5.1 The global economy

Name: _____ Class: _____ Date: _____ **Total: 25 marks**

KEY WORDS free trade • sustainable development

The global economy

Objective

Explain the gains from free trade and the protection debate, read the tariff and exchange-rate diagrams, outline the balance of payments, and evaluate development measures, barriers and strategies (syllabus 4.1–4.10, SL).

1 Key knowledge and worked examples

Global toolkit. Free trade gains: competition, lower prices, choice, scale, resource access, growth. Tariff on the shared diagram: world price 12 → imports 48; tariff 4 → price 16, imports 24, domestic output up, a revenue rectangle and two welfare-loss triangles. Exchange model: demand meets supply at 5 domestic per foreign currency; import-demand growth → 6.5 = a depreciation. Integration: FTA → customs union → common market → economic and monetary union. Development: HDI's three components; savings gap and poverty trap among the barriers; liberalisation, FDI, aid, microfinance, human capital among the strategies.

2 Practice

2.1 Explain any two gains from free trade, one for consumers and one for firms. [4]

2.2 Name any three types of trade protection. [2]

2.3 Name the four stages of economic integration in increasing depth. [2]

2.4 Define the exchange rate. In the model the rate moves from 5 to 6.5 domestic per foreign currency: name the change and state one effect on import prices. [2]

2.5 Name the three components of the Human Development Index and one measure that complements it. [3]

3 Exam-style questions

3.1 *(Original, Paper 2 style.)* On the diagram the world price is 12, at which imports are 48; a tariff of 4 raises the domestic price to 16 and imports fall to 24. Using a labelled diagram, explain the effects of the tariff on consumers, domestic producers, the government and overall welfare. [5]

3.2 *(Original.)* Growing import demand shifts the demand for foreign currency right, moving the exchange rate from 5 to 6.5. Explain the effect of the depreciation on exports and imports, and evaluate one drawback for the economy. [4]

3.3 *(Original, development.)* A low-income country's savings are too small to fund the investment its growth needs. Name the barrier, and evaluate one strategy that addresses it. [3]

Solutions

2.1 Consumers: lower prices and greater choice, because specialisation and competition cheapen imports and widen variety (2). Firms: larger markets give economies of scale and access to cheaper inputs – or more competition forces efficiency and innovation (2).

2.2 Any three of: tariffs (taxes on imports); quotas (quantity limits); subsidies to domestic producers; administrative/technical barriers (safety standards, licensing delays).

2.3 Free-trade area → customs union (common external tariff) → common market (free movement of factors) → economic and monetary union (single currency).

2.4 The price of one currency expressed in another (1). The rise from 5 to 6.5 is a DEPRECIATION of the domestic currency, so imports become more expensive in domestic currency (1).

2.5 A long and healthy life (life expectancy), education (schooling years), and a decent standard of living (income per head) (3 – or 2 with the complement: any one of health, education or gender measures, e.g. literacy rates or gender-development index) (1).

3.1 Diagram: domestic price rises from the world price 12 to 16; quantity demanded falls, domestic supply rises, imports shrink from 48 to 24 (1). Consumers lose: higher price and lower consumption, lost consumer surplus (1). Domestic producers gain: higher price and output, gained producer surplus (1). Government gains the revenue rectangle: the tariff (4) times the imports that remain (24) (1). Overall welfare falls: the two welfare-loss triangles – inefficient domestic production and forgone consumption – exceed no one's gain (1).

3.2 The depreciation makes imports dearer and exports cheaper abroad, so import quantity falls and export quantity rises – net exports improve and AD rises (2). Drawback: imported inputs and fuel cost more, so cost-push inflation erodes the gain (1); if exports and imports are demand-inelastic in the short run, the current account worsens before it improves (1).

3.3 The barrier is the SAVINGS GAP – domestic saving too small to fund the investment needed for growth (1). Strategy: foreign aid or FDI fills the gap directly – evaluated: aid brings funds without repayment (concessional) but risks dependency and governance distortions; FDI adds capital and technology but repatriates profit and may dictate policy (1); the durable route is growing domestic saving through financial development, which the strategy should build toward (1).

Local review guidance: the tariff diagram labelled with all four areas – at SL the diagram carries the marks; (R1 3.2/3.3) each evaluation reaches a named drawback or judgement, not a list; name the direction of the rate change before its effects. This is authored classroom guidance.