

Exercise walk-through

7.1

Trade and exchange: introductory reasoning

Pearson Edexcel · International A-Level · Economics

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The method

Method — Worked example

Comparative advantage means lower opportunity cost, not being absolutely faster. Calculate each country's forgone alternative in the same units. A feasible exchange between the two opportunity costs can make specialization and exchange attractive in a simplified model. Transport, adjustment, distribution and productive assumptions matter; the model does not guarantee benefits for every worker.

Protection can support a named industry, but tariffs also raise some consumer or input costs and can provoke retaliation. An infant-industry argument requires a plausible learning mechanism, a credible temporary plan and review; permanent protection is not established by the label. In a currency quotation of domestic units per foreign unit, an increase means domestic depreciation. Import costs can rise before quantities adjust; the current account also includes income and transfers, so it is not simply the goods balance. Integration can lower barriers within a group while affecting outside suppliers differently. Evaluate the actual rule and source conditions rather than treating every agreement as identical.

Method — Worked example

Country A uses three worker-hours per cloth unit and six per grain unit. Country B uses four per cloth and four per grain. Calculate opportunity costs, then consider exchange of one grain unit for 1.5 cloth units, assuming constant costs and no trade costs.

In A, one cloth costs $3/6 = 0.5$ grain and one grain costs $6/3 = 2$ cloth. In B, one cloth costs $4/4 = 1$ grain and one grain costs 1 cloth. A has comparative advantage in cloth; B in grain. A obtains one grain for 1.5 cloth instead of producing it at a cost of two cloth. B receives 1.5 cloth for grain costing it one cloth. The stated trade ratio lies between one and two cloth per grain. Feasible production and transport costs must still be checked; no distribution claim follows automatically.

Exercises 2.1·3.1

2.1 Use the worked case to explain the relevant method, its application and a material condition. [3]

3.1 After depreciation, import expenditure rises. A commentator calls the comparative-advantage model false and recommends a permanent tariff. Assess both leaps. [3]

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3.1 Depreciation can raise domestic-currency import prices while contracts and limited substitutes slow quantity adjustment. Import spending alone does not establish the whole current account or refute an opportunity-cost model. A tariff recommendation needs a specific objective, effect on consumers and input users, adjustment and retaliation evidence, and a comparison with feasible alternatives. Set a review condition rather than infer permanent protection from one observation. This is introductory interpretation; detailed IA2 trade, integration and exchange-rate analysis remains held. Authored points for judgement, case-linked reasoning and qualification. Accept justified alternatives.