Exercise walk-through

7.1
Trade and exchange: introductory reasoning

Pearson Edexcel · International A-Level · Economics

Specialisation and comparative advantage

- When countries **specialise** , each produces the goods it makes best and trades for the rest.
- World output rises.
- But a country that specialises in a few products depends on their prices: when world copper prices fell by more than half in late 2008, Zambia's export earnings fell sharply.
- A country has an **absolute advantage** when it can produce more of a good from the same resources.

Balance of payments and exchange rates

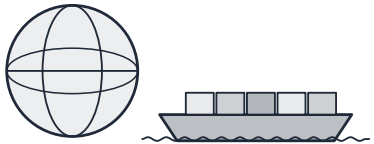
- the **current account** : trade in goods, trade in services, primary income (wages, profits and interest earned abroad) and secondary income (transfers such as remittances and aid);
- the **capital account** : small flows such as debt forgiveness and the transfer of patents;
- the **financial account** : FDI, purchases of shares and bonds (portfolio investment), bank lending and changes in reserves.

Sources for this lesson (2)

- A. Flaaen, A. Hortaçsu and F. Tintelnot, "The Production Relocation and Price Effects of US Trade Policy: The Case of Washing Machines", *American Economic Review* 110 (2020).
- People's Bank of China announcements of 21 July 2005 and 11 August 2015; Court of Justice of the European Union, *Commission v Ireland and Apple* (10 September 2024).
- Pearson Edexcel International A Level Economics specification (WEC14), Issue 2, sections 4.3.1–4.3.3, and the WEC14/01 Sample Assessment Materials.

Exercises 2.1·2.2

2.1 Name the three characteristics of globalisation. [2]



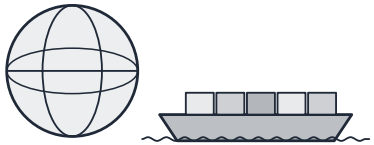
2.2 Country A makes 4 wheat or 2 cloth per hour; Country B makes 1 wheat or 1 cloth. Which country has the absolute advantage in wheat, and which the comparative advantage in cloth? [3]

A: 4 wheat or 2 cloth

B: 1 wheat or 1 cloth

Exercises 2.1·2.2

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2.1 Trade as a proportion of GDP rises; TNCs and FDI gain importance; migration increases.

2.2 Country A makes 4 wheat or 2 cloth per hour; Country B makes 1 wheat or 1 cloth. Which country has the absolute advantage in wheat, and which the comparative advantage in cloth? [3]

A: 4 wheat or 2 cloth
B: 1 wheat or 1 cloth

2.2 Absolute advantage in wheat: Country A (4 against 1). Comparative advantage in cloth: Country B – one cloth costs B only one wheat while it costs A two.

Exercises 2.3·2.4

2.3 *(SAM WEC14/01 Q3, adapted.)* Export prices rise from 100 to 128.9 while import prices rise from 100 to 117.1. Calculate the terms of trade index. [3]

export prices: 100 → 128.9

import prices: 100 → 117.1

2.4 Name the four types of trading bloc in increasing depth of integration. [2]



Exercises 2.3·2.4

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export prices: 100 → 128.9
import prices: 100 → 117.1

2.3 $ToT = \frac{128.9}{117.1} \times 100 = 110.1$ – an improvement of 10.1% over the base 100.

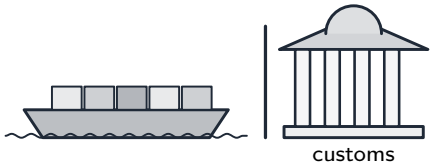
2.4 Name the four types of trading bloc in increasing depth of integration. [2]



2.4 Free-trade area; customs union; common market; economic and monetary union.

Exercises 2.5·2.6

2.5 State any four of the six motives for restricting free trade. [2]



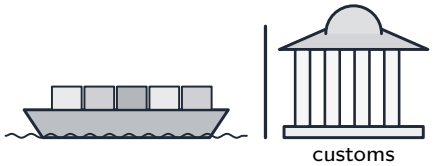
2.6 Distinguish a revaluation from an appreciation. [2]

revaluation

appreciation

Exercises 2.5·2.6

2.5 State any four of the six motives for restricting free trade. [2]



2.5 Any four of: protect infant/geriatric industries; protect domestic industries and employment; national security; prevent dumping; correct a current-account deficit; raise revenue.

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revaluation appreciation

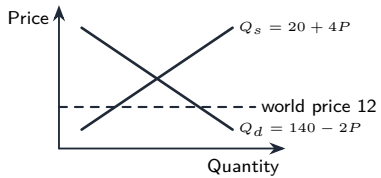
2.6 A revaluation is a deliberate RAISE of a FIXED exchange rate by the government; an appreciation is a market-driven rise in a FLOATING rate.

Exercises 2.7·3.1

2.7 State the Marshall–Lerner condition. [2]

PED exports PED imports

3.1 *(Original.)* With $Q_d = 140 - 2P$ and $Q_s = 20 + 4P$ and a world price of 12, the government imposes a tariff of 4. Calculate the imports before and after, the government revenue and the total deadweight loss. [5]



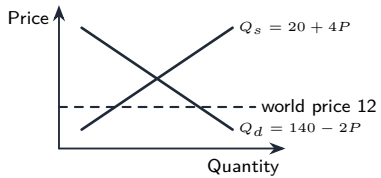
Exercises 2.7·3.1

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2.7 Depreciation improves the current account only if the sum of the price elasticities of demand for exports and imports exceeds one: $|PED_X| + |PED_M| > 1$.

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3.1 Before: $Q_d(12) = 116$, $Q_s(12) = 68 \rightarrow$ imports 48. After the tariff the price is 16: $Q_d = 108$, $Q_s = 84 \rightarrow$ imports 24. Revenue $= 4 \times 24 = 96$. Deadweight loss: production triangle $\frac{1}{2} \times (84 - 68) \times 4 = 32$ plus consumption triangle $\frac{1}{2} \times (116 - 108) \times 4 = 16$, total 48.

Exercise 3.2

3.2 *(Original.)* Explain two reasons why TNCs undertake FDI and one impact of FDI on a recipient country. [4]



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3.2 Reasons (any two): access to the local market (avoiding transport costs and tariffs); cheaper labour; secure resources; tax advantages. Impact: FDI adds to the capital stock, jobs and tax revenue – but profits may be repatriated and local firms crowded out (any one, developed).

Exercise 3.3

3.3 *(Original.)* A country's currency depreciates by 8.2%. Explain the Marshall–Lerner condition and the J-curve effect for its current account. [4]

currency: -8.2%

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3.3 Marshall–Lerner: in the traditional initially balanced-trade model with perfectly elastic supply and full price pass-through, the magnitudes of export and import demand elasticities must sum to more than one for the trade balance to improve after depreciation. Other current-account income and transfer flows must also be considered. A J-curve is possible if quantities respond slowly: after the 8.2% depreciation, a higher local import bill can initially worsen the trade balance. Later volume changes can improve it if the demand responses are sufficient. State the contract, currency-pricing and timing assumptions; depreciation alone does not establish the initial worsening or eventual improvement.

Local review guidance: both equilibria computed before the revenue and DWL; comparative advantage answered through OPPORTUNITY COST, not output; Marshall–Lerner stated as a condition on the SUM of elasticities. This is authored classroom guidance.