Topic 6 – International trade and globalisation

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6.1 International specialisation

Specialisation: Process by which individuals, firms & economies concentrate on producing a certain good/service which they have an advantage

- Countries specialising in production where they have a comparative advantage
- Related to division of labour - dividing up of production processes into sequence of different tasks

International specialisation - when countries concentrate on production on certain goods/services due to cost & comparative adv.

Analyse the advantages and disadvantages of worker specializing (8)

Advantages	Disadvantages

• Workers concentrate on a particular task
  ○ Become very good at it
  ○ ↑ productivity, ↑output, ↑wage, ↓time waste
	• ↑ wage, ↓cop
	• ↓ occupational mobility – difficult to find another careers
	• Task become repetitive – boring – de-motivation - ↓productivity
	• Reply on key workers – if sick/leave – disrupt production process

Describe the benefits and disadvantages of specialisation at regional/national level (8)

Advantages	Disadvantages

• ↑market size
  ○ Take advantage of econ of scale eg bulk-buying
• Become very good at it
  ○ ↑ productivity, ↑output
• Making best use of factor endowments
  ○ Eg natural climate / resources
• Gain reputation
  ○ ↑demand for product – purchase goods/services - ↑GDP
  ○ Ppl go there - ↑labour force
	• ↑ wage, ↓cop
	• ↓ variety for consumers
	  ○ Country becomes vulnerable
	  ○ Demand ↓ due to changing trends
	  ○ New/alternative products available at lower price / better quality elsewhere
	• Overspecialisation - individuals, firms, regions or countries concentrate too much on production on certain good/service
	  ○ ↓ factor endownments – non-renewable resource eg oil – country no income if run out
	  ○ 'brain drain' – well-educated workers leave country
	  ○ Regional & structural unemployment

6.2 Globalisation, free trade and protection

Globalisation: process of world's economies become increasingly interdependent & interconnected due to greater international trade & cultural exchange

Adv	Dis
• Create jobs & wealth	• ↑ reliance on other country

• Enjoy greater econ of scale • ↑ choice of goods/services • ↑ cultural understanding & appreciation	• ↑ income inequality

Role of multinational companies

Multinational corporation (MNCs): an organisation that operates in two or more countries but has its headquarter based in a country eg Apple

Adv	**Dis**

• Create jobs
• Enjoy greater econ of scale
• ↑ choice of goods/services
• ↑ cultural understanding & appreciation
• Produce in foreign country
  ○ Avoid trade restrictions eg taxes
  ○ ↓ transportation costs
	• Create jobs
	• Criticised for cost-cutting practices eg poor working conditions & low wages in LEDCs
	• Huge market power → exploit econ of scale → local firms struggle to compete
	• When LEDCs rely too much on MNCs → major problems occur when relocation eg mass unemployment
	• Lack of local knowledge eg laws, cause major problems for MNCs
	• Fluctuation exchange rates ↑ difficulty to measure value of MNC's sales & profits in overseas markets
	• Business failure if doesn't meet local demand

International trade: exchange of goods/services beyond national borders

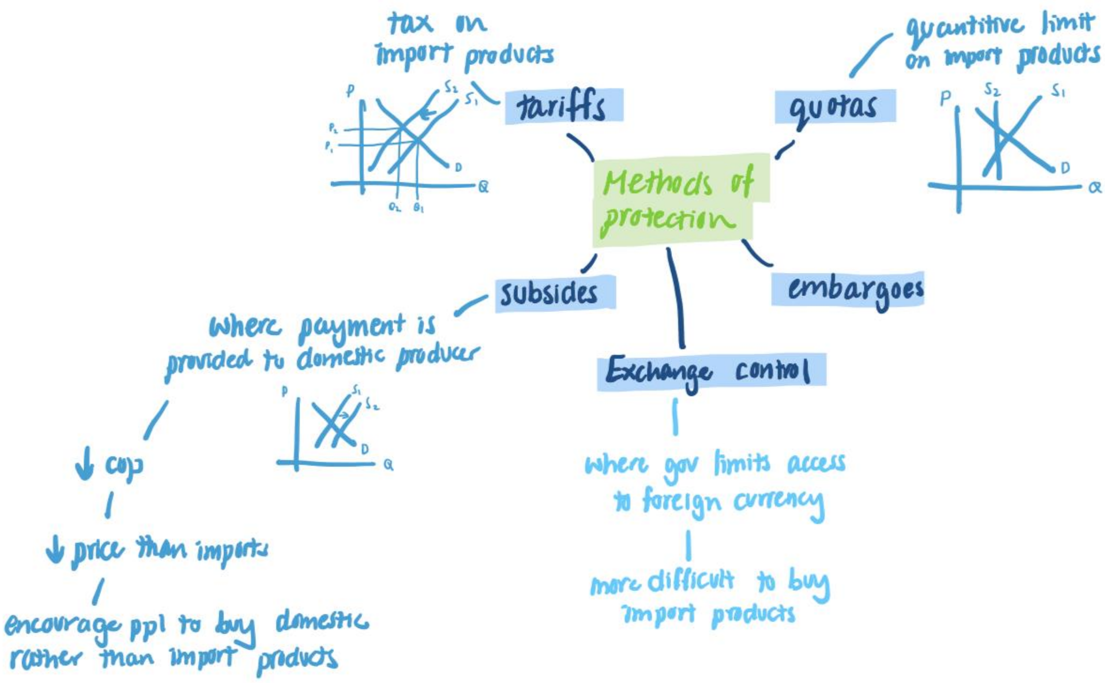
Free trade
- international trade takes place without protection eg tariffs
- Is encouraged by organisations eg World Trade Organisation
- Increase world output when each country is specialised in producing certain goods/services they are best at producing
- Can increase standard of living

Adv of international trade
1. **Access to resources**
2. **Enjoy econ of scale**
3. **↑ choice**
4. **↑ efficiency**
5. **Improve international relations**

Protection: use of trade barriers to restrain foreign trade & limit overseas competition

Methods of protection
1. **Tariffs**: tax on import products
2. **Import quotas**: quantitative limit on sale of foreign good
3. **Subsides** - help firms compete against foreign firms
4. **Embargo**: ban on trade with certain country due to trade dispute / political conflict
5. **Rules & regulations** - takes lots of time, ↑ costs for overseas firms

Adv	**Dis**
• Protect infant industries from foreign competition • Protect job • (tariff) ↑ tax revenue • Improve balance of payment • Prevent foreign countries (dumping: sell goods/services in large quantities below cop) • ↓ reliance on other countries	• Market distortions → misallocation of resources e.g firms too reliant on gov, ↓ efficiency • ↓ competition & innovation, ↑ cop, imported inflation • Retaliation, ↓ economic growth



Tariffs / quotas

stop unemployment occurring in domestic firm
maintain domestic production
↑ demand to buy domestic products
improve current account position
↓ quality
↓ competition
↑ cop ↑ price
Adv
prevent dumping
prevent domestic firms close down
stop declining industries closing down
structural unemployment
protect infant industries
enable industry to grow
take adv of econ of scale
↑ GDP, employment
become internationally competitive

Dis
foreign products might be cheaper & better quality
retaliation with gov of other countries imposing trade restriction
↓ exports
unemployment in export industries
↑ cost of imported raw materials
↑ cop
cost-push inflation
protect jobs in home country but create unemployment in other countries
CO_2
mislocation of resources

Explain why gov might decide to protect a strategic industry? (4)

Strategic industry
What
industry which is important for country's economy / safety
eg defence / agriculture
essential for survival
aim to ensure supply is constant
if too dependent on imports of eg food
face risk of shortage of supply due to war / natural disaster
how to protect
protectionist measures give country ability & capacity to produce all goods / services needed

Discuss whether protection of declining industry can be justified (8)

Declining industry
What
experience -ve econ growth
protection
Adv
prevent high costs of benefits
↑ employment
↑ productivity
↑ output
Dis
owner resist protection being removed
industry won't decline
inefficient allocation of resources
↓ standard of living
oppo cost
subsidies
train workers

Discuss whether protection of an infant industry can ever be justified (8)

- **Infant industry**
  - **What**
    - new, unestablished industry
      - not able to compete on equal terms with longer established foreign producers
  - **protection**
    - once industry can compete equally with foreign producers
      - can remove
    - **Adv**
      - enable industry to grow
        - take adv of econ of scale
        - become internationally competitive
        - ↑ GDP, employment
    - **Dis**
      - difficult to identify which new industries have potential to be successful
        - may waste gov expenditure
          - opportunity cost
            - eg spend $ on education
      - industry becomes dependent on protection
        - less competitive

Discuss whether a reduction in country's trade protection will improve its economic performance (8)

- **yes**
  - ↑ competition
    - put pressure on domestic firms
      - ↓ price
        - ↓ inflation
  - ↓ imported raw material price
    - ↓ cop
      - ↓ cost-push inflation
  - ↓ finished imports price
    - ↑ supply
      - ↑ choice
  - efficient allocation of resources
    - instead of infant/declining industries that might have little chance to succeed
    - education
    - healthcare
      - ↑ standard of living
  - other countries reciprocate
    - ↓ trade protection measures
      - country export more
        - ↑ output
          - ↑ employment

No
infant / declining industries go out of business
↑ unemployment
↓ output
↑ dumping
foreign firms exports goods at lower price than domestic price / cop
unfair competition
domestic firms close down
↓ sales tax
↓ gov revenue
may become dependent on other countries
risk of supply-side shock

6.3 Foreign exchange rates

Exchange rate

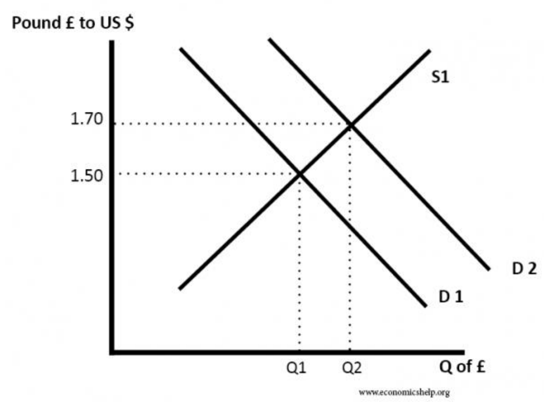
- Price of one currency measured in terms of other currencies
- External value of a currency

Determination of exchange rates in foreign exchange market

- ↓ price, ↑ demand for exports of goods/services
- ↑ country's currency, ↑ demand for imports

Floating exchange rate system

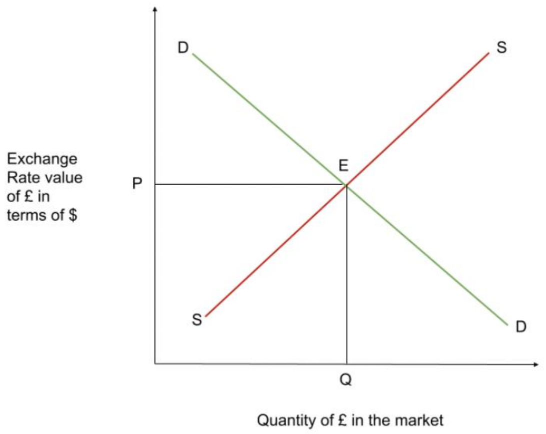
- Currency determined by market forces of demand & supply for currency
- **Appreciation** - exchange rate rising against other currencies
- **Depreciation** - exchange rate falls against other currencies



Advantages	Disadvantages
• It should automatically eliminate current account imbalances by floating down when there is a deficit • No currency reserves are needed as the government will not intervene to influence the value of the currency • No government intervention needed as the exchange rate will be at the market price /determined by supply and demand • The exchange rate is not a policy target policy measures do not have to be used to influence its value	• Price of exports ↓, quantity of exports demanded ↑, value of exports ↑, net exports ↑ • Price of imports ↑, quantity demanded for imports ↓, value of imports ↓ • Price of imported raw materials ↑, cop ↑, inflation ↑

Fixed exchange rate system

- Gov intervenes in foreign exchange markets (where different currencies can be bought or sold) to ensure value of its currency staus at pegged value
- **Revaluation** - currency value raised against other currencies
- **Devaluation** - currency value reduced against other currencies



Advantages	Disadvantages

• ↓ uncertainties for international trade
  • Allow firms to be certain about future costs & prices
  • Encourage international trade & exchange
Eg
HK declines against pegged USD
• HKMA ↑ demand to ↑ value
To prevent HKD falling
• HKMA buy HKD to ↑ price from foreign exchange markets
	• ↓ country's ability to use monetary policy
	• Huge opportunity cost in using large amounts of foreign exchange reserves to maintain fixed rate

Describe the differences between a fixed and a floating exchange rate. [4]

Up to 2 marks for a fixed exchange rate:

- a fixed exchange rate is maintained by the government/central bank (1)
- it is maintained through intervention in the foreign exchange market, buying or selling the currency/changes in the interest rate to maintain a particular value (1)

Up to 2 marks for a floating exchange rate:

- the value is determined by the market forces of demand and supply (1)
- the value can change frequently due to changes in demand and supply (1), e.g. speculation/rate of inflation etc. (1)
- there is no need for a government/central bank to maintain a particular exchange rate (1)

(d) Discuss whether a floating exchange rate system is always preferable to a fixed exchange rate system. [7]

Up to 4 marks for why it may be preferable:

- a government/central bank does not need to hold foreign currency reserves (1) these can be used for other purposes (1)
- a government/central bank can focus on other policy objectives (1), e.g. a government/central bank can increase the rate of interest to reduce inflation (1) without worrying that it may raise the exchange rate (1)
- the exchange rate can move to offset a current account deficit or surplus (1), e.g. if there is a deficit the exchange rate can fall (1) causing export prices to fall and import prices to rise (1)

Up to 4 marks for why it may not be preferable:

- there can be a large degree of volatility (1) this can cause uncertainty (1) which makes it difficult to plan (1) this can discourage investment (1)
- it may reduce international trade (1) exporters and importers may be uncertain as to how much they will receive in payment and how much they will have to spend (1)
- there is no guarantee there will be a current account balance (1), e.g. the exchange rate can be influenced by speculation (1)

Exchange rate fluctuations

Causes	Consequences
• Changes in demand for exports - ↑ demand ↑ demand for country's currency ↑ exchange rate • Changes in demand for imports - ↑ demand ↑ value of freign currency to facilitate purchase of foreign goods/services • Price & inflation - ↑ price of goods/services by domestic inflation, ↓ demand for exports, ↓ exchange rate value • Foreign direct investment (FDI) - globalisation & expansion of MNCs mean investment in overseas production plants requires use of foreign currencies • Speculation - foreign exchange traders move money around world to take adv of higher interest rates in earn profit • Gov intervention	• Customers - ↑ purchasing power • Exporters - lose • Importers - ↑ purchasing power • Balance of payment • Employment • Inflation • Economic growth

Coping with high exchange rate

- Cut export prices to main price competitiveness against foreign rivals
- Seek alternative overseas suppliers of cheaper raw materials
- Improve productivity to keep average labour costs under control

- Focus on supplying more price inelastic products coz customers become less sensitive to exchange rate fluctuations
- Focus on non-price factors that are important to overseas customers eg brand awareness
- Relocating production processes overseas, where cop are low

6.4 Current account of balance of payments

Balance of payment: financial record of country's transactions with the rest of the world for a given time period

Current account: records all exports & imports of goods/services between country & trading partners, and net income transfers

Current account deficit on balance of payment: the combined value of the debit items in the four sections of the current account of the balance of payments is greater than the combined value of the credit items in the four sections of the current account

Current account surplus on balance of payment: the combined value of the debit items in the four sections of the current account of the balance of payments is less than the combined value of the credit items in the four sections of the current account, when the revenue from trade in goods & services exported is less than imported

Structure

1. **Trade in goods**

Visible balance: trade in physical goods eg raw materials / manufactured goods
Visible exports: goods sold to foreign customers
Visible imports: goods bought by foreign customers

2. **Trade in services**

Invisible balance: trade in services eg banking / tourism
Invisible export: services sold to a foreign customers
Invisible import: services bought by foreign customers

1. **Primary income** (investment income): record country's net income earned from investments abroad	1. **Secondary income**: income transfers between residents & non-residents
Eg • Profits earned by subsidiary companies based in overseas countries • Interest received from loans and deposits in overseas companies • Dividends earned from financial investments in overseas companies • Foreign direct investments of individuals or businesses in overseas business ventures • Money sent home by people working abroad	Eg • Donations to charities abroad • Foreign aid • Subsidies or grants paid to companies based in overseas locations • Payments of pensions to retired people now based in overseas countries • Scholarships paid to students based in overseas universities

Calculation of current account

Current account = balance of trade + primary income + secondary income

	Current account deficits: when country spends more money than it earns	**Current account surplus**: when country exports more than imports
Causes	1. **↓ demand for exports** - due to ↓ competition / recession / ↑ exchange rate 2. **↑ demand for imports** - due to ↑ exchange rate / domestic inflation	1. **↑ demand for exports** - due to ↑ competition / recession / ↓ exchange rate 2. **↓ demand for imports** - due to ↓ exchange rate / inflation
Consequences	1. **↓ demand → Unemployment** - due to derived demand → **↓ living standards** 2. **↑ borrowing** 3. **↓ exchange rate** → ↑ price of imports	1. **↑ demand → Employment** - due to derived demand → **↑ living standards** 2. **Inflationary pressure** - ↑ demand of exports → demand-pull inflation 3. **↑ exchange rate**

Explain why large current account deficit is a serious problem. (4)

- Country is consuming more than it is producing, i.e. the country is living beyond its means
- If too many goods are being imported from abroad, not enough is being produced in the home country, ↑ unemployment
- Country's goods X competitive enough on world markets
- ↓ value of the currency → imported inflation
- ↓ exchange rate ↑ price of imports

Current account surplus

- The combined value of the debit items in the four sections of the current account of the balance of payments is less than the combined value of the credit items in the four sections of the current account, when the revenue from trade in goods & services exported is less than imported

Adv	Dis
• ↑ exports means more output is needed, more workers will be needed as demand for labour is a derived demand • A surplus means more funds flowing into economy, ↑ total aggregate demand which could generate jobs • ↑income, ↑consumption, ↑firms revenue, which could then be reinvested	• Exports may be capital-intensive using less labour to produce exports • A surplus may create a deficit in another, other countries may not e able to continue buying exports or may impose protectionist policies to prevent future deficits • ↑surplus ↑exchange rate, ↓net exports, ↑unemployment

Solutions

- Focus on reducing imports: tariffs, quotas, subsidies, exchange controls, gov encourage ppl to buy home produced products
- Focus on encouraging exports: devaluation/depreciation of exchange rate, subsidies

Policies to achieve balance of payment stability

1. **Fiscal policy**
2. **Monetary policy**
3. **Supply-side policies**
4. **Protectionist measures**

Exam questions

6 About 30% of Nigeria's labour force is employed in agriculture but the country still spends more than US$12 billion a year importing food. The Nigerian Government is seeking to reduce the imports of food. With a high birth rate and many small farms, this may be difficult to achieve.

(a) Define 'birth rate'. [2]

(b) Explain **two** causes of a high birth rate. [4]

(c) Analyse how an increase in the size of farms may affect the cost of producing food. [6]

(d) Discuss whether a reduction in its imports will always benefit an economy. [8]

6 (a) Define 'birth rate'. [2]

- the number of births per 1,000 of the country's population per year (2)
- the number of births per 1,000 of the country's population (1)

(b) Explain two causes of a high birth rate. [4]

- a high infant mortality rate (1) people having a high number of children not expecting all of them to live (1)
- a lack of financial support for the elderly (1) people having children to support them in old age (1)
- women marrying at a young age (1) giving them longer time in which to have children (1)
- a young population (1) with a high proportion of people of child bearing age (1)
- a lack of availability/willingness to use contraception (1) resulting in more births than planned (1)
- not many women working (1) not restricting the number of children they have in order to follow a career (1)
- a lack of education (1) reduces knowledge of contraception/cost of bringing up children/ proportion of women working (1)
- government incentives to have children (1) high state benefits would increase willingness and ability of people to have children

(c) Analyse how an increase in the size of farms may affect the cost of producing food. [6]

- larger farms may produce higher output (1) this will increase total cost (1)
- larger farms may be able to take advantage of economies of scale (1) examples of economies of scale available to farmers e.g. buying (purchasing seed in bulk), technical (using e.g. combine harvesters), managerial (specialist workers e.g. shepherds) up to (2) will lower average costs (1)
- larger farms may experience diseconomies of scale (1) examples e.g. worse labour relations (1) will increase average costs (1)
- larger farms are likely to have higher fixed and variable costs (1) but their average fixed costs are likely to be lower (1) as these costs will be spread over a higher output (1) their average variable costs may be lower due to economies of scale/or higher due to

7 **(a) Define 'recession'.** **[2]**

- fall in a country's output/GDP (1) over a period of six months/two successive quarters (1)

(b) Explain <u>two</u> reasons why an economy may have a high foreign exchange rate. **[4]**

- a high demand for the currency (1) this may arise from e.g. good quality/lower price of exports/speculation that the currency will rise in the future (1)
- a low supply of the currency (1) due to, for instance, a low demand for imports/a low level of investment abroad (1)
- government setting a high exchange rate (1) by buying the currency/raising the exchange rate (1)

(c) Analyse how supply-side policy measures could increase productivity. **[6]**

Up to 4 marks for any one policy measure analysed:

- improved education/training (1) may raise workers' skills (1) increase output per worker hour (1)
- privatisation (1) may increase competitive pressure on firms to keep costs low (1) encourage more investment (1) increase output per factor hour (1)
- reforming trade unions (1) may reduce restrictive practices (1) this may allow firms to use their workers more efficiently (1) increase output per worker hour (1)
- cutting corporation tax (1) may increase profit (1) increase investment (1) increase output per factor hour (1)
- giving subsidies (1) to encourage firms to invest in advanced technology, engage in research and development and/or train workers (1)

(d) Discuss whether a fall in the international value of its currency will always benefit an economy. **[8]**

Up to 5 marks for why it might:

- it will lower export prices (1) and raise import prices (1) make domestic products more internationally competitive (1) this may raise export revenue and lower import expenditure (1) if demand for exports and imports is elastic (1) this may improve the current account position/reduce a current account deficit (1)
- producing more domestic products (1) may raise output/GDP (1) cause economic growth (1) raise employment/reduce unemployment (1) increase income (1) and living standards (1)
- if the value was being maintained by the government above the equilibrium level (1) reserves of foreign currency may not now have to be used (1) these could be used for another purpose (1) interest rate may not have to be as high (1) a lower interest rate may stimulate economic activity (1)

Up to 5 marks for why it might not:

- higher import prices may cause inflation (1) raise costs of raw materials (1) increase costs of production (1) put less downward pressure on domestic firms to be price competitive (1)
- lower prices of exports may be offset by low quality of exports (1) fall in incomes abroad (1) increase in trade restrictions imposed by foreign governments (1)
- demand for exports and imports may be price inelastic (1) in this case export revenue may fall (1) and import expenditure may rise (1)

3 The Canadian economy in 2014 was generally doing well. Money was largely retaining its value and unemployment was falling. The country did, however, have rising household debt and a deficit on the current account of its balance of payments. The Canadian Government in 2014 was seeking to increase exports whilst recognising that such an increase may have an impact on the exchange rate.

(a) Identify **two** functions of money. [2]

(b) Explain **two** reasons why household borrowing may increase. [4]

(c) Analyse **three** ways in which international trade differs from internal trade. [6]

(d) Discuss whether an increase in exports will increase the exchange rate. [8]

3 (a) Identify two functions of money. [2]

1 mark each for any two of the following:

- medium of exchange / means of payment
- store of value
- unit of account/measure of value
- standard of deferred payment.

(b) Explain two reasons why household borrowing may increase. [4]

1 mark for identifying a reason and 1 mark for explaining:

- The rate of interest may fall (1) making it cheaper to borrow (1).
- Incomes may fall / prices may rise / inflation (1) so people may borrow to purchase basic necessities (1).
- People may become more optimistic about the future (1) more confident that they will repay loans (1).
- The price of housing may fall (1) encouraging people to take out mortgages (1).
- Increase in family size (1) creates a greater need to borrow to support more children (1)
- The cost of health care/education may increase (1) requiring people to pay more for the services (1).

(c) Analyse three ways in which international trade differs from internal trade. [6]

1 mark for identification of a difference and 1 mark for analysis:

- International trade usually covers greater distances (1) which increases the cost of transport (1) may take longer for delivery (1).
- International trade means a bigger market than the internal market (1) and more competitive (1) enabling firms to gain economies of scale (1)
- Internal trade involves using the same currency (1) international trade may involve two or more currencies (1) increasing transaction costs (1).
- International trade means a wider range of goods & services (1) this gives consumers greater choice (1)
- Trade restrictions may be imposed on products traded internationally (1) raising costs of production (1).
- Tastes and cultures may differ (1) requiring differences in products offered (1).
- Regulations may differ (1) requiring adjustments in products (1).
- Languages may differ (1) e.g. incurring costs of translation (1).

(d) Discuss whether an increase in exports will increase the exchange rate. [8]

- The exchange rate is the price of a currency (1)

Up to 5 marks for why it might:

- An increase in exports may increase export revenue (1) this will increase demand for the currency (1) higher demand pushes up the price of the currency (1) raising the value of a floating exchange rate (1) which is determined by market forces (1).

Up to 5 marks for why it might not:

- Exports may increase but export revenue may not (1) more exports may be bought for a lower price (1) and so demand for the currency will not rise (1).
  (1) An increase in exports may be offset by an increase in imports / lower interest rate (1) or government intervention by selling domestic currency (1) so demand and supply of the currency will increase (1) which may leave the exchange rate unchanged (1).