

International economic issues (A Level)

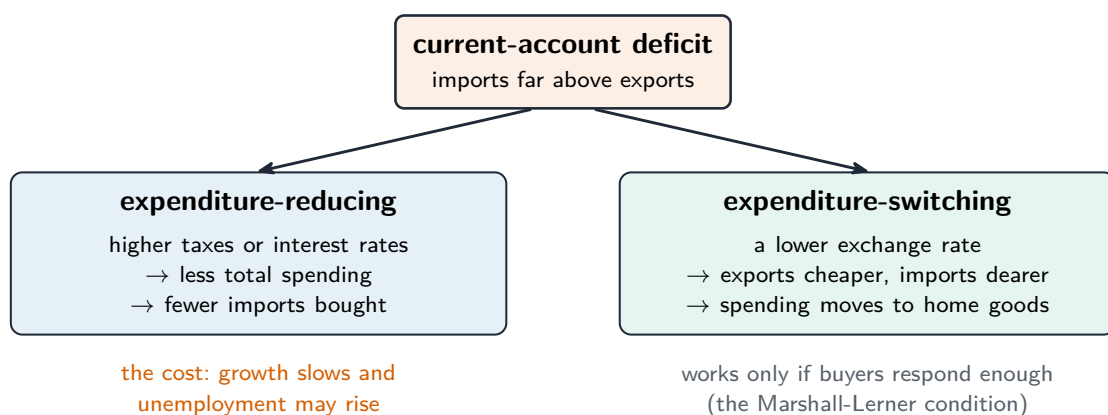
A-Level Economics

This final topic covers trade imbalances, exchange rates in depth, and how countries develop and connect.

Correcting a balance of payments imbalance

A country with a large **balance of payments** problem – usually a deficit on the **current account** – can use two kinds of policy.

- **expenditure-reducing** policies cut total demand (higher taxes or interest rates). With less spending, people buy fewer imports. But growth slows and unemployment may rise.
- **expenditure-switching** policies move spending away from imports towards home goods. The main tool is a lower **exchange rate** – a **depreciation** under floating rates, or a **devaluation** under a fixed system – which makes exports cheaper and imports dearer.



Two routes out of a deficit: spend less overall, or switch spending to home goods

■ The Marshall–Lerner condition and the J-curve

A lower exchange rate only improves the current account if buyers respond enough. The **Marshall-Lerner condition** says the sum of the price elasticities of demand for exports and imports must be greater than one:

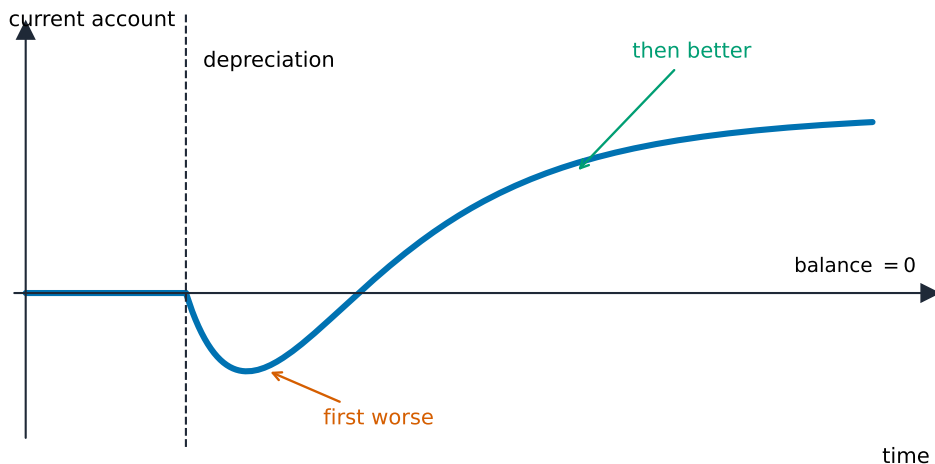
$$PED_{\text{exports}} + PED_{\text{imports}} > 1$$

Worked example. After a depreciation, the demand for a country's exports has $PED = 0.6$ and its demand for imports has $PED = 0.7$. Will the current account improve?

$$0.6 + 0.7 = 1.3 > 1,$$

so the Marshall-Lerner condition **is** met, and the depreciation should improve the current account in the long run. (If the two elasticities had summed to less than 1 – for example $0.3 + 0.4 = 0.7$ – a depreciation would make the deficit **worse**.)

Even when this holds, the gain takes time. The **J-curve effect** describes what happens: just after a depreciation, the current account first gets **worse** (imports cost more straight away, but trade volumes are slow to change), then later improves as buyers adjust – tracing the shape of a letter J.



J-curve: after depreciation, CA first worse then better

After a depreciation the current account first worsens (imports cost more at once), then improves as trade volumes adjust – tracing a letter J.

Exchange rates

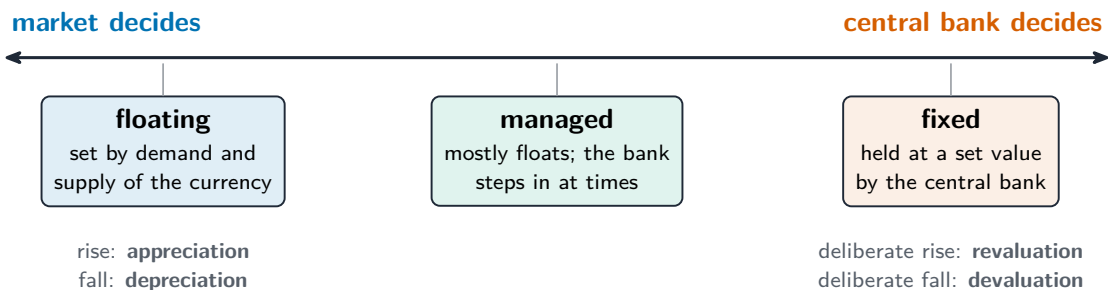
An **exchange rate** is the price of one currency in terms of another. There is more than one way to measure it:

- the **nominal exchange rate** is the everyday market rate between two currencies.
- the **real exchange rate** adjusts the nominal rate for differences in prices between the countries, so it shows true competitiveness.
- the **trade-weighted exchange rate**, also called the **effective exchange rate**, is an average of a currency's value against all its trading partners, weighted by how much trade is done with each.

■ The three systems

- a **floating exchange rate** is set by the demand for and supply of the currency.
- a **fixed exchange rate** is held at a set value by the central bank.
- a **managed exchange rate** mostly floats, with the central bank stepping in at times.

Under floating rates, a rise in value is an **appreciation** and a fall is a **depreciation**. Under a fixed system, a deliberate rise is a **revaluation** and a deliberate fall is a **devaluation**. A weaker currency tends to raise exports and inflation; a stronger currency does the opposite.



The three exchange-rate systems, and the words for a rise or fall in each

Economic development

It is important not to confuse two ideas:



Growth is more income; development is wider wellbeing too

- **economic growth** is simply a rise in real output.
- **economic development** is wider. It is about people's **standard of living** – their health, education, and freedom of choice, not just their income.



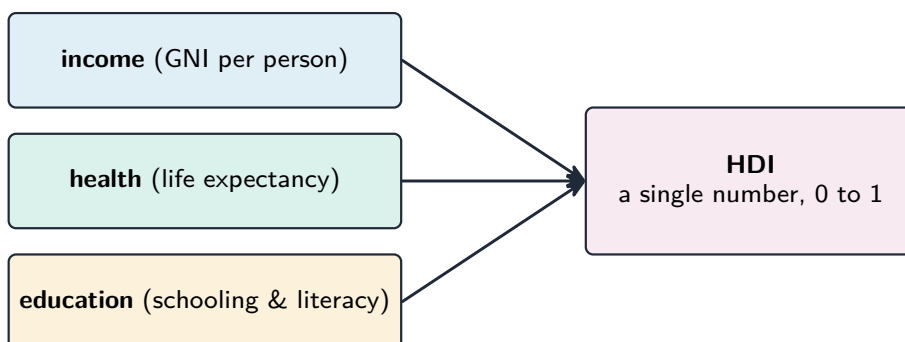
Economic development is wider than growth: it is about living standards in a fast-growing developing economy.

A country can grow without developing much (if the extra income goes to a few people). Development usually means rising incomes **plus** better health, more schooling, and less poverty.

■ Measuring development

The best-known measure is the **Human Development Index** (HDI). It combines three things into one number between 0 and 1:

- income (GNI per person),
- health (**life expectancy** at birth),
- education (mean and expected **years of schooling**).



The HDI rolls income, health and education into one number – so it captures living standards far better than income alone

Other useful signs of development include access to clean water, the number of doctors

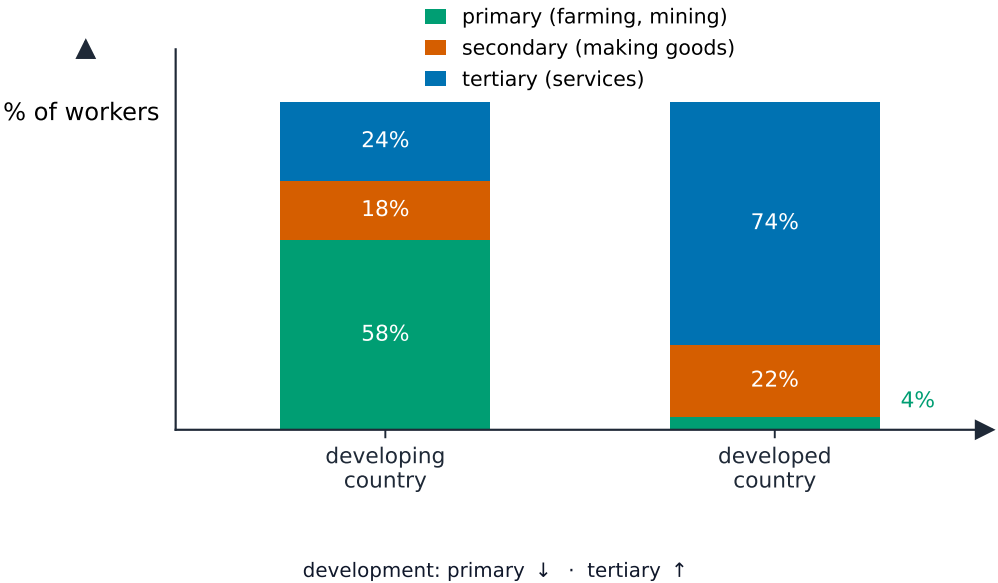
per person, and mobile-phone and internet use.

Comparing countries at different levels of development

We often compare a **developed country** (high income, like Germany) with a **developing country** (lower income, like Kenya). They differ in clear ways:

Feature	Developed	Developing
income per person	high	low
birth rate and population growth	low	often high
life expectancy	high	lower
share of workers in farming	small	large

The **employment structure** also differs. As a country develops, workers move out of the **primary sector** (farming and mining), into the **secondary sector** (making goods), and later into the **tertiary sector** (services).



As a country develops, workers shift out of the primary sector and into the secondary and then the tertiary (services) sector.

Many things shape development: savings and investment, the quality of education and health, infrastructure, stable government and law, and access to world markets.

Relationships between countries

Richer and poorer countries are linked in several ways, each with good and bad sides.

- **trade** can raise incomes, but many developing countries rely on a few primary exports whose prices swing sharply.
- **foreign aid** can fund schools and roads, but it may create dependency or be wasted.
- **debt** owed to other countries can pay for development, but repaying it can drain a poor country's budget.
- **foreign direct investment** (FDI) by a **multinational corporation** brings money, jobs and technology, but profits may flow back abroad and workers may be poorly treated.
- **migration** of workers can ease unemployment and bring in **remittances** (money sent home), but it can also drain a country of its most skilled people.

Globalisation

globalisation is the growing links between countries – in trade, money, technology and people – so that the world acts more like one market. Its causes include cheaper transport and communication, **free trade** agreements, and the spread of multinational firms.

Countries often join a **trade bloc** – a group that trades freely among themselves (like the European Union).



Globalisation: falling trade and transport costs tie national economies together.

■ Benefits and costs

Benefits	Costs
lower prices and more choice	some industries and jobs are lost to cheaper countries
faster growth and technology transfer	the gap between rich and poor can widen
larger markets for firms	more pollution and use of resources
poorer countries can industrialise	powerful multinationals may avoid tax and dodge protectionism rules

Globalisation helps developed and developing economies in different ways, but the gains are not shared evenly, which is why it remains so argued about.

Exam tips

- Distinguish **expenditure-reducing** from **expenditure-switching** policies for a deficit.
- Explain the **Marshall-Lerner condition** ($PED_x + PED_m > 1$) and the **J-curve** (the deficit worsens before it improves).
- Compare development with the **HDI** (income, education, health), not GDP alone.
- Evaluate **globalisation** with its winners and losers (growth and choice versus inequality and instability).

Vocabulary card meanings

devaluation: An official reduction in a currency's fixed price. Marshall-Lerner condition: The requirement that trade volumes respond enough for a cheaper currency to improve the trade balance. J-curve effect: The trade balance worsening just after a currency falls, then later improving. real exchange rate: A currency's price after adjusting for prices at home and abroad. trade-weighted exchange rate: An index of a currency's price against its partners' monies, with each partner weighted by its share of trade. effective exchange rate: An average of a currency's price against the currencies that matter for its trade. revaluation: An official increase in a currency's fixed price. years of schooling: How long people stay in education, on average. developed country: A country with high income and established industry. developing country: A country whose income and industry are still catching up. employment structure: How jobs are split among farming, making goods, and services. trade bloc: A group of countries that lower trade barriers among themselves.