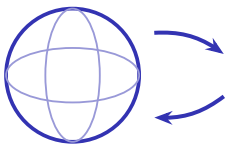
International Economic Issues

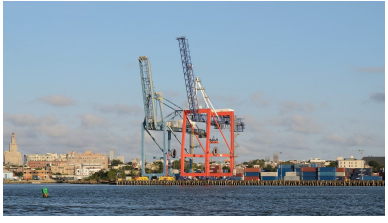
A-Level Economics ▪ Topic 6

A-Level Economics



What we will cover

1. Comparative advantage
2. Protectionism
3. Tariffs
4. The balance of payments
5. Exchange rates
6. Correcting a deficit



trade moves goods worldwide

1 Trade

Absolute advantage is not the rule for specialisation

International trade 国际贸易 lets residents exchange goods and services across borders. To **specialise** 专业化, compare what production gives up.

Same resources in each country; maximum outputs

A can make 20 wine or 10 cloth; B can make 5 wine or 5 cloth. Assume straight-line PPCs and unchanged technology. Which country has an absolute advantage? Which should specialise in cloth?

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A has an **absolute advantage** 绝对优势 in both goods: it can produce more with the stated resources. But **comparative advantage** 比较优势 means lower **opportunity cost** 机会成本. Work out both ratios before choosing a product.

Calculate what one extra unit costs

With straight-line PPCs, divide output forgone by output gained:

$$\text{OC}_A(\text{cloth}) = \frac{\text{wine forgone}}{\text{cloth gained}} = \frac{20}{10} = 2 \text{ wine/cloth}$$

$$\text{OC}_B(\text{cloth}) = \frac{\text{wine forgone}}{\text{cloth gained}} = \frac{5}{5} = 1 \text{ wine/cloth}$$

$$\text{OC}_A(\text{wine}) = \frac{\text{cloth forgone}}{\text{wine gained}} = \frac{10}{20} = 0.5 \text{ cloth/wine}$$

$$\text{OC}_B(\text{wine}) = \frac{\text{cloth forgone}}{\text{wine gained}} = \frac{5}{5} = 1 \text{ cloth/wine}$$

B gives up less wine per cloth, so has comparative advantage in cloth. A gives up less cloth per wine, so has comparative advantage in wine. A's absolute advantage in both does not remove possible gains from trade.

Find an exchange ratio both sides can accept

Exchange cloth for wine

B gives up 1 wine to produce 1 cloth. A gives up 2 wine to produce 1 cloth. Would exchanging 1 cloth for 1.5 wine benefit both compared with producing that extra unit at home?

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B receives 1.5 wine for cloth that costs it 1 wine: a gain of 0.5 wine per cloth. A pays 1.5 wine for cloth that would cost it 2 wine to make: a saving of 0.5 wine per cloth.

The strict gain range is $1 <$ wine per cloth < 2. At an endpoint one country is indifferent in this model. Real gains also require transport and other trading costs to fit inside the saving.

Show gains with consumption, not just production

Compare feasible bundles

Without trade, A makes 16 wine and 2 cloth; B makes 3 wine and 2 cloth. Now A makes 20 wine and B makes 5 cloth. B sends A 2.5 cloth for 3.75 wine. Find what each can consume.

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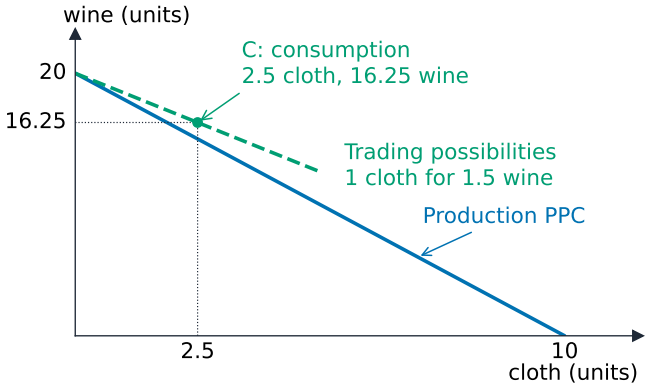
Compare feasible bundles

Without trade, A makes 16 wine and 2 cloth; B makes 3 wine and 2 cloth. Now A makes 20 wine and B makes 5 cloth. B sends A 2.5 cloth for 3.75 wine. Find what each can consume.

Country	Wine after trade	Cloth after trade
A	$20 - 3.75 = 16.25$	$0 + 2.5 = 2.5$
B	$0 + 3.75 = 3.75$	$5 - 2.5 = 2.5$

Both can consume more of both goods than in the stated no-trade bundles. Total consumption equals total production: 20 wine and 5 cloth. Gains are possible; their size and distribution depend on the exchange ratio and costs.

Trade can expand consumption beyond the PPC



A's **trading possibility curve** 贸易可能性曲线 shows consumption choices at the stated exchange ratio. Its production PPC has not shifted; trade gives access to a different bundle.

Calculate and interpret the terms-of-trade index

Terms of trade 贸易条件 compare export prices with import prices, using indices with a common base.

Illustrative indices: exports 110, imports 105

Find the terms of trade and explain what an index above 100 means. Does it prove export revenue or welfare rose?

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$$\mathrm{ToT} = \frac{P_X}{P_M} \times 100$$

$$\mathrm{ToT} = \frac{110}{105} \times 100 \approx 104.8$$

A given export quantity buys about 4.8% more imports than in the base period. This is a price ratio, not an export-volume or current-account balance. Dearer exports may sell fewer units; cheaper imports can have a different cause.

Rearrange the index when a price is unknown

Illustrative transfer task

Terms of trade fall from 95 to 85 while the import-price index stays 120. Find both export-price indices and their change. Is the change the same as the fall in terms of trade?

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$$\text{ToT} = \frac{P_X}{P_M} \times 100 \;\Rightarrow\; P_X = \frac{\text{ToT} \times P_M}{100}$$

$$P_{X0} = \frac{95 \times 120}{100} = 114$$

$$P_{X1} = \frac{85 \times 120}{100} = 102$$

$$\Delta P_X = P_{X1} - P_{X0} = 102 - 114 = -12$$

Export prices fall **12** index points, not 10. Commodity demand, supply and production costs can change the price ratio; it is not determined by trade volumes alone.

Test the limits before recommending specialisation

The calculated saving is 0.5 wine per cloth

Shipping and border costs use resources worth 0.6 wine per cloth. Would the same exchange still beat home production? What if workers cannot move into the expanding industry?

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The trading cost exceeds the saving in this example. A favourable opportunity-cost ratio alone does not guarantee net gains after costs.

The simple model holds technology and resources fixed, uses constant opportunity costs and omits barriers. Moving resources between industries can take time, retraining and investment. Product quality, changing costs and dependence on one export also matter.

Trade can increase choice and competition; evaluate adjustment losses and who receives the gains. Do not treat unequal productivity itself as a limitation that prevents comparative advantage.

2

Protectionism

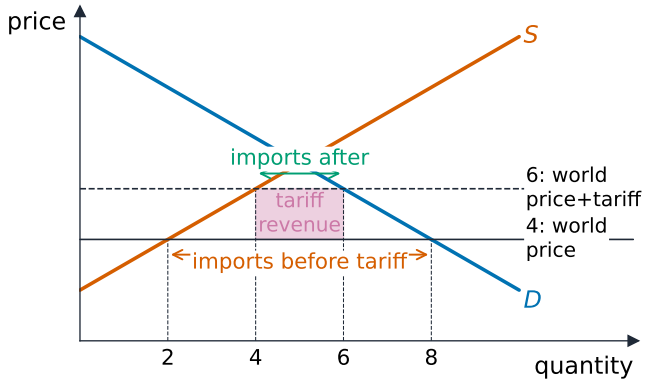
Compare the mechanism of each protection tool

Protectionism 贸易保护主义 shields domestic producers from foreign competition.

Tool	Direct mechanism	A condition or cost
Tariff 关税	Taxes imported units.	Revenue needs taxable imports.
Quota 配额	Caps import quantity.	Licence allocation affects gains.
Export **subsidy** 补贴	Pays exporters, lowering effective costs.	Requires public funding.
Embargo 禁运	Bans specified trade.	Alternatives may be costly.
Administrative barriers 行政壁垒	Excessive procedures hinder imports.	Distinguish useful safety rules.

The tools differ: an export subsidy does not automatically raise every domestic price. Explain the specified market and response.

Read the tariff diagram under stated assumptions



Small-country model, unchanged world price and **tariff** 关税 passed into the domestic price: compare demand, domestic supply and the import gap before and after the tariff.

Compute imports and revenue after the tariff

Illustrative market: prices £/unit, quantities million units/year

World price 4: domestic supply 2, demand 8. Tariff 2 raises price to 6: supply 4, demand 6. Find imports before/after and annual tariff revenue.

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$$M_0 = Q_{d0} - Q_{s0} = 8 - 2 = 6 \text{ million units/year}$$
$$M_1 = Q_{d1} - Q_{s1} = 6 - 4 = 2 \text{ million units/year}$$
$$R = t \times M_1 = £2/\text{unit} \times 2 \text{ million units/year}$$
$$R = £4 \text{ million/year}$$

Use imports after the tariff. Revenue is not the tariff multiplied by all domestic consumption, nor by the old import quantity.

Trace gains and losses for each stakeholder

A **stakeholder** 利益相关者 is a person or group affected. In the stated tariff market:

Group	Mechanism and qualification
Home consumers	Pay 6 rather than 4; buy 6 rather than 8 million units. Higher prices reduce purchasing power.
Home producers	Sell 4 rather than 2 million units at a higher price; higher-cost production may expand.
Government	Receives £4 million/year while imports remain taxable. This is a transfer, not proof of a net national gain.
Foreign suppliers	Export fewer units in this model; their revenue effects depend on price received and quantity.

Firms using imported inputs can also face higher costs. Judgement needs the balance of gains, losses and wider responses.

A quota and a tariff need not give revenue to the same person

Import quota: 2 million units/year

Suppose the quota produces the same domestic price 6 as the tariff example while foreign supply remains available at 4. Who might receive the £2 per-unit difference?

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A licence holder able to buy at 4 and sell at 6 may receive the difference. If licences are auctioned, government can capture some or all of it. If foreign suppliers hold market power or receive licences, gains may go abroad.

A quota restricts quantity directly; tariff imports depend on demand and supply. A non-binding quota has no current effect. Never assume all quotas generate no government receipts or always give gains to domestic importers.

Evaluate an infant-industry argument with a condition

A young industry asks for temporary protection

Firms claim they will learn and lower costs, becoming competitive in five years. What evidence and safeguards would make the argument stronger?

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An **infant industry** 幼稚产业 may need time to learn or reach efficient scale. Look for a credible cost-reduction path, measurable targets and an end date. Protection can instead preserve inefficiency and impose higher costs on buyers.

Strategic capacity and adjustment time for workers may also matter. **Dumping** 倾销 concerns exports priced below normal value, often assessed against home-market prices or costs; low prices alone do not prove predatory intent.

Retaliation 报复 can reduce export sales. Compare tools, duration, consumer costs and alternatives before giving a justified conclusion.

3 Balance of payments and exchange rates

Record cross-border transactions, not domestic sales

The **balance of payments** 国际收支 records transactions between residents and non-residents during a period. The **current account** 经常账户 covers goods, services, primary income and secondary income; it is not the whole balance of payments.

Classify before adding

A resident firm exports machinery; a foreign visitor pays a resident hotel; a resident receives interest from a foreign bond; a household receives a gift from abroad. Where does each receipt belong? Does buying an existing foreign bond belong here?

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Machinery: **trade in goods** 货物贸易. Hotel service: **trade in services** 服务贸易. Interest: **primary income** 初次收入. Gift: **secondary income** 二次收入.

Buying the bond is a financial-asset transaction, not current-account income. Goods produced and consumed domestically do not become exports.

Calculate each balance on the same basis

Illustrative annual flows; £bn/year

Goods: exports 80, imports 100. Services: exports 50, imports 20. Primary income: receipts 5, payments 20. Secondary income: receipts 2, payments 5. Find the goods, services and combined trade balances.

Calculate each balance on the same basis

Illustrative annual flows; £bn/year

Goods: exports 80, imports 100. Services: exports 50, imports 20. Primary income: receipts 5, payments 20. Secondary income: receipts 2, payments 5. Find the goods, services and combined trade balances.

Balance equals receipts minus payments: X is exports, M imports; g goods, s services and t total trade.

$$B_g = X_g - M_g = 80 - 100 = -20$$
$$B_s = X_s - M_s = 50 - 20 = +30$$
$$B_t = B_g + B_s = -20 + 30 = +10$$

All balances are £bn/year. Goods are in deficit, services in surplus and combined trade in surplus. A receipt is a credit; a payment is a debit. Keep signs consistent.

A trade surplus can coexist with a current-account deficit

Continue the same annual flows: combined trade balance $+10$, primary-income receipts 5 and payments 20, secondary-income receipts 2 and payments 5, all £bn/year. Find CAB. N means net income, R receipts and P payments; subscripts p and s identify primary and secondary income.

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$$N_p = R_p - P_p = 5 - 20 = -15$$
$$N_s = R_s - P_s = 2 - 5 = -3$$
$$\mathrm{CAB} = B_t + N_p + N_s$$
$$\mathrm{CAB} = 10 + (-15) + (-3) = -8$$

The **current account deficit** 经常账户赤字 is £8bn/year: total current-account debits exceed credits. It is not defined solely by imports exceeding exports.

Reverse the sign for a **current account surplus** 经常账户盈余. Neither sign by itself proves that living standards rose or fell.

Identify the flow causing the imbalance

Change one flow; hold everything else constant

Starting from CAB $= -8$ (£bn/year), compare an extra 12 of service exports with an extra 12 of interest payments abroad. What happens to CAB in each case?

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$$\mathrm{CAB}_{\mathrm{exports}} = \mathrm{CAB}_0 + \Delta X_s = -8 + 12 = +4$$
$$\mathrm{CAB}_{\mathrm{interest}} = \mathrm{CAB}_0 - \Delta P_p = -8 - 12 = -20$$

Stronger overseas demand can raise exports. Strong domestic spending can raise imports. Changes in investment income or transfers can alter CAB even with unchanged trade. Diagnose the components before choosing a policy.

Judge financing, persistence and what imports purchase

Two deficits of the same size

Economy A imports machinery for a viable new export industry. Economy B persistently loses overseas customers while paying more income abroad. Both have CAB $= -8$. Must the economic consequences be identical?

Judge financing, persistence and what imports purchase

Two deficits of the same size

Economy A imports machinery for a viable new export industry. Economy B persistently loses overseas customers while paying more income abroad. Both have CAB $= -8$. Must the economic consequences be identical?

A's capital goods may improve future capacity and export earnings, but benefits depend on successful use. B's lost sales may weaken demand and employment; other spending can offset this.

A deficit requires counterpart financing or asset/reserve changes in the wider accounts. Financing may involve borrowing, equity investment or selling assets: debt does not automatically rise by the deficit.

Assess persistence, financing terms, future income payments, exchange-rate pressures and productive use. A surplus also needs context; it can reflect competitiveness or weak domestic spending.

4 Exchange rates

State the currency quote before describing a change

Illustrative quote: £1 buys US$1.40, then US$1.60

Has the pound risen or fallen in value? Who demands pounds when buying a UK export? Who supplies pounds when a UK resident buys a US product?

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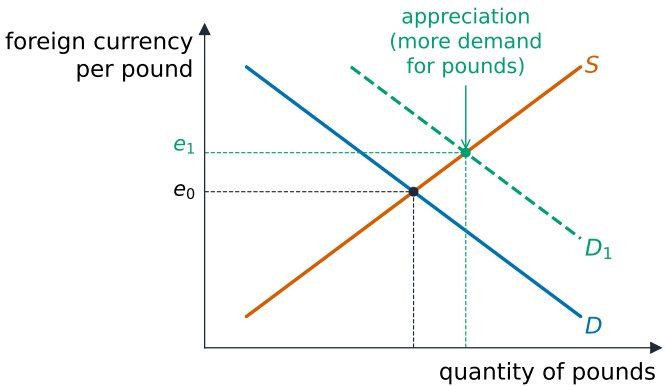
The **exchange rate** 汇率 is a price of one currency in another. Here it is dollars per pound. The pound buys more dollars, so it has **appreciation** 升值.

A buyer exchanging dollars for pounds to pay a UK exporter demands pounds. A UK importer exchanging pounds for dollars supplies pounds. Follow the currency exchanged, not the buyer's nationality.

A demand shift changes a floating exchange rate



With supply unchanged, higher demand raises foreign currency per pound: **appreciation** 升值.
A **floating exchange rate** 浮动汇率 adjusts where currency demand meets supply.

Explain a supply shift using the actual transaction

UK residents buy more US goods, all else unchanged

Importers sell pounds to obtain dollars. Which curve shifts in the market for pounds? What happens to the dollar price of a pound if demand is unchanged?

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Supply of pounds shifts right. The dollar-per-pound rate falls: **depreciation** 贬值. This is a curve shift caused by more currency offered, not a movement caused by the pound's own price.

Export demand and inward investment can raise demand for pounds. Outward investment can raise supply. Higher relative interest returns may attract funds, but expectations and risk can offset the response. State other influences held constant.

Keep the exchange-rate system separate from the trade balance

System	How the currency price is determined
Floating	Market demand and supply determine the rate. This is the core AS model here.
Fixed exchange rate 固定汇率	Authorities maintain a stated rate or band, using intervention or other policy measures. Maintaining it can require reserves and policy adjustments.
Managed exchange rate 管理浮动汇率	Market forces operate, with intervention to influence the rate.

These describe currency arrangements. A current-account surplus describes credits exceeding debits in a different account; it does not identify the exchange-rate system.

Convert an export price using units

A UK machine keeps its £200 price

The rate rises from US$1.40/£ to US$1.60/£. Find the US buyer's dollar price before and after. Assume the price change is passed through.

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Multiply the pound price by dollars per pound; pounds cancel.

$$P_{\$} = P_{£} \times e$$

$$P_{\$,0} = P_{£} \times e_0 = £200 \times \text{US\$}1.40/£ = \text{US\$}280$$

$$P_{\$,1} = P_{£} \times e_1 = £200 \times \text{US\$}1.60/£ = \text{US\$}320$$

The export becomes dearer in dollars. Sales may fall, depending on demand, contracts, quality and how firms adjust their prices; the arithmetic alone does not prove fewer sales.

Convert an import invoice in the opposite direction

A UK firm owes a fixed US$700 invoice

Use the same rates: US$1.40/£ then US$1.60/£. Find its pound cost. Why divide here?

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Dividing dollars by dollars per pound gives pounds.

$$P_{£} = \frac{P_{\$}}{e}$$

$$P_{£,0} = \frac{P_{\$}}{e_0} = \frac{\text{US\$700}}{\text{US\$1.40/£}} = £500$$

$$P_{£,1} = \frac{P_{\$}}{e_1} = \frac{\text{US\$700}}{\text{US\$1.60/£}} = £437.50$$

The pound's appreciation lowers this invoice's pound cost. A quote in pounds per dollar moves the opposite way; identify the units before multiplying or dividing.

Calculate prices after a depreciation

US$1.40/£ falls to US$1.20/£

A £200 export keeps its pound price. A US$700 import keeps its dollar price. Find their foreign/home prices after depreciation. Keep the units in each conversion.

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$$P_{\$} = P_{£} \times e$$

$$P_{\$} = P_{£} \times e = £200 \times \text{US\$1.20}/£ = \text{US\$240}$$

$$P_{£} = \frac{P_{\$}}{e}$$

$$P_{£} = \frac{P_{\$}}{e} = \frac{\text{US\$700}}{\text{US\$1.20}/£} \approx £583.33$$

The export is cheaper in dollars; the import costs more pounds. These are price effects, holding the stated invoice prices unchanged.

Distinguish a price effect from a trade-balance response

Export prices fall abroad; import prices rise at home

Name two reasons the trade balance may not improve immediately. What else must be checked before concluding that the current account improves?

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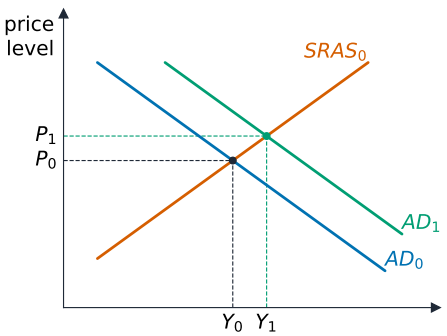
Buyers may need time to change suppliers or be tied to contracts. Essential imports can be hard to replace, and exporters may lack spare capacity.

Revenue and spending equal price times quantity. Cheaper exports do not automatically mean greater export receipts, and dearer imports do not automatically mean lower import spending. Check the quantities and the currency of measurement.

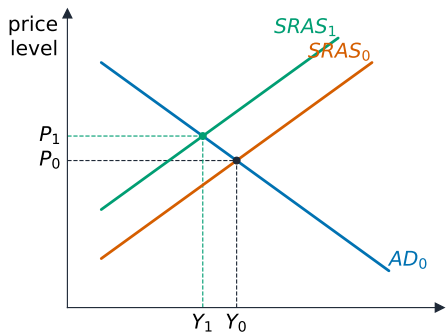
The current account also includes income and transfers. The overall balance can change for reasons outside trade.

Separate demand and imported-cost effects in AD/AS

Demand increases



Production costs increase



Depreciation can raise **aggregate demand** 总需求 through net exports and raise input costs, shifting SRAS left. Panels isolate the two effects.

Explain why output and jobs need a conditional judgement

An economy relies on imported fuel

Its currency depreciates. Export orders rise, but fuel costs rise too. Explain why it is unsafe to conclude that real output and employment must increase.

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Higher net exports can shift AD right, raising real output and prices with upward-sloping SRAS. Higher input costs can shift **short-run aggregate supply** 短期总供给 (SRAS) left, raising prices while reducing real output.

If both effects occur, real output depends on their relative size and capacity. Employment also depends on hours and productivity. Compare demand gains with cost pressure rather than assuming depreciation removes structural unemployment.

5 Correcting current-account imbalances

Trace fiscal and monetary policies through imports and exports

Expenditure-reducing 支出减少 policies lower domestic demand; imports may fall as part of that response.

Illustrative tool	Mechanism and possible offset
Higher income taxes or lower government purchases	Lower domestic spending may reduce imports. Output and jobs can fall if demand is already weak.
Higher interest rates	Dearer borrowing may reduce spending and imports. Capital inflows may appreciate the currency, weakening exports and making imports cheaper.

A lower import bill is not the same as an improved whole current account. Check other components, demand responses and competing objectives.

Compare switching expenditure with reducing expenditure

A government considers a tariff or an export subsidy

How could each change trade? Which directly raises public spending, potentially worsening the budget balance if other flows do not change?

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Expenditure-switching 支出转换 changes relative prices to favour domestic goods. A tariff may reduce imports; an export subsidy may support foreign sales and directly costs public funds. Tariff receipts and subsidy costs are different budget effects.

A depreciation can also change relative prices, but a floating rate is not simply set lower by government command. Monetary measures may influence it with uncertain responses. Higher import costs, **retaliation** 报复, limited capacity and weak demand responses can offset gains.

Choose a supply-side response that addresses the constraint

Two exporters lose sales for different reasons

Firm A cannot deliver reliably because the port is congested. Firm B has spare capacity but sells products foreign buyers no longer want. Would the same training programme solve both problems?

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Supply-side policy can improve **competitiveness** 竞争力 through productivity, reliability, quality and costs. Port investment may address A's delivery problem; B may need product development or a different market.

Skills, infrastructure and technology take resources and can have lags. Capacity does not guarantee sales. Compare the actual constraint, opportunity cost and foreign demand before predicting higher exports.

Diagnose the component before recommending a policy

CAB is −£8bn/year despite a £10bn trade surplus

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The deficit is not evidence that trade itself is in deficit. A tariff targets imports, not the income payments causing this imbalance. It could still change trade, but its size, consumer/input costs and retaliation need analysis.

Stability of the current account means assessing persistence and sustainable financing, not forcing a zero balance every year at any cost. Compare policy benefits with growth, jobs, inflation and the source of income flows.

6 Apply and review

Combine the accounts with a currency calculation

Attempt before revealing

Annual balances (£bn): goods−12, services+8, primary income−7, secondary income+1. Find CAB. Then £1 falls from US$1.50 to US$1.20: find the dollar price of a fixed £150 export. Does its lower dollar price prove CAB will improve?

Combine the accounts with a currency calculation

Attempt before revealing

Annual balances (£bn): goods-12, services$+8$, primary income-7, secondary income$+1$. Find CAB. Then £1 falls from US$1.50 to US$1.20: find the dollar price of a fixed £150 export. Does its lower dollar price prove CAB will improve?

$$\text{CAB} = B_g + B_s + N_p + N_s = -12 + 8 - 7 + 1 = -£10\text{bn/year}$$

$$P_{\$} = P_{£} \times e = £150 \times \text{US\$1.20/£} = \text{US\$180}$$

Previously it was US$225. The pound depreciates. Export quantities, import costs, income and transfers still determine the account; the price conversion does not settle the overall effect.

Check yourself

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A lower foreign price can support export demand if buyers respond and firms can expand. Dearer imported inputs may increase costs and prices, while essential imports can keep the import bill high.

Judge the cause of the imbalance, demand responsiveness, capacity and timing. Compare alternatives that address the identified problem. A justified conclusion follows those conditions; it does not promise that one tool meets every objective.