

7.1 Globalisation, trade and exchange rates

Name: _____ Class: _____ Date: _____

Total: 29 marks

KEY WORDS terms of trade • depreciation

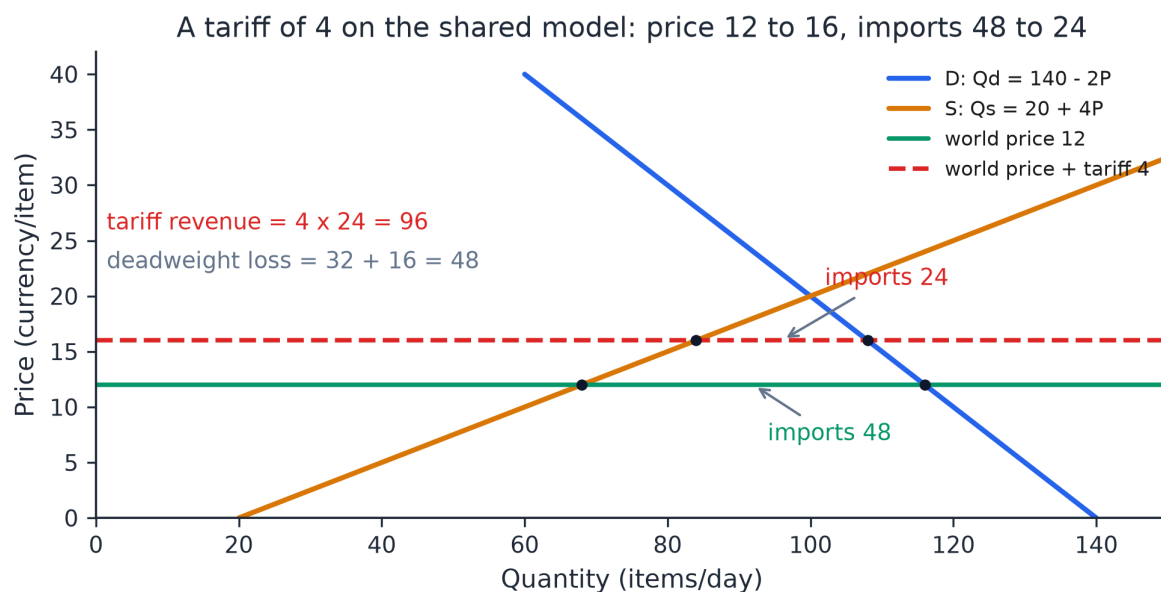
Globalisation, trade and exchange rates

Objective

Apply the characteristics, causes and costs of globalisation, the comparative advantage model, the terms-of-trade calculation, bloc types, protection motives, balance of payments structure, exchange-rate systems and the Marshall–Lerner condition (spec 4.3.1–4.3.3, rows shared with the essay-standard sheet 7.2).

1 Key knowledge and worked examples

Trade toolkit. Comparative advantage = lowest opportunity cost (A: 4 wheat or 2 cloth; B: 1 wheat or 1 cloth; trade between 1 and 2 wheat per cloth). Terms of trade = $\text{export index} \div \text{import index} \times 100$ (SAM Tanzania: $128.9/117.1 \times 100 = 110.1$). Tariff on the shared model: world price 12 $\rightarrow$ imports 48; tariff 4 $\rightarrow$ imports 24, revenue 96, DWL 48. In the traditional balanced-trade model, Marshall–Lerner tests the elasticity condition for a trade-balance improvement after depreciation. A J-curve is a possible initial worsening, not a guaranteed path.



Original model; all figures are computed in the handout.

2 Practice

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]

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]

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

[2]

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

2.6 Distinguish a revaluation from an appreciation. [2]

2.7 State the Marshall–Lerner condition. [2]

3 Exam-style questions

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]

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

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]

Solutions

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

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.

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

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

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.

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.

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

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.

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).

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.