

The global economy

IB DP Economics HL Unit 4 sections 4.1-4.10 full package

1. Unit 4 at a glance

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IB Economics HL Unit 4.1-4.10: why nations trade and how they protect, economic integration, exchange rates, the balance of payments, the terms of trade, and economic development - its measures, barriers and strategies.

Must-know: comparative advantage 4/2 vs 1/1 so each country specialises where its opportunity cost is lower; the shared tariff model at world price 12 (imports 48 to 24, revenue 96, deadweight loss 48); the exchange rate 5 to 6.5 as a depreciation; terms of trade $128.9/117.1 \times 100 = 110.1$.

2. Trade, protection and integration

Trade, protection and integration

Absolute advantage: more output from the same inputs. Comparative advantage: the lower opportunity cost - with $4/2$ vs $1/1$ one country gives up 2 per unit, the other 1, so trade at a rate between them gains both. Benefits: prices, variety, scale, competition; limits: constant costs, no transport costs.

Protection: a tariff lifting 12 to 16 cuts imports 48 to 24, raises 96 revenue, loses 48 deadweight (32 production, 16 consumption); quotas hand rent to licence holders; subsidies cost the taxpayer. Arguments - infant industry, jobs, strategic sectors, dumping - each with its free-trade counter.

Integration deepens stepwise: preferential agreement, free trade area, customs union (common external tariff), common market (factor mobility), monetary union. Trade creation versus diversion is the evaluative edge; the WTO is the multilateral route.

3. Exchange rates and the balance of payments

Exchange rates and the balance of payments

A floating rate is the price of foreign currency: rising import demand shifts demand right, so 5 becomes 6.5 - a depreciation. Imports dearer, exports cheaper abroad; the current account improves only if Marshall-Lerner holds (elasticities sum above 1), and the J-curve records the short-run worsening first.

Fixed and managed regimes hold the rate with reserves and interest rates (revaluation, devaluation). Floating absorbs shocks but adds uncertainty; fixed gives certainty but imports policy constraints.

Balance of payments: current account (goods, services, income, transfers) plus capital and financial accounts, summing to zero. A persistent deficit is corrected by expenditure-switching (depreciation, protection), expenditure-reducing (deflation) or supply-side competitiveness.

4. Development: measures, barriers, strategies

Development: measures, barriers, strategies

Terms of trade = export price index / import price index $\times 100$: $128.9/117.1 \times 100 = 110.1$, a 10.1 percent improvement; commodity exporters risk long-run decline (Prebisch-Singer) and volatility. Sustainable development meets present needs without compromising future ones.

Measures: GDP per head at PPP, HDI (health, schooling, income), Gini, poverty lines. Barriers: the savings gap (Harrod-Domar: $\text{growth} = \text{savings ratio} / \text{capital-output ratio}$), the poverty trap, weak institutions, capital flight, primary-product dependence, debt.

Strategies: market-based (liberalisation, FDI), interventionist (redistribution, public services, infrastructure), export promotion versus import substitution, aid and debt relief, microfinance. Evaluate each against the barrier it targets.

Check yourself

Check yourself

Comparative advantage $4/2$ vs $1/1$; the tariff solve 48 to 24, 96, 48; five stages of integration, creation versus diversion.

Exchange rate 5 to 6.5 as a depreciation; Marshall-Lerner and the J-curve; fixed versus floating.

Balance-of-payments accounts summing to zero; three correction routes for a persistent deficit.

Terms of trade 110.1; HDI and the other measures; savings gap and poverty trap; one strategy per barrier, evaluated.