility for their finances

Please see the '14.2 The international economy
Worked Examples' pack for exam style questions.

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