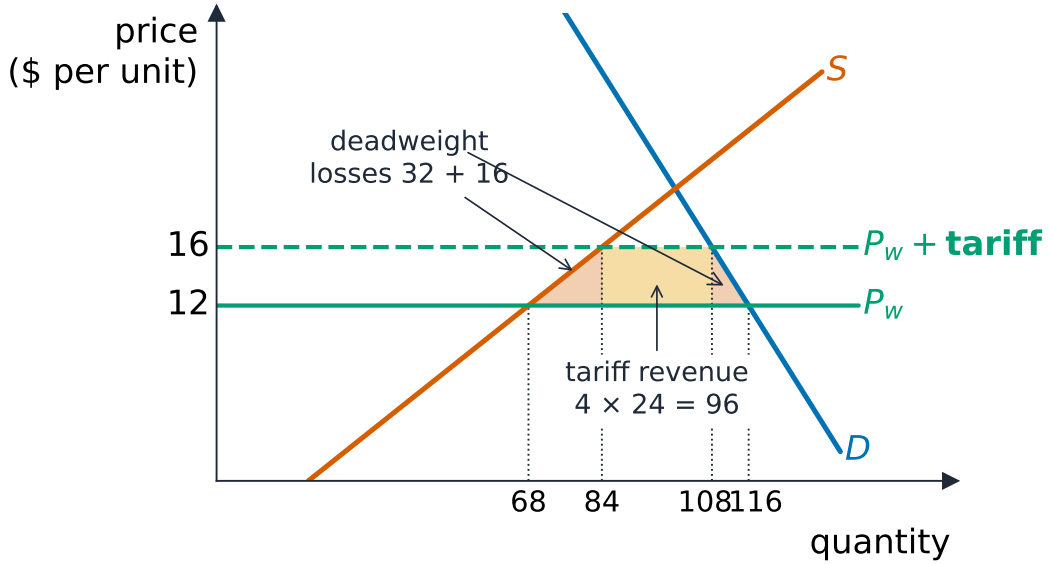
Exercise walk-through

5.5
Balance of payments

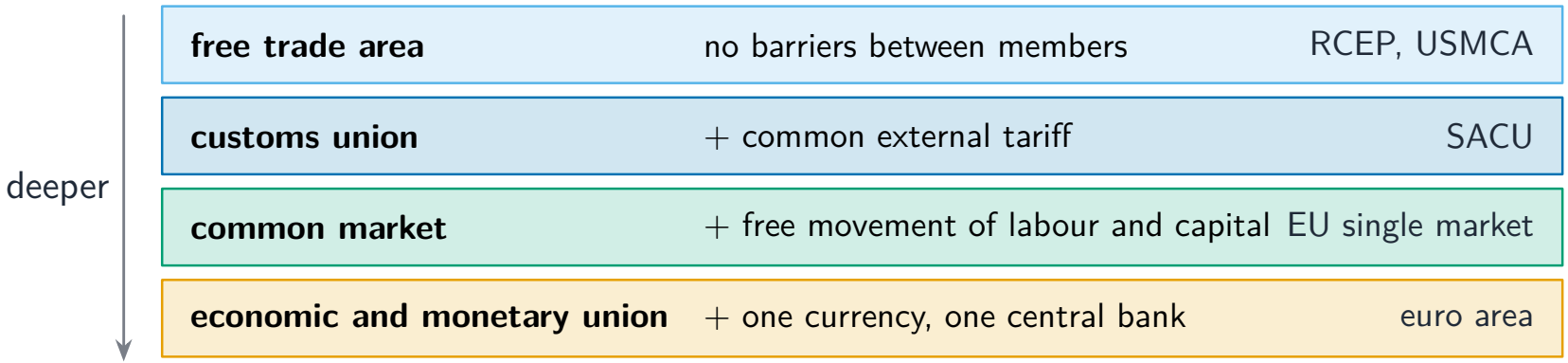
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Figure: Trade protection



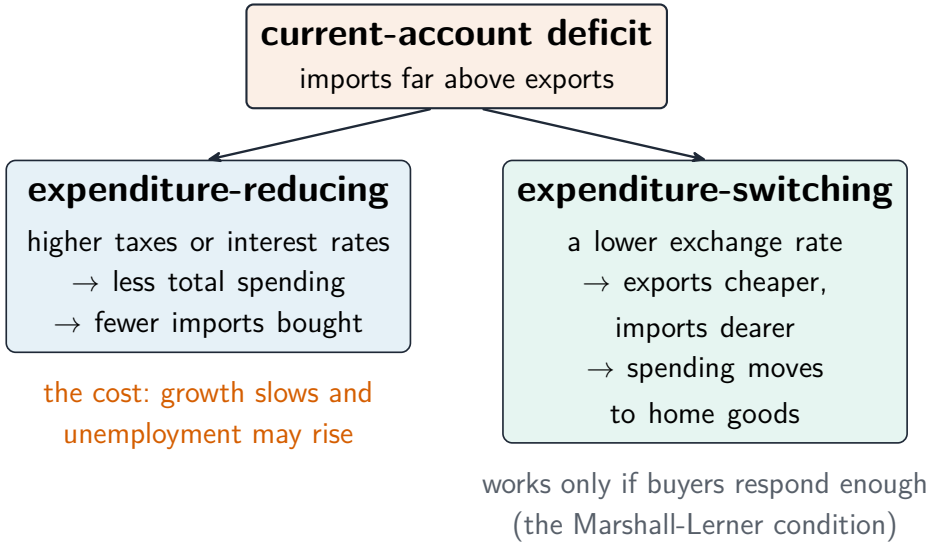
- A **tariff** of 4 halves imports, raises 96 for the government and wastes 48
- Match each part of the diagram to the text.

Figure: Economic integration



- Each stage adds to the last
- Match each part of the diagram to the text.

Figure: The balance of payments



- Two routes out of a deficit: spend less overall, or switch spending to home goods
- Match each part of the diagram to the text.

Exercises 2.1·2.2

2.1 State **two** items recorded in the current account. [2]

goods services $ income

2.2 Explain why a current account deficit must be matched by a surplus on the capital and financial accounts. [2]

current + capital and financial $= 0$

Exercises 2.1·2.2

2.1 State **two** items recorded in the current account. [2]



2.1

any two: trade in goods; trade in services; primary income such as profits, interest or wages from abroad; secondary income such as remittances or aid

2.2 Explain why a current account deficit must be matched by a surplus on the capital and financial accounts. [2]

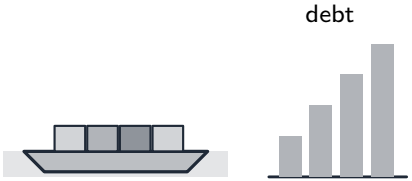


2.2

the balance of payments must sum to zero; a country paying out more on its current account must finance it by borrowing or selling assets abroad, which are inflows on the financial account

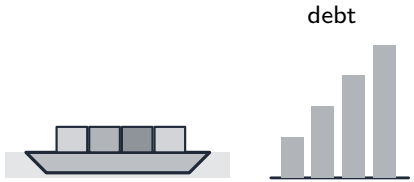
Exercise 2.3

2.3 Explain **two** possible consequences of a persistent current account deficit. [4]



Exercise 2.3

2.3 Explain **two** possible consequences of a persistent current account deficit. [4]



2.3

any two, explained: rising foreign debt, so more income goes on interest payments abroad; downward pressure on the exchange rate, which may raise import prices and inflation; more foreign ownership of domestic firms and assets; interest rates may have to rise to attract capital, slowing growth

Exercise 2.4

2.4 A country's data ($ bn): exports of goods 400, imports of goods 450, exports of services 120, imports of services 80, net primary income −20, net secondary income +10. Calculate the balance of trade in goods and the current account balance. [3]

	exports	imports
goods	400	450
services	120	80
net income	−20, +10	

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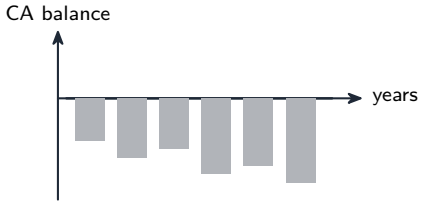
2.4

trade in goods = 400 − 450 = −$**50** bn; trade in services = +40; current account = −50 + 40 − 20 + 10 = −$**20** bn

Exercise 3.1

3.1 A country has had a large current account deficit for many years.

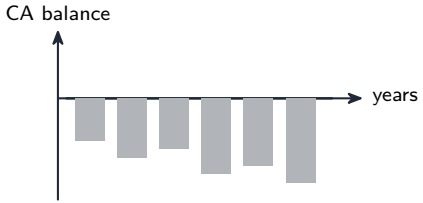
Evaluate the policies that the government could use to reduce the deficit. [10]



Exercise 3.1

3.1 A country has had a large current account deficit for many years.

Evaluate the policies that the government could use to reduce the deficit. [10]



3.1

award up to [10]: expenditure-switching: a depreciation makes exports cheaper and imports dearer; but imported inflation; and it depends on elasticities; protection reduces imports, but risks retaliation and inefficiency, and may break WTO rules; expenditure-reducing: higher taxes, lower government spending or higher interest rates cut AD and so imports; but they also cut growth and raise unemployment; supply-side policies (education, infrastructure, productivity) raise competitiveness; but they take a long time and are costly; a deficit may not be harmful if it finances investment that raises future exports; the best mix depends on the cause of the deficit; reasoned conclusion