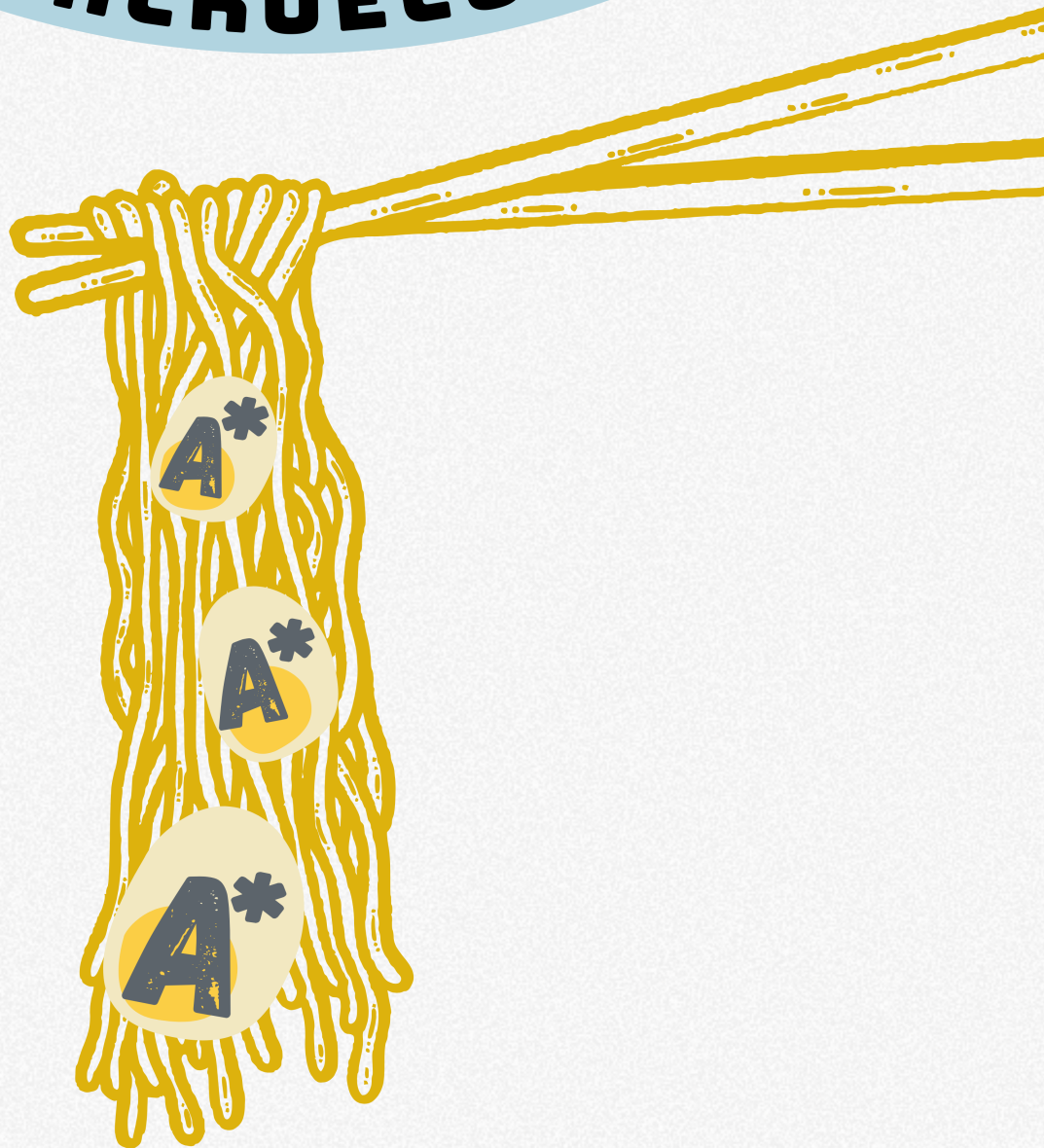


KNOCKOUT.ECONOMICS

ECONQUICK

INSTANT REVISION NOTES

IGCSE MACROECONOMICS



JUST IN ONE BITE

Table of content

Chapter	Page
CHAPTER 24 : THE ROLE OF GOVERNMENT	1
CHAPTER 25 : THE MACROECONOMIC AIMS OF GOVERNMENT	2
CHAPTER 26 : FISCAL POLICY	8
CHAPTER 27 : MONETARY POLICY	17
CHAPTER 28 : SUPPLY SIDE POLICIES	24
CHAPTER 29 : ECONOMIC GROWTH	29
CHAPTER 30 : EMPLOYMENT AND UNEMPLOYMENT	36
CHAPTER 31 : INFLATION AND DEFLATION	43
CHAPTER 32 : LIVING STANDARD	53
CHAPTER 33 : POVERTY	57
CHAPTER 34 : POPULATION	62
CHAPTER 35 : DIFFERENCES IN ECONOMIC DEVELOPMENT BETWEEN COUNTRIES	69
CHAPTER 36 : INTERNATIONAL SPECIALISATION	73
CHAPTER 37 : GLOBALISATION, FREE TRADE AND PROTECTION	80
CHAPTER 38 : FOREIGN EXCHANGE RATES	88
CHAPTER 39: CURRENT ACCOUNT OF BALANCE OF PAYMENT	98

CHAPTER 24

THE ROLE OF GOVERNMENT

Checklist

1. The functions of government at local and national level
2. The functions of government at an international level

1. The functions of government at local and national level

Roles of government at local and national level

1. Government directly **provides public goods**, such as national defense, street light

2. Government **protects strategic industries** e.g. agricultural industry and national defense which is important to a country's stability and safety.

3. Government provides and **subsidises merit goods** such as education and healthcare.

4. Government **employs workers** and managers to operate its state-owned enterprises to achieve government aims.

2. The functions of government at an international level

Roles of government at international level

1. Promote free international trade
 **Free trade: buying and selling of goods and services between countries without any restrictions.

2. Promote Multinational companies (MNCs)
 ** Multinational companies: companies that operate in more than one countries such as KFC and Starbucks.

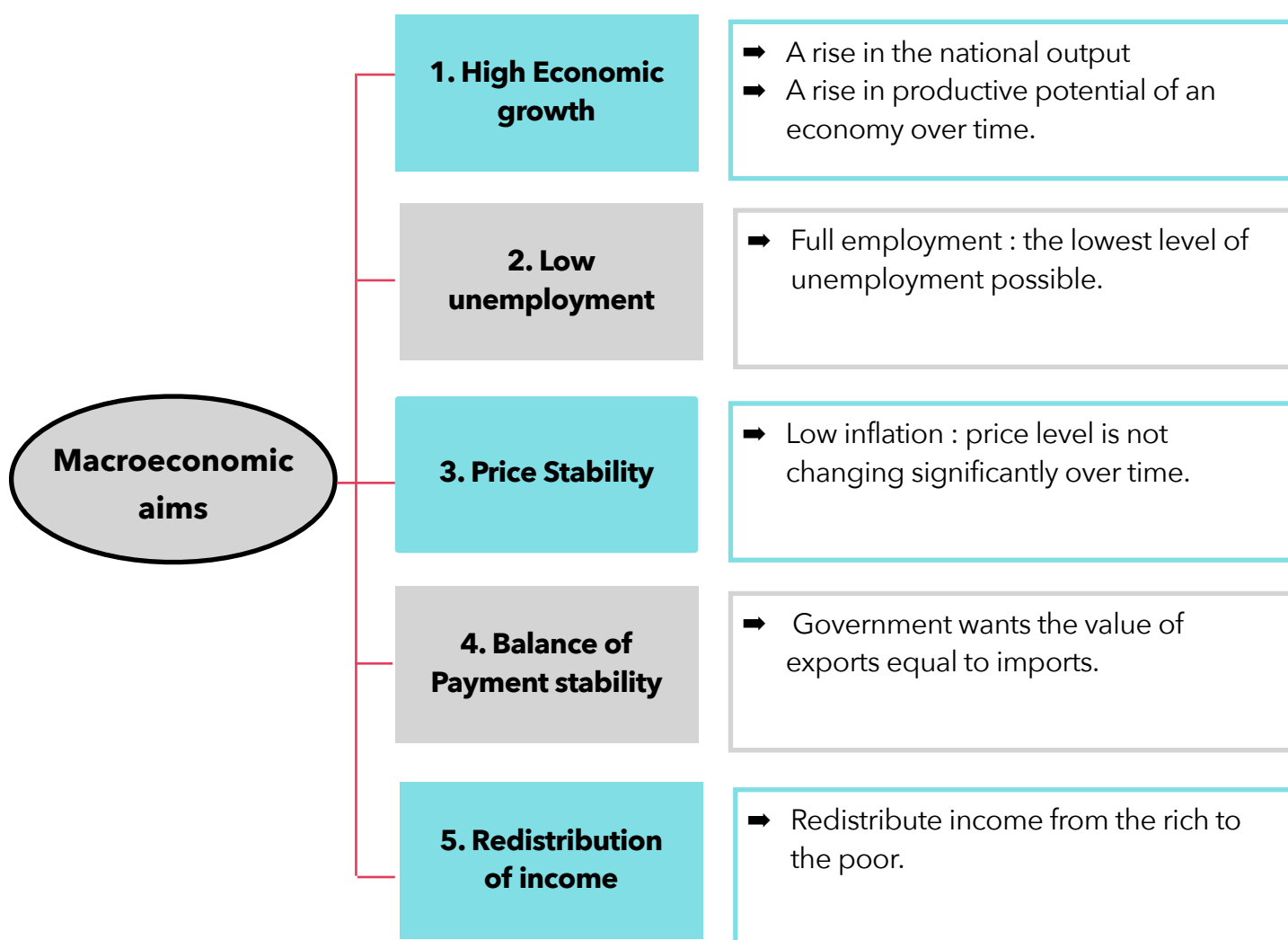
3. Member of trade bloc to promote trade between members
 ** Trade bloc: a group of countries in the same region agree to trade freely between themselves.

CHAPTER 25 THE MACROECONOMIC AIMS OF GOVERNMENT

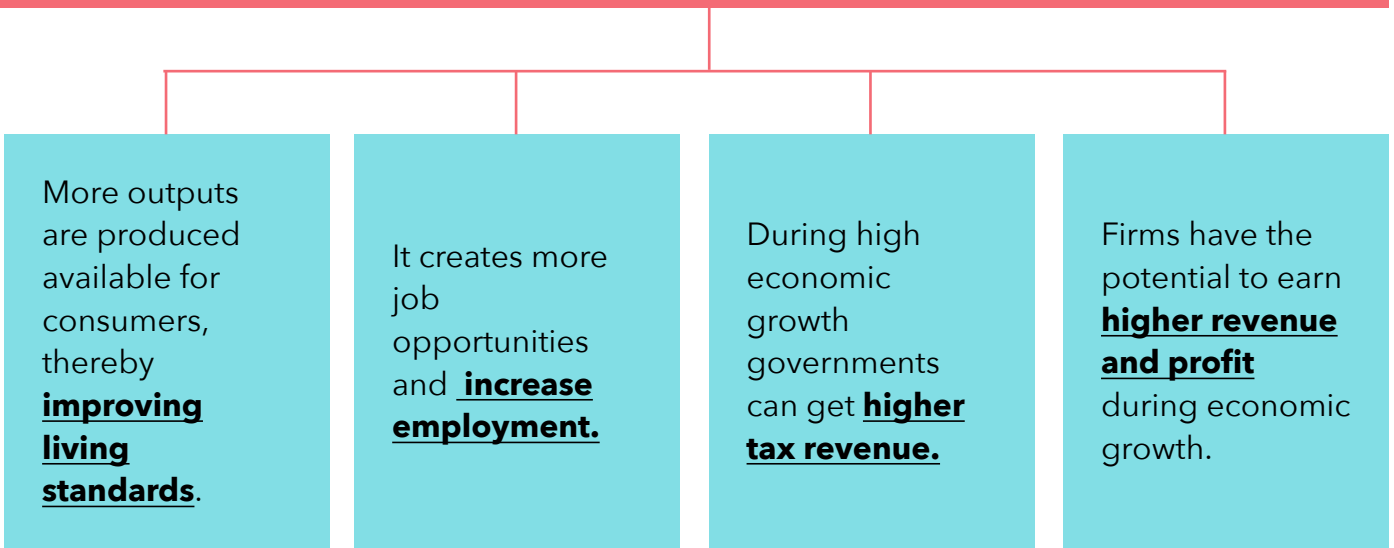
Checklist

1. The macroeconomic aims of government
2. Conflicts between macroeconomic aims

1. Macroeconomic aims



1.1 Reasons why governments aim for high economic growth



1.2 Reasons why governments aim for low unemployment:



1.3 Reasons why governments aim for price stability:

Attaining price stability ensures greater **economic certainty**, encouraging businesses to invest.

Maintaining stable prices enhances **price competitiveness of exports**.

Stable prices **protect households' purchasing power**, maintaining the value of money.

1.4 Reasons why governments aim for balance of payments stability

In the long run, a government aims for the value of exports to be equal to the value of imports to **achieve a balanced trade situation**.

The government prevent scenarios where the value of imports exceeds exports, resulting in **money outflow from an economy and rising in national debt**.

Excessive exports of goods and services can result in **a shortage of products** for the residents of the country.

2. Conflicts between macroeconomic aims

2.1 Conflicts between **high economic growth** and **low Inflation**

When there is low unemployment, firms have to offer higher wages in competition for workers.



The rise in production costs consequently leads to an increase in prices of goods and service or inflation.

2.2 Conflicts between **low unemployment** and **low Inflation**

When there is low unemployment, firms have to offer higher wages in competition for workers.



The rise in production costs consequently leads to an increase in prices of goods and service or inflation.

2.3 Conflicts between **high economic growth** and **balance of payment stability**

In periods of high economic growth, employment and income levels rise.



This, in turn, boosts the spending on goods and services, including imports. Consequently, the balance of payments worsens.

2.4 Conflicts between low unemployment and balance of payment stability

As people have jobs and income, their demand for goods and services, including imports, rises.



This contributes higher import expense and a worsening of the balance of payments.

Summary of conflicts between macroeconomic aims

Conflicts between macroeconomic aims		
High economic growth	VS	Price stability
	VS	Balance of payment stability
	VS	Pollution and resource waste
Full employment	VS	Price stability
	VS	Balance of payment stability

Key takeaways

- Macroeconomic aims are high economic growth, low unemployment, price stability and stability in balance of payment
- However, government cannot achieve all economic aims at the same time.

Economic growth \neq price stability

Economic growth \neq balance of payment stability

Economic growth \neq pollution and resources wastes

Full employment \neq Price stability

Full employment \neq Balance of payment stability

CHAPTER 26 FISCAL POLICY

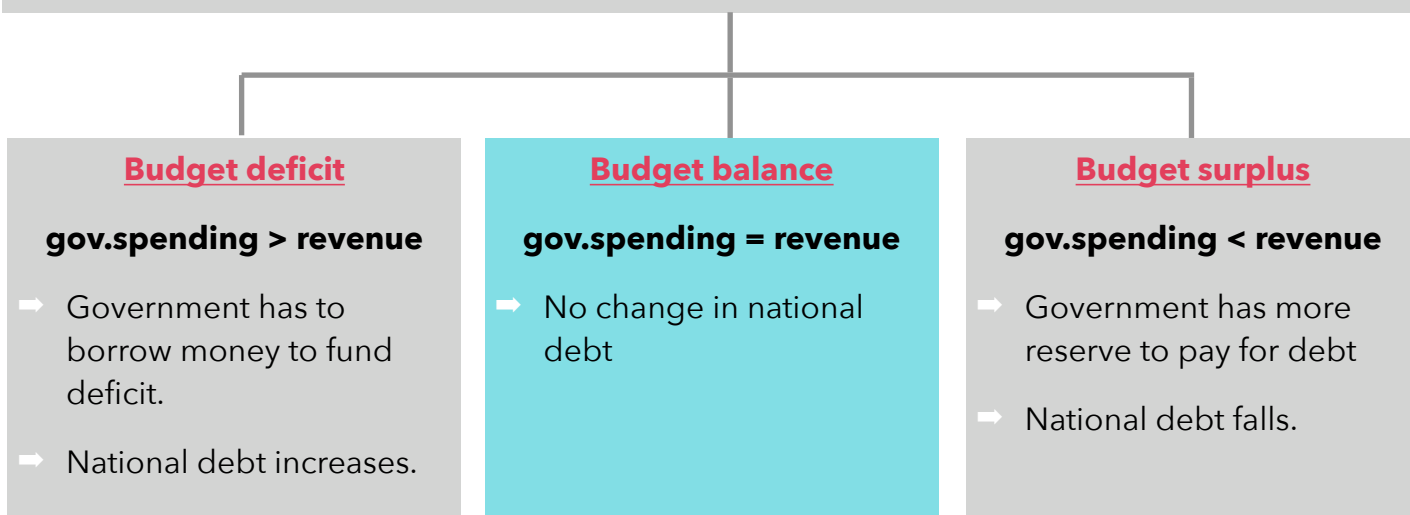
Checklist

1. Government budget; budget balance, budget deficit and budget surplus.
2. Reasons for government spending and taxation
3. Types of taxes
4. Principles of taxation
5. Fiscal policy measures
6. Effect of fiscal policy on macroeconomic aims

1. Government budget

Government Budget

The relationship between government revenue and spending



2. Reasons for government spending and taxation.

The reasons for government spending

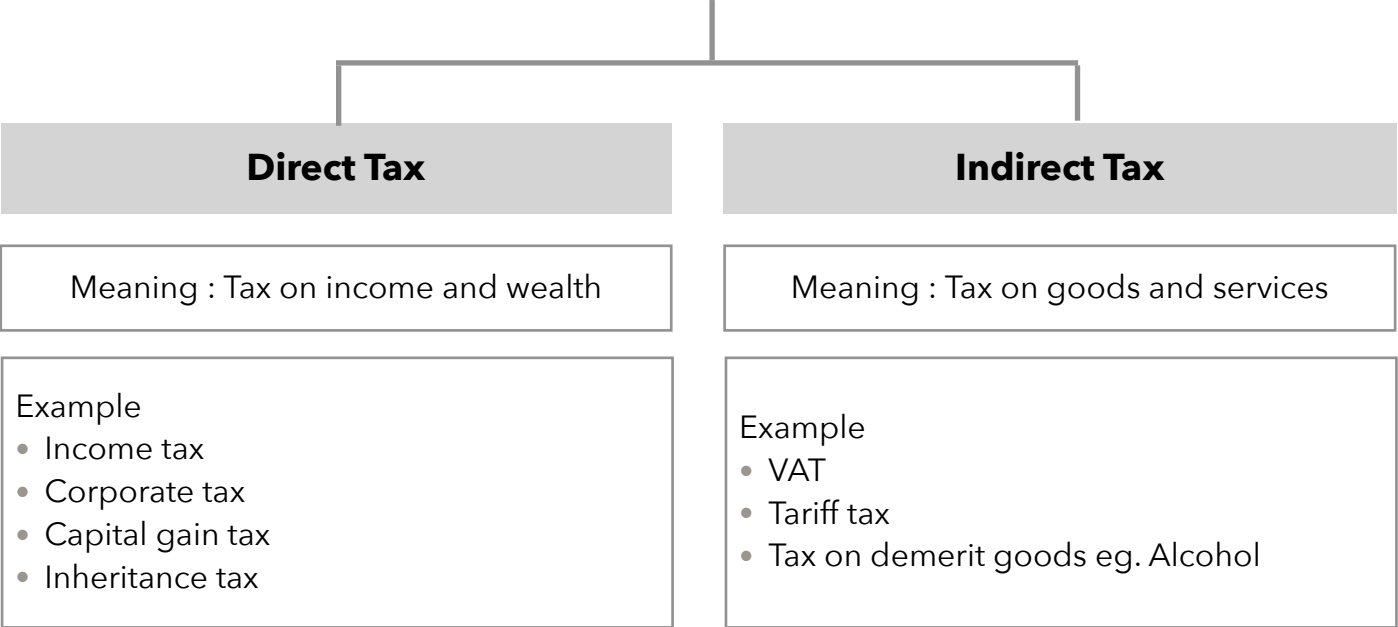
1. Government spends on **public goods** like roads and national defense.
2. Government expenditure supports the provision of **merit goods**, including education and healthcare, to enhance the overall well-being of society.
3. Government spending on **helping vulnerable individuals**, such as unemployment benefits.
4. Government spends on the **payment of interest on loans**.

The reasons for taxation

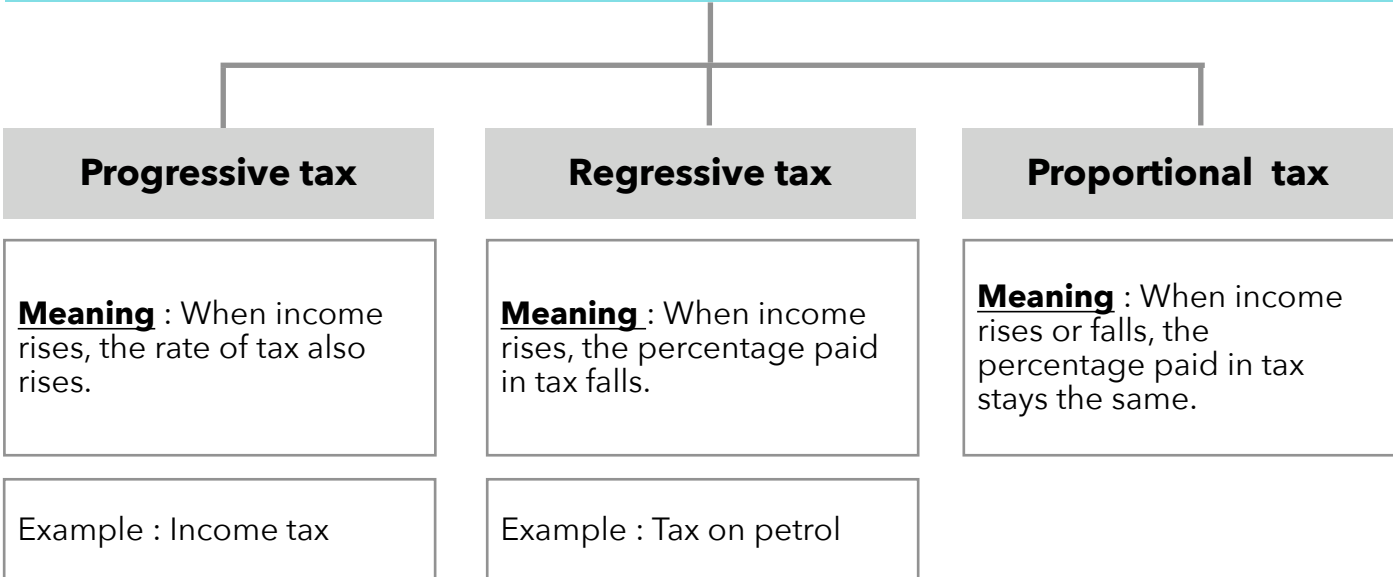
1. **Tax on income** aims to redistribute income and wealth from the rich to the poor.
2. **Tax on demerit goods** is implemented to discourage their consumption.
3. **Tax on pollution** serves to increase costs for firms, encouraging them to reduce externalities.
4. **Import taxes** are imposed to discourage the consumption of imports and to promote the consumption of domestic goods.

3. Types of taxes and principles of taxation

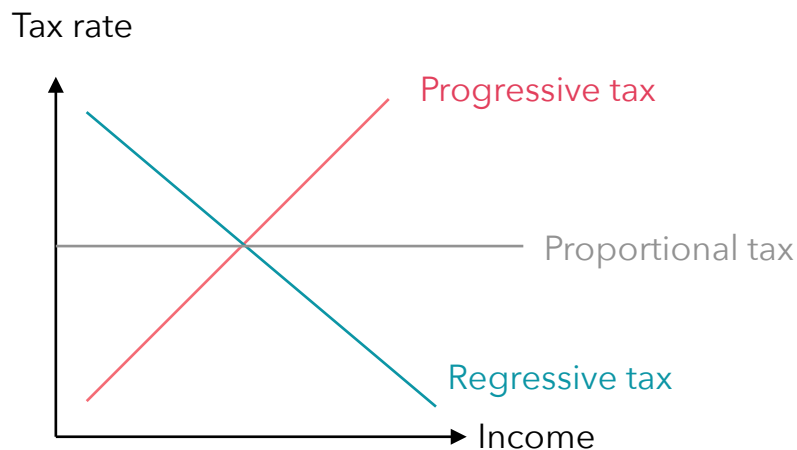
3.1 Types of taxes



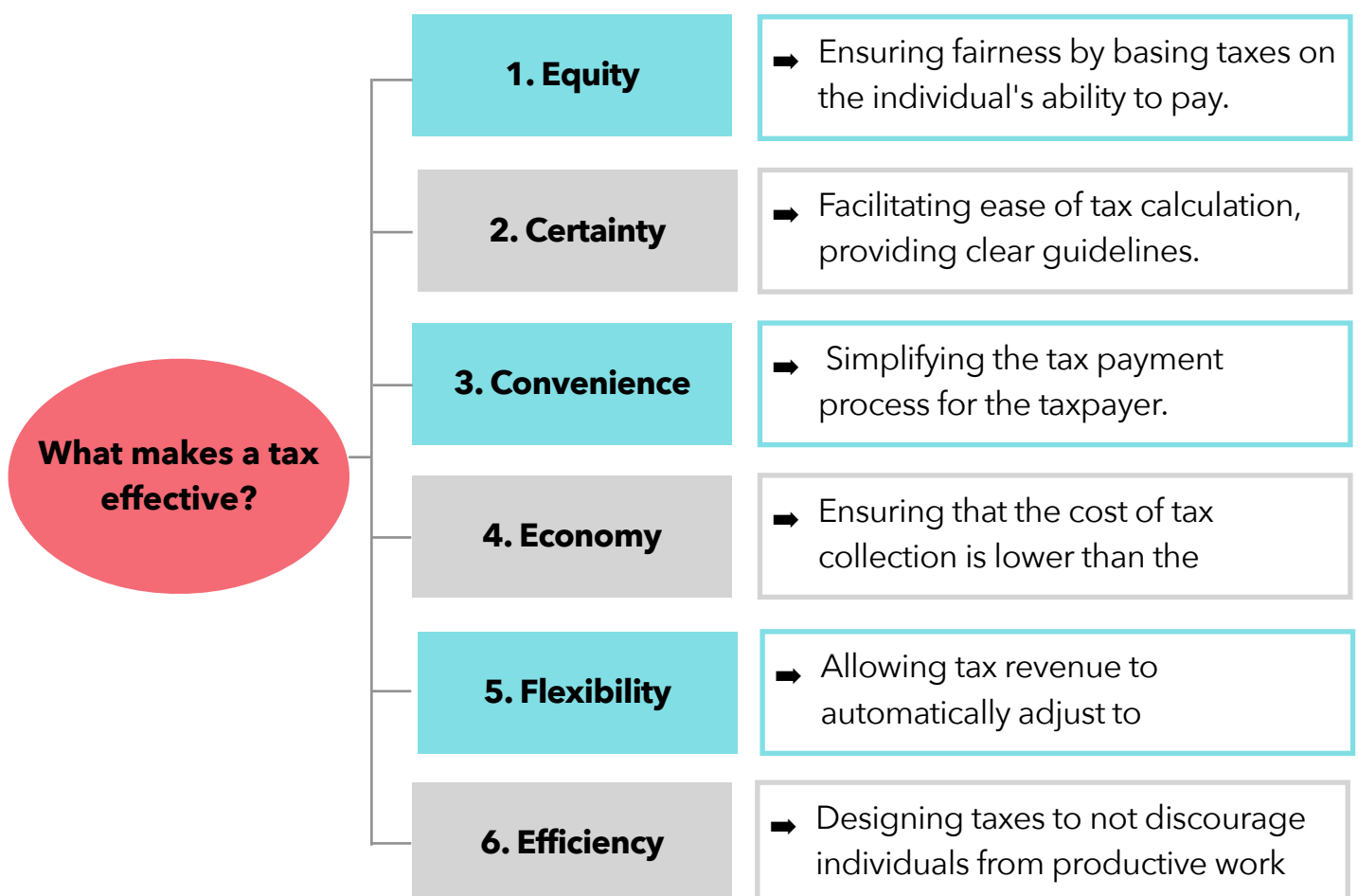
3.2 Types of taxes



Summary

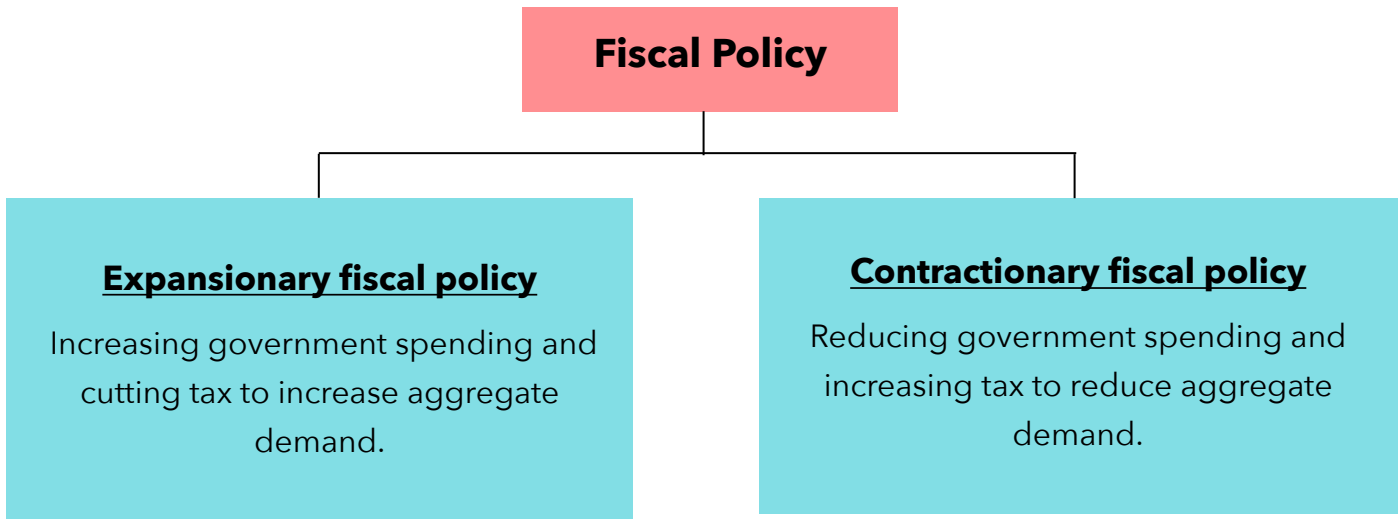


4. Principles of taxation



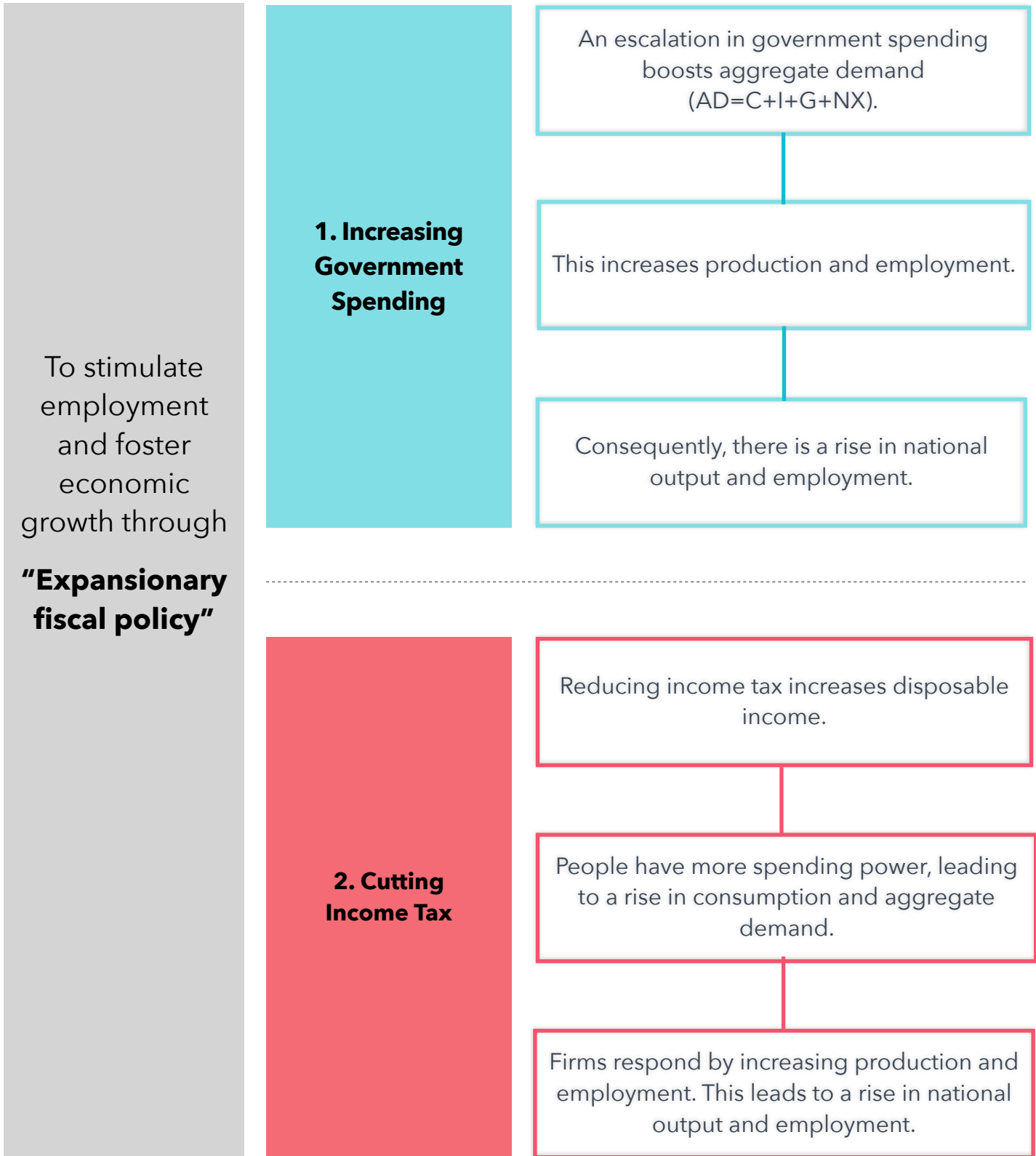
5. Fiscal policy measures

Fiscal policy: changes in government spending and taxation to influence aggregate demand.

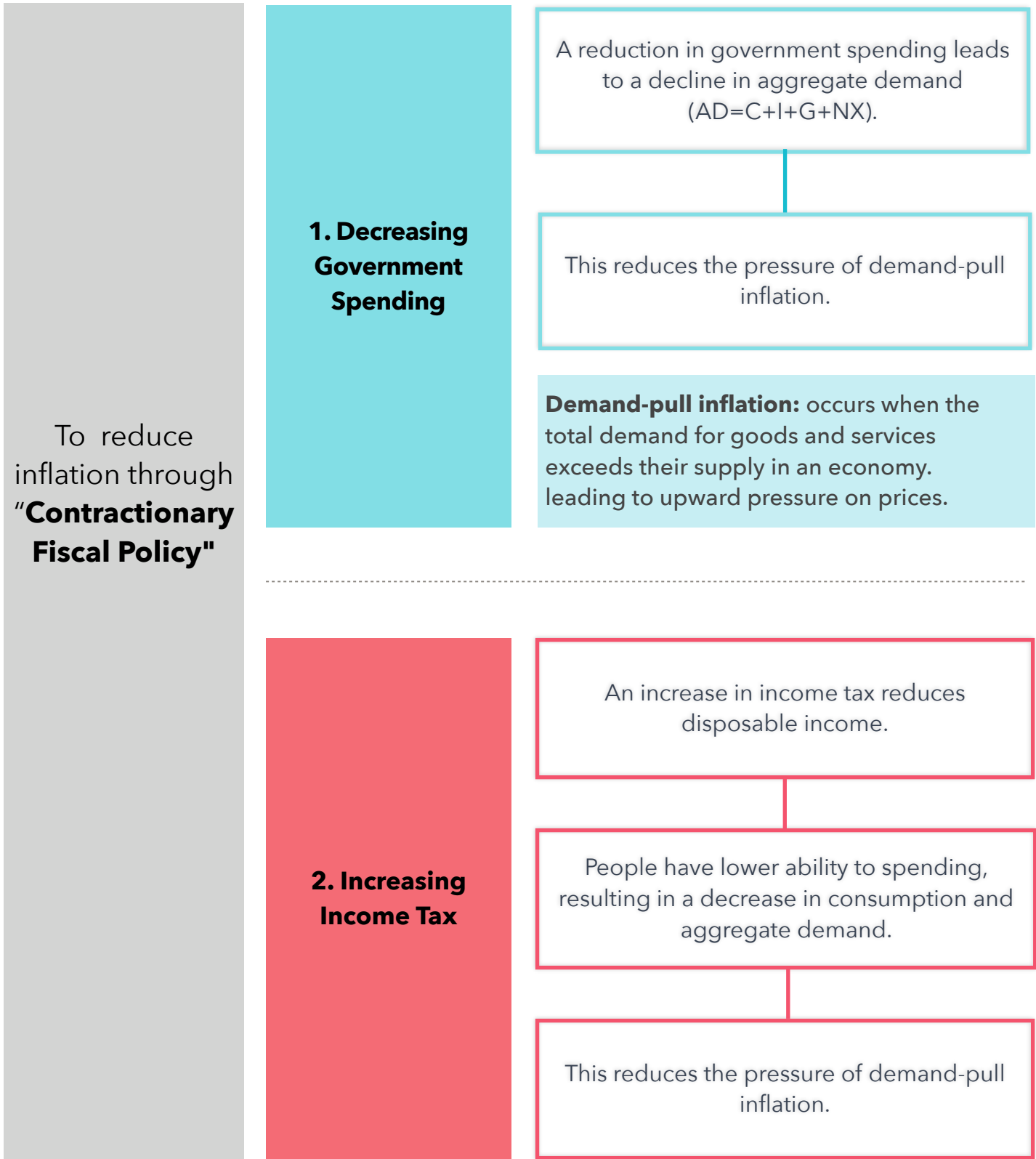


Aggregate demand(AD) : total spending in an economy
 $AD = \text{Consumption} + \text{Investment} + \text{Government spending} + (\text{Exports} - \text{Imports})$

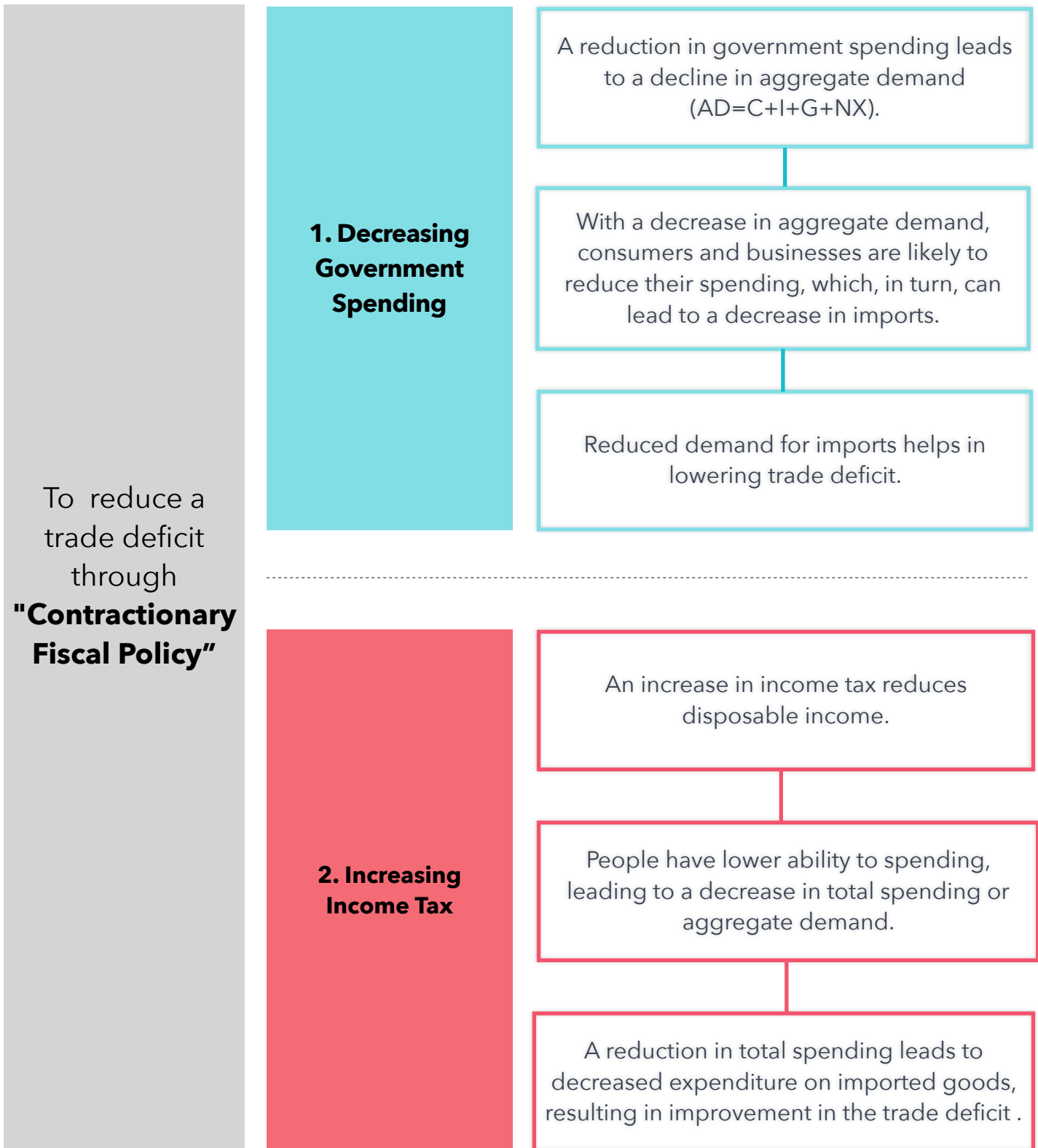
6. Effect of fiscal policy on macroeconomic aims



6. Effect of fiscal policy on macroeconomic aims



6. Effect of fiscal policy on macroeconomic aims



Key takeaways

- A budget deficit (Government spending > Tax revenue) \neq a trade deficit (Imports > Exports).
 - VAT (Value Added Tax) is a regressive tax, while income tax is progressive.
 - Expansionary Fiscal Policy: When the government increases spending and reduces taxes to boost aggregate demand (AD), leading to higher economic growth and increased employment.
 - Contractionary Fiscal Policy: When the government decreases spending and increases taxes to reduce aggregate demand (AD), resulting in reduced inflation and a smaller trade deficit, leading to stability in the balance of payments.
-

CHAPTER 27

MONETARY POLICY

Checklist

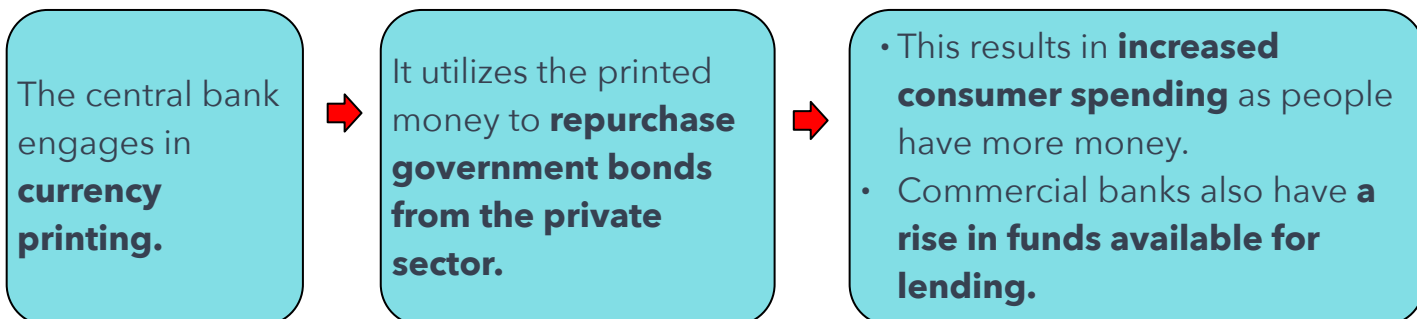
1. Money supply and monetary policy measures
2. Effects of monetary policy on macroeconomic aims

1. Money supply and monetary policy measure

Money supply : all money in an economy including coins, banknotes and bank deposit.

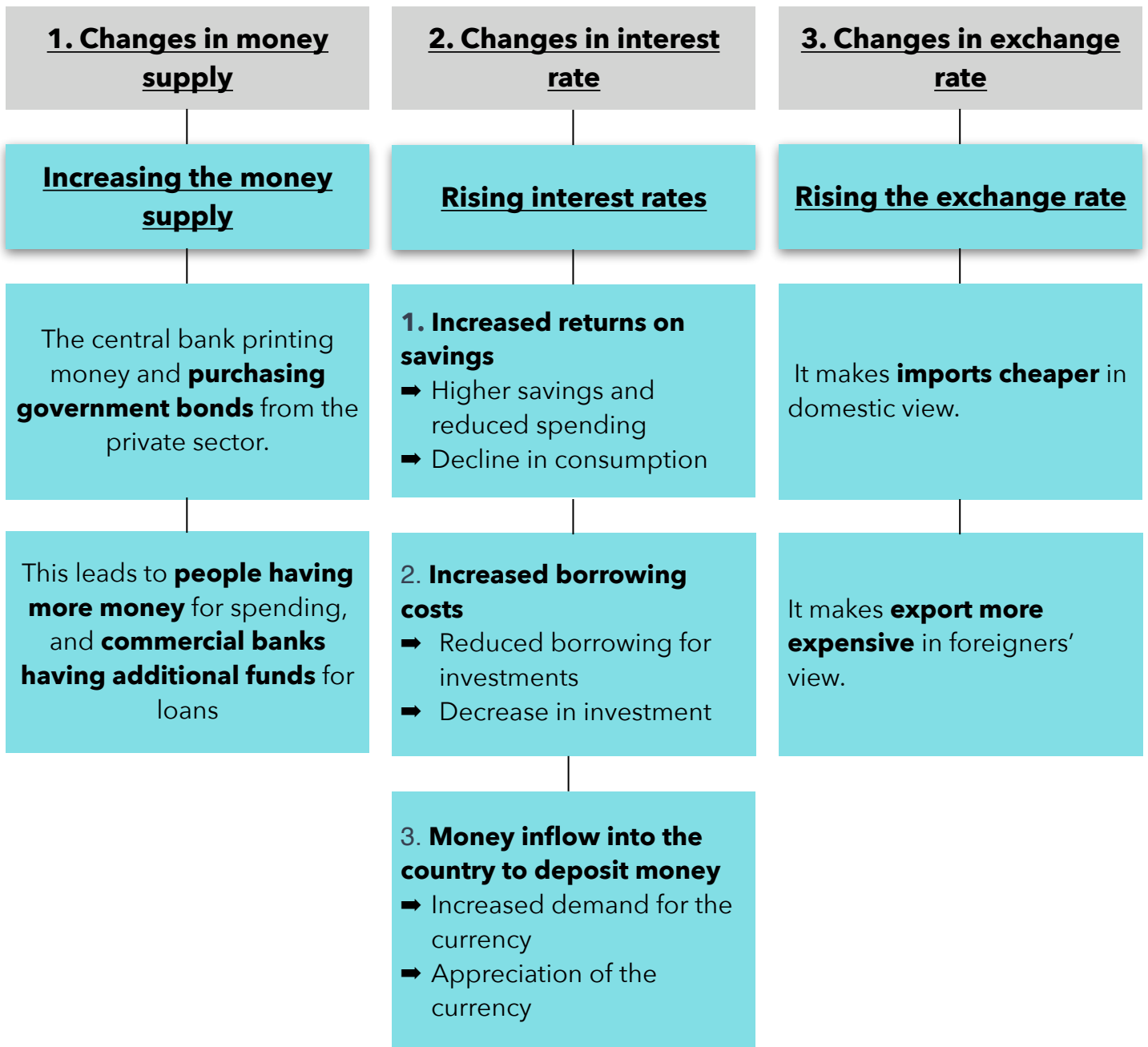
How can central bank manage the money supply

To boost the money supply:



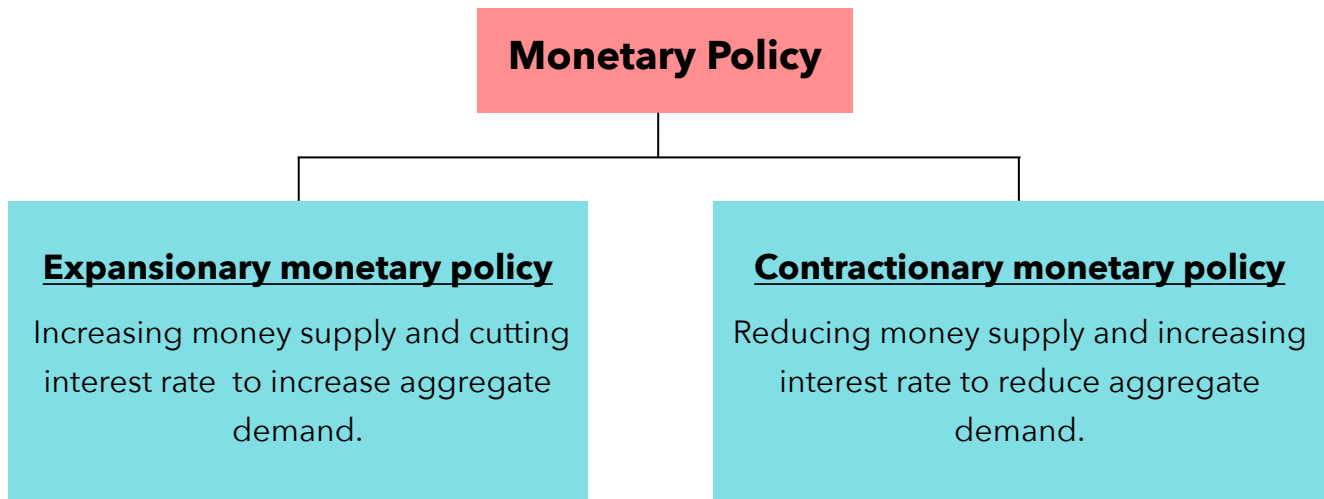
Monetary policy measure

Monetary policy : Policies to control AD and inflation rate by changing money supply, the rate of interest and the exchange rate to influence aggregate demand.



Monetary policy measure

Monetary policy : changing money supply, the rate of interest and the exchange rate to influence aggregate demand and inflation rate.



Aggregate demand(AD) : total spending in an economy
 $AD = \text{Consumption} + \text{Investment} + \text{Government spending} + (\text{Exports} - \text{Imports})$

2. Effects of monetary policy on macroeconomic aims

To stimulate employment and foster economic growth through
“Expansionary monetary policy”

1. Reducing interest rate

People tend to boost spending instead of saving due to a fall in returns on savings
 ➔ This leads to a rise in consumption.

Businesses have lower cost of borrowing, tend to borrow more for investments.
 ➔ This leads to an rise in investment.

The aggregate demand ($AD=C+I+G+NX$) increases, leading to a rise in production and employment. This, in turn, fosters an increase in economic growth.

Economic growth : the increase in a country's production of goods and services over time.

2. Increasing money supply

When individuals have increased income, they tend to spend more.
 ➔ This leads to an rise in consumption.

Commercial banks can increase lending, investments in the economy rise.
 ➔ This leads to an increase in investment.

This contributes to an increase in aggregate demand (AD), leading to increased production and employment. Ultimately, this supports higher economic growth.

2. Effects of monetary policy on macroeconomic aims

To reduce inflation through "Contractionary monetary Policy"

1. Increasing interest rate

People would like to save more money as the returns on savings increase, leading to a fall in consumer spending.

Businesses, facing higher borrowing costs, reduce their borrowing for investments.

The reduction in consumer spending and business investment contributes to a decline in Aggregate Demand ($AD = C+I+G+NX$). This reduces the pressure of demand-pull inflation.

Demand-pull inflation: occurs when the total demand for goods and services exceeds their supply in an economy.

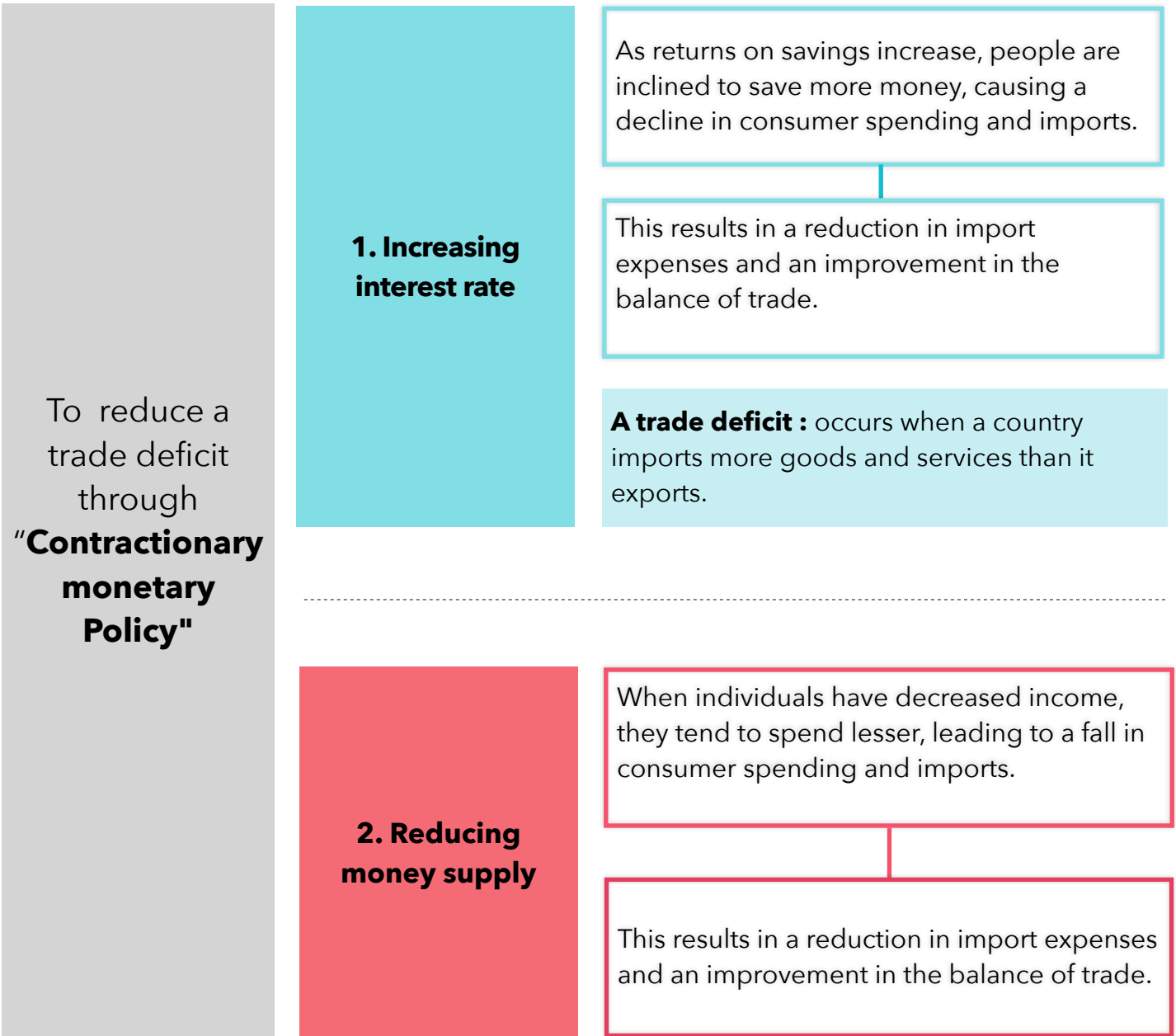
2. Reducing money supply

When individuals have decreased income, they tend to spend lesser, leading to a fall in consumption

When commercial banks have lesser fund for making loans, it results in a fall in investments.

The reduction in consumer spending and business investment contributes to a decline in Aggregate Demand ($AD = C+I+G+NX$). This reduces the pressure of demand-pull inflation.

2. Effects of monetary policy on macroeconomic aims



Key takeaways

- **Economic growth** : an increase in national income and output or an increase in productive potential of an economy over time.
- **A trade deficit** : occurs when a country imports more goods and services than it exports.
- **Demand-pull inflation**: occurs when the total demand for goods and services exceeds their supply in an economy. This can lead to an increase in the price level.
- **Expansionary Monetary Policy**: increasing money supply and cutting interest rate to increase aggregate demand (AD). This leads to "higher economic growth" and "high employment."
- **Contractionary Monetary Policy**: Reducing money supply and increasing interest rate to reduce aggregate demand (AD). This leads to "reduced inflation" and "a reduced trade deficit, resulting in stability in the balance of payments."

CHAPTER 28 SUPPLY-SIDE POLICY

Checklist

1. Supply-side policy measures
2. Effects of supply-side policy on macroeconomic aims

1. Supply-side policy measure

Supply side policies : policies to increase productive potential of an country or aggregate supply.

Supply side policies measures

Education and training

Enhancing the skills and productivity of workers leads to increased national outputs.

Cut in income tax

Reducing income tax creates motivation to work, encouraging people to contribute more to the workforce and resulting in an increase in output.

Cut in corporate tax

Lowering corporate taxes boosts the motivation for businesses to invest and expand, leading to increased overall outputs.

Deregulation

Deregulation lowers barriers and costs to entering the market, leading to an increased supply of products.

Control power of trade union & industrial action

Limiting the influence of trade unions and industrial actions encourages firms to hire more workers and expand their businesses.

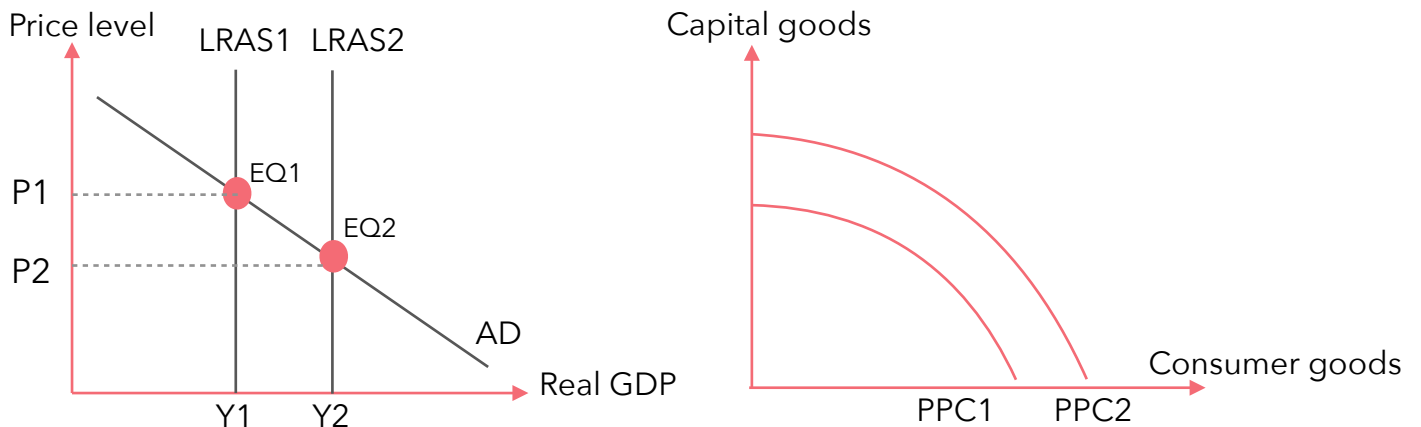
Subsidies

Providing subsidies to firms lowers their costs, leading to an increase in the supply of products.

2. Effects of Supply-side policy on macroeconomic

<p>To stimulate employment and foster economic growth through “ Supply-side policy”</p>	<p>1. Education and training</p>	<p>Education enhances the skills and productivity of the workforce, enabling workers to produce more goods and services.</p> <ul style="list-style-type: none"> ➔ This leads to increased employment and productive potential of an economy.
	<p>2. Cut in income tax</p>	<p>A reduction in income tax increases the incentive to work.</p> <ul style="list-style-type: none"> ➔ This results in the creation of more outputs. ➔ Consequently, it contributes to higher national income and output or economic growth.
	<p>3. Providing subsidy</p>	<p>Producers can utilize subsidies to invest in machines.</p> <ul style="list-style-type: none"> ➔ This investment lowers the cost of production and boosts the supply of outputs. ➔ Consequently, it contributes to higher national income and output and employment .

Economic growth : the increase in a country's production of goods and services over time.



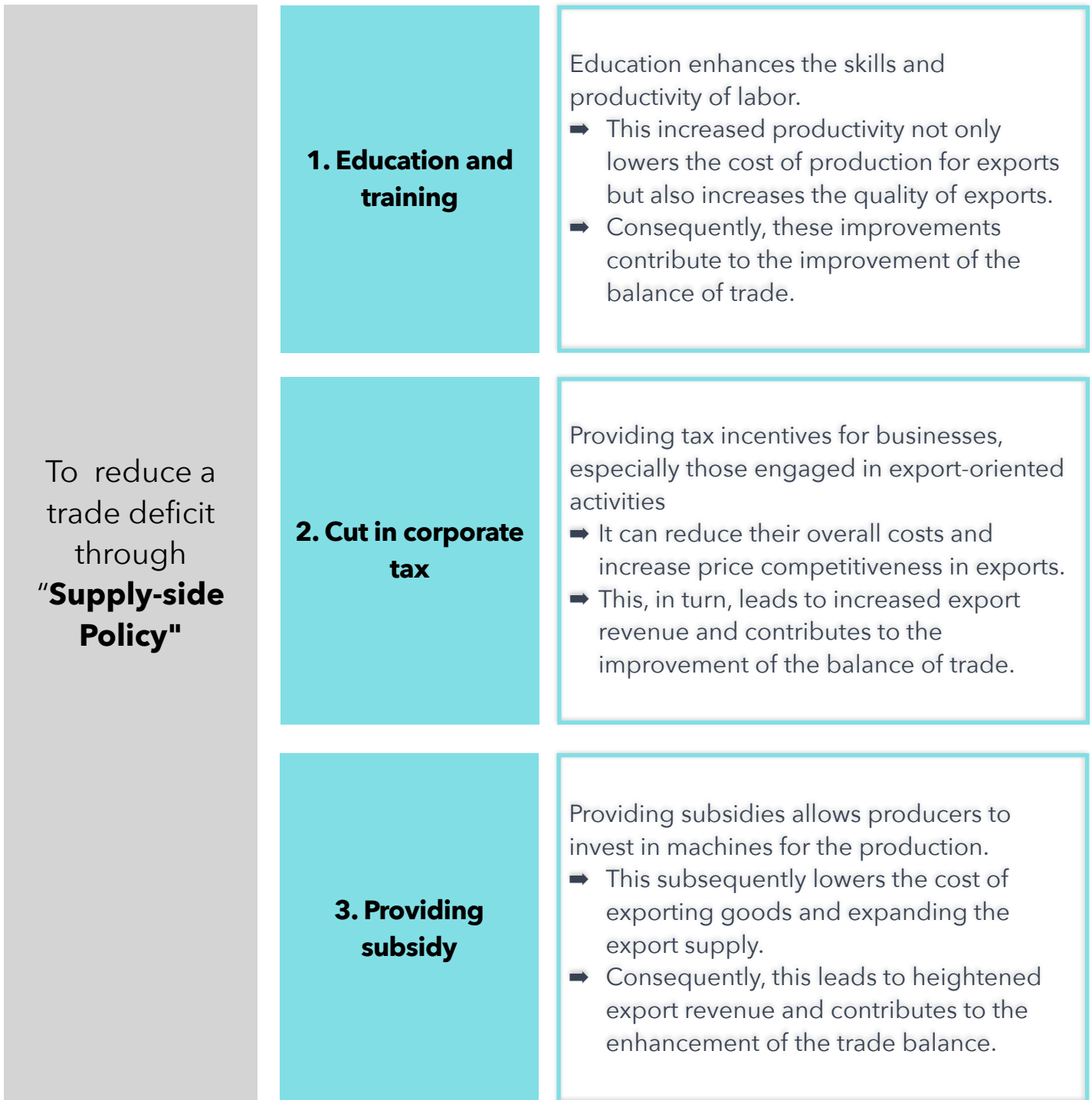
No part of this resource may be reproduced, distributed, or transmitted in any form by any means for non-personal use without the prior written permission from Knockout.Economics

2. Effects of Supply-side policy on macroeconomic



Inflation: the sustained increase in the general price level of goods and services in an economy over a period of time.

2. Effect of supply-side policy on macroeconomic



A trade deficit : occurs when a country imports more goods and services than it exports.

3. Summary of supply-side policy to achieve

Supply-side policy achieve government aims	
<p>Supply-side policy:</p> <ul style="list-style-type: none"> • education • cutting income tax • cutting corporate tax • deregulation • control power of trade union & industrial action • subsidies 	<p>High economic growth (It increases national output)</p>
	<p>High employment (It increases production and employment)</p>
	<p>Low inflation (It increases productivity and reduces cost of production and price level)</p>
	<p>Balance of payment stability (It reduces prices of export and increases export competitiveness)</p>

Key takeaways

- **Supply side policies** : policies to increase productive potential of an country or aggregate supply.
- **Supply side policy measure;** education and training, cutting income tax, cutting corporate tax, deregulation, control power of trade union & industrial action and subsidies

CHAPTER 29

ECONOMIC GROWTH

Checklist

1. Definition of economic growth
2. Measurement of economic growth
3. Causes and effects of recession
4. Causes and effects of economic growth
5. Policies to promote economic growth

1. Definition of economic growth

Economic growth: An increase in national income and output or an increase in GDP. An increase in productive potential of an economy over the period of time.

Gross Domestic Product(GDP): the total value of output produced in a country in a year

2. Measurement of economic growth

1. **Gross Domestic Product (GDP)** : the total value of output produced in a country in a year
2. **Nominal GDP** : Money GDP or GDP at current price. It is not adjusted for inflation
3. **Real GDP** : GDP at constant price or adjusted for inflation

$$\text{Real GDP}_{2024} = \text{Nominal GDP}_{2024} \times \frac{\text{Price index}_{\text{base year}}(100)}{\text{Price index}_{2024}}$$

4. **Real GDP per head** : Real GDP divided by population

$$\text{Real GDP per head}_{2024} = \frac{\text{Real GDP}_{2024}}{\text{Population}_{2024}}$$

5. **Economic growth** : The percentage change in GDP on a year earlier

$$\text{Economic Growth}_{2024} = \frac{\text{GDP}_{2024} - \text{GDP}_{2023}}{\text{GDP}_{2023}} \times 100$$

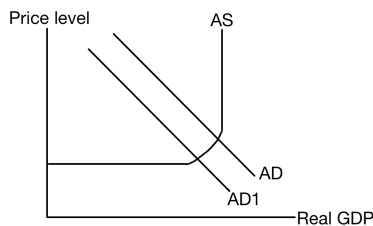
3. Causes and effects of recession

Recession : a negative economic growth or a decline in GDP for two or more consecutive quarters

Causes of recession

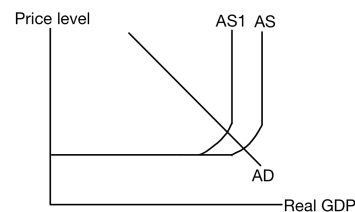
1. A decrease in aggregate demand(AD)

➔ When there is a decline in AD, such as reducing consumers and businesses spending, it leads to a decrease in aggregate demand for goods and services, which can trigger a recession.



2. A decrease in aggregate supply(AS)

➔ A rise in production costs, like increasing prices of oil and raw materials, reduces firms' profit. This can lead to a contraction in Gross Domestic Product (GDP) and potentially cause a recession.



Effects of recession

- Diminished National Output:** The overall economic production experiences a decline.
- Increased Unemployment:** A consequential effect is a notable increase in unemployment rates, impacting individuals and communities.
- Reduced Living Standards:** The decline in both income and output contributes to a reduction in living standards for many individuals and households.
- Government Budget Deficit:** The increased unemployment during a recession can result in a government budget deficit due to reduced tax revenue and increased spending on unemployment benefits.
- Decrease in Price Level:** As Aggregate Demand (AD) decreases, a subsequent effect is a decline in the general price level.

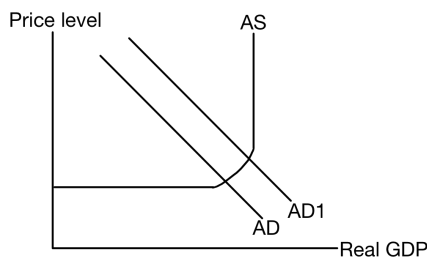
4. Causes and effects of economic growth

Economic growth : An increase in national income and output or an increase in GDP.
An increase in productive potential of an economy over the period of time.

Causes of economic growth

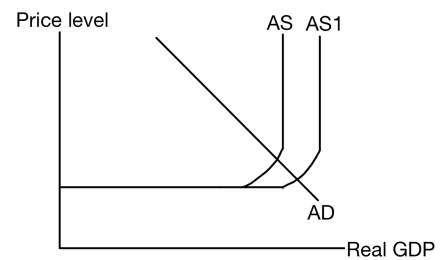
1. A increase in aggregate demand(AD) in the short run

- ➔ $AD = C + I + G + NX$
- ➔ For example, a boost in investment due to high business confidence and a rise in consumption owing to high consumer confidence can increase production, resulting in higher national income, output, or economic growth.



2. A increase in aggregate supply(AS) or productive potential of an economy in long run

- ➔ Increased quantity of resources, such as labor immigration and oil discoveries.
- ➔ Enhanced quality of resources, exemplified by improvements in education and training.
- ➔ Technological advancement.
- ➔ These can significantly increase the productive potential of an economy, leading to economic growth.



4. Causes and effects of economic growth

Economic growth : An increase in national income and output or an increase in GDP. An increase in productive potential of an economy over the period of time.

Effects of economic growth

Positive effects of economic growth

- 1. Improved Living Standards:** Economic growth leads to increased income and a rise in the standard of living for people.
- 2. Job Creation:** Growing economies generate more employment opportunities.
- 3. Increased Investments:** Economic growth attracts more investments, both domestic and foreign.
- 4. Higher Government Revenues:** A growing economy results in increased tax revenues for the government, enabling it to invest in public services, education, healthcare, and infrastructure.

Negative effects of economic growth

- 1. Resource Depletion:** The increased demand for resources in a growing economy may lead to the overexploitation of finite resources.
- 2. Income Inequality:** Economic growth may lead to a rise in income inequality.
- 3. Extended Working Hours:** An increase in production may cause workers to work overtime resulting in lower living standards.
- 4. Rising Inflation:** Economic growth could be driven by an increase in aggregate demand (AD), which in turn may contribute to a rise in inflationary pressures.

5. Policies to promote economic growth

Policies to promote economic growth

1. Expansionary fiscal policy

- **A rise in government spending** boosts production, leading to increased national output.
- **Reducing income tax** enhances disposable income and expenditure, resulting in heightened production.

2. Expansionary monetary policy

- **A cut in interest rate** lowers cost of borrowing. As a result, firms world like to borrow money to invest in capital, contributing to an expansion in the productive capacity of the economy.

3. Supply side policy

- **Education and training** improves skills of workers, contributing to an increase in the country's productivity.
- **Subsidies** decrease costs for firms and encourage business expansion, contributing to higher national output and economic growth.

Constraints of Economic Growth Promotion Policies:

- 1. Dependency on Confidence:** The success of fiscal and monetary policies hinges on the confidence of consumers and businesses in the economy's outlook. When confidence is lacking, individuals tend to reduce spending, even if the government reduces income taxes to stimulate economic growth.
- 2. Opportunity Costs of Government Spending:** Government spending for economic growth entails sacrificing other potential uses of resources, known as opportunity costs.
- 3. Scale Dependency:** The impact of policies is influenced by their magnitude; for instance, a slight interest rate reductions may yield limited effects on increasing economic growth.
- 4. Quality of Education:** The efficacy of education in fostering economic growth is tied to its quality; better education tends to have a more significant impact on economic growth and economic development.

Key takeaways

- **Economic Growth:** An increase in national income, output, or GDP, reflecting the growth in the productive potential of an economy over time.
- **Gross Domestic Product (GDP):** The total value of output produced in a country within a year.
- **Nominal GDP:** Also known as Money GDP or GDP at the current price. It is not adjusted for inflation.
- **Real GDP:** GDP at a constant price or adjusted for inflation.
- **Real GDP per Head:** Real GDP divided by the population.
- **Economic Growth:** The percentage change in GDP from the previous year.
- **Recession:** A period of negative economic growth or a decline in GDP for two or more consecutive quarters.
- **Causes of Economic Growth:** An increase in aggregate demand and a rise in aggregate supply.
- **Positive Effects of Economic Growth:** Improved living standards, job creation, increased investments, and higher government revenues.
- **Negative Effects of Economic Growth:** Resource depletion, income inequality, extended working hours, and rising inflation.

CHAPTER 30

EMPLOYMENT AND UNEMPLOYMENT

Checklist

1. Definition of employment, unemployment and full employment
2. Changing patterns and level of employment
3. Measurement of unemployment
4. Causes of unemployment
5. Effects of unemployment
6. Policies to reduce unemployment

1. Definition of employment, unemployment and full employment

Employment: Individuals who are both willing and able to work, and they get jobs.

Unemployment: Individuals who are willing and able to work but they do not get jobs.

Full employment: When people who are willing and able to work get a job. Unemployment is at its lowest possible rate

Unemployment Rate: The percentage of the workforce that is unemployed.

$$\text{Unemployment Rate} = \frac{\text{Unemployment}}{\text{Labour force (Employed+Unemployed)}} \times 100$$

2. Changing patterns and level of employment

Size of the labour force depends on the size of working age and labour force participation rate.

<p>1. The working-age population is influenced by:</p>	<ul style="list-style-type: none"> • Birth rate : Birth rate ↑ ⇒ working age ↑ • Death rate : Death rate ↑ ⇒ working age ↓ • Net migration : Net immigration ⇒ working age ↑
<p>2. Labour participation rate is influenced by:</p>	<ul style="list-style-type: none"> • Wage Levels: Wage ↑ ⇒ labor force participation ↑ • Employment of Women: Employment of Women ↑ ⇒ labor force participation ↑ • Availability of Child and Elder Care: The child and elder care service ↑ ⇒ labor force participation ↑ • Inclusion of Disabled Individuals: The provision of jobs for disabled individuals ⇒ labor force participation ↑ • Proportion of School Leavers: The number of individuals transitioning from education to employment ↑ ⇒ labor force participation ↑

3. Measurement of unemployment

<p>1. Claimant count</p>	<p>Count those in receipt of unemployment benefits</p>
<p>2. Labour force survey (ILO)</p>	<p>Count unemployed people in a survey</p>

4. Causes of unemployment

Unemployment: Individuals who are willing and able to work but they do not get jobs.

1. Frictional unemployment

Occurs when workers are between jobs

1.1 Casual Unemployment

When workers experience periods of unemployment between periods of employment such as actors and home builder.

1.2 Seasonal Unemployment

When workers face reduced demand during specific times of the year, such as in the tourism sector.

2. Structural Unemployment

Arises from a decline in industries and specific occupations due to long-term changes in demand and supply.

2.1 Regional Unemployment

Involves a decrease in job opportunities in a particular geographic area.

2.3 Technological Unemployment

Occurs when workers are replaced by machines such as ATM, CCTV and robot in the factory.

3. Cyclical Unemployment

Occurs during economic recessions when there is a lack of aggregate demand. In such times, the demand for labor is likely to decrease.

5. Effects of unemployment

Unemployment: Individuals who are willing and able to work but they do not get jobs.

Effects of unemployment

Positive effects of unemployment

1. **High unemployment tends to lower inflation.** An abundance of available workers drives down wages offered by firms, reducing production costs and, subsequently, the prices of goods and services.
2. **High unemployment decreases spending on imported goods.** Thereby it improves the trade balance.
3. **Frictional unemployment can result in wage increases.** As workers transition between jobs, they often negotiate higher wages, leading to an enhancement in their living standards.

Negative effects of unemployment

1. **Unemployed individuals face reduced income.** They may experience lower living standards.
2. **Firms experience decreased profits.** This is because of reduced consumer spending resulting from unemployment.
3. **Resources are inefficiently utilized.** As labor remains underutilized, leading to lower national output.
4. **The nation experiences a decrease in national income and output** due to reduced productivity.
5. **The government faces lower tax revenue and increased expenses on unemployment benefits** as a result of higher unemployment rates.

6. Policies to reduce unemployment

Unemployment: Individuals who are willing and able to work but they do not get jobs.

Policies to reduce unemployment

1. To reduce frictional unemployment through supply-side policy:

- **Reduce income tax:** This increases workers' disposable income, incentivizing them to seek employment.
- **Cut unemployed benefits:** This increases the incentive for individuals to actively search for new jobs.

2. To reduce structural unemployment through supply-side policy:

- **Provide education and training:** Offering education and training programs equips unemployed individuals with new skills, facilitating their transition into new jobs.
- **Offer subsidies to industries in areas with high unemployment:** This encourages firms to create jobs in those regions, benefiting the local workforce.

3. To reduce cyclical unemployment through expansionary fiscal and monetary policy:

- **Increase government spending:** This boosts aggregate demand (AD), prompting firms to increase production and employment.
- **Reduce income tax:** This boosts consumer spending, leading to increased demand for goods and services and subsequent job creation.
- **Lower interest rates:** This encourages consumer spending and business investment, stimulating aggregate demand and reducing unemployment.

6. Policies to reduce unemployment

Constraints of Unemployment Reduction Policies:

1. **Education Quality Dependency:** Policy effectiveness relies on education quality, which varies and affects outcomes.
2. **Potential for Inflation:** Policies boosting aggregate demand may cause inflation if not managed properly.
3. **Confidence Dependence:** Success depends on consumer and business confidence levels, impacting their ability to stimulate economic activity.
4. **Opportunity Costs:** Government spending on these policies carries opportunity costs, potentially limiting their effectiveness.

Key takeaways

- **Employment:** Individuals who are both willing and able to work, and they get jobs.
- **Unemployment:** Individuals who are willing and able to work but they do not get jobs.
- **Full employment:** When people who are willing and able to work get a job. Unemployment is at its lowest possible rate
- **Unemployment Rate:** The percentage of the workforce that is unemployed.
- **Measurement of unemployment:** Claimant count and Labour force survey (ILO)
- **Causes of unemployment:** From frictional unemployment (e.g., workers are between jobs), structural unemployment (e.g., regional unemployment and technological unemployment), and cyclical fluctuations (e.g., economic recessions)
- **Effects of unemployment:** Include economic consequences such as reduced consumer spending, decreased firms' profits, lower productivity, decreased government's tax revenue and psychological impacts like stress and decreased well-being.
- **Policies to reduce unemployment:** include expansionary fiscal and monetary policies designed to boost aggregate demand, thereby generating job opportunities. Additionally, supply-side strategies involve investments in education and training programs, along with subsidies, to enhance workforce skills and productivity.

CHAPTER 31

INFLATION AND DEFLATION

Checklist

1. Definition of inflation and deflation
2. Measurement of inflation and deflation
3. Causes of inflation and deflation
4. Effects of inflation and deflation
5. Policies to control inflation and deflation

1. Definition of inflation deflation and deflation

Inflation: a general and sustained rise in price of goods and services over a period of time.

Deflation: a general and sustained fall in price of goods and services over a period of time.

Disinflation: a fall in the rate of inflation.

2. Measurement of inflation and deflation

Consumer price Index (CPI) : a measure of the weighted average of the prices of a representative basket of goods and services

Basket of goods	Weight income	Price changes	Weighted price index
Food	0.4	105	42
Housing	0.2	100	20
Transport	0.3	95	28.5
Entertainment	0.1	105	10.5
CPI	1.00		<u>101</u>

Constructing CPI

- Selecting a Base Year:** Choose a reference year against which future price changes will be compared.
- Basket Selection:** Determine the products and services to include in the basket based on typical household spending patterns.
- Price Change Calculation:** Gather price data for each item in the basket and calculate the percentage change in prices from the base year.
- Weighted Spending Calculation:** Assign weights to each item based on their share of household spending.
- Constructing the Weighted Price Index:** Multiply the weighted spending for each item by the percentage change in price and sum these values.

6. **Inflation Calculation** =
$$\frac{CPI\ of\ the\ year - CPI\ of\ base\ year}{CPI\ of\ base\ year} \times 100$$

$$\text{Inflation rate} = \frac{CPI\ year - CPI\ base\ year}{CPI\ base\ year} \times 100$$

3. Causes of inflation and deflation

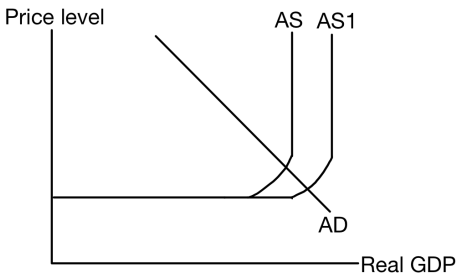
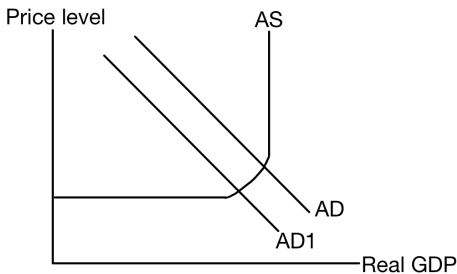
Inflation: a general and sustained rise in price of goods and services over a period of time.

Causes of inflation		
1. Cost push inflation	2. Demand pull inflation	3. Monetary inflation
<ul style="list-style-type: none"> When the cost of production increases, compelling firms to maintain their profits by raising the prices of their products. 	<ul style="list-style-type: none"> When aggregate demand rises and aggregate supply cannot increase at the same rate as the rise in aggregate demand, prices of goods and services increase. 	<ul style="list-style-type: none"> Monetarists argue that inflation is primarily caused by an increase in the money supply that exceeds the growth of output.
<ul style="list-style-type: none"> For instance, increases in the cost of raw materials, wages, indirect taxes, and capital expenses can all contribute to cost-push inflation 	<ul style="list-style-type: none"> For example, a rise in consumption, higher investment, increased government spending, or higher net exports all contribute to an increase in aggregate demand 	<ul style="list-style-type: none"> For example, when the money supply increases, people tend to spend more, which in turn leads to an increase in prices.
<p>The diagram shows a downward-sloping aggregate demand curve (AD) and two vertical aggregate supply curves. The initial equilibrium is at the intersection of AD and AS1. A rightward shift to AS2 (labeled AS) moves the equilibrium to a higher price level and lower real GDP.</p>	<p>The diagram shows a vertical aggregate supply curve (AS) and two downward-sloping aggregate demand curves. The initial equilibrium is at the intersection of AS and AD. A rightward shift to AD1 moves the equilibrium to a higher price level and higher real GDP.</p>	<p>The diagram shows a vertical aggregate supply curve (AS) and two downward-sloping aggregate demand curves. The initial equilibrium is at the intersection of AS and AD. A rightward shift to AD1 moves the equilibrium to a higher price level and higher real GDP.</p>

3. Causes of inflation and deflation

Deflation: a general and sustained fall in price of goods and services over a period of time.

Causes of deflation

Supply-side (Good deflation)	Demand-side (bad deflation)
<ul style="list-style-type: none"> • Where improvements in efficiency and lower production costs result in a decrease in the price level, contributing to overall deflation. 	<ul style="list-style-type: none"> • A reduction in aggregate demand ($AD = C + I + G + NX$) leads to lower price levels and deflation."
<ul style="list-style-type: none"> • For example, technological advancements and increased labor productivity, which lead to higher output per worker over a given time period, can contribute to 'good deflation' by reducing production costs. 	<ul style="list-style-type: none"> • For example, lower consumption, reduced investment, decreased government spending, or lower net exports all lead to a decrease in aggregate demand.
 <ul style="list-style-type: none"> • Lower price • Higher real GDP • Higher employment 	 <ul style="list-style-type: none"> • Lower price • Lower real GDP • Lower employment

4. Effects of inflation and deflation

Inflation: a general and sustained rise in price of goods and services over a period of time.

Effects of Inflation

Harmful effects of inflation

1. **Consumers** suffer reduced purchasing power and living standards.
2. **Fixed-income earners** face declining real income due to inflation.
3. **Producers** encounter higher production costs, resulting in lower profits. Also, they face menu costs (the cost of changing prices in catalogs) and shoe-leather costs (the cost of increased effort in finding lower-priced goods).
4. **Multinational corporations (MNCs)** may be discouraged from investing in countries with high inflation due to increased uncertainty.
5. **Taxpayers** bear higher indirect taxes as product prices rise.
6. **Savers** receive a lower real interest rate or real return on their savings. (Real interest rate = Nominal interest rate - Inflation rate)
7. **The current account balance** can deteriorate when a country's inflation rate is relatively higher than that of its competitors. This can make exports less competitive while making imports cheaper than domestic goods, leading to lower export revenue and higher import expenses.

Beneficial effects of inflation

1. **Demand-pull inflation**, which results from increasing national output and employment, can be considered "good" inflation as it stimulates economic growth.
2. **Producers** may experience higher revenue if inflation is driven by increased spending or demand-pull factors.
3. **Governments and borrowers** benefit from lower real debt or borrowing costs when prices rise, as it reduces the real burden of debt. (Real interest rate = Nominal interest rate - Inflation)
4. **The current account balance** may not worsen if the inflation rate in a country remains lower than that of rival countries. In such cases, inflation may not negatively impact international competitiveness.

4. Effects of inflation and deflation

Deflation: a general and sustained fall in price of goods and services over a period of time.

Effects of Deflation

Harmful effects of deflation

1. **Bad deflation** stems from a decrease in aggregate demand, leading to declines in domestic production, employment, and economic growth.
2. **Deflation can trigger economic recession** as consumers postpone purchases in anticipation of further price drops, reducing spending and production.
3. **Producers and multinational corporations** may be discouraged from investing when deflation results from decreased AD or overall spending.
4. **Borrowers and governments** may face higher real debt burdens, as the real interest rate increases with deflation. (Real interest rate = Nominal interest rate + Deflation)

Beneficial effects of deflation

1. **Good deflation** arises from an increase in aggregate supply, such as technological advancements, leading to higher national income and employment.
2. **Consumers** enjoy higher purchasing power, resulting in an improved standard of living.
3. **Savers and lenders** benefit from a higher real interest rate. (Real interest rate = Nominal interest rate + Deflation rate)
4. **The current account** improves as deflation makes exports cheaper for foreigners and imports more expensive than domestic goods. This dynamic increases demand for exports and reduces demand for imported goods.

5. Policies to control inflation and deflation

Inflation: a general and sustained rise in price of goods and services over a period of time.

Policies to reduce demand-pull inflation

1. Contractionary fiscal policy:

- **Decreasing government spending** lowers aggregate demand (AD), reducing demand-pull inflation.
- **Increasing income tax** reduces consumption and AD, further mitigating demand-pull inflation.

2. Contractionary monetary policy:

- **Raising interest rates** incentivizes saving over spending, leading to decreased consumption and AD, thereby reducing demand-pull inflation.

Limitations of contractionary fiscal and monetary policies to reduce demand-pull inflation:

- **Dependency on consumer and business confidence:** The effectiveness of these policies relies on confidence levels. For instance, even with interest rate hikes, high confidence may lead people to spend more, limiting their impact on curbing inflation.
- **Policy size matters:** The magnitude of these policies is crucial. A small increase in interest rates may have limited impact on reducing aggregate demand (AD), potentially resulting in little decrease in the inflation rate.

5. Policies to control inflation and deflation

Inflation: a general and sustained rise in price of goods and services over a period of time.

Policies to reduce cost push inflation

1. Supply-side policy:

- **Investing in education and training** enhances labor productivity, which in turn lowers production costs and reduces prices for goods.
- **Deregulation** lowers costs for firms, allowing them to increase output supply at lower prices.
- **Encouraging competition** in markets through antitrust regulations and promoting market entry by new firms can prevent monopolistic pricing behavior, helping to keep prices down and mitigate cost-push inflation.

Limitations of supply-side policies to reduce cost-push inflation:

- **Poor quality of education** may limit the effectiveness of efforts to improve labor productivity.
- **Supply-side policies often have a time lag**, with the effects of measures such as education improvements being realized in the long run rather than immediately.
- **Certain policies, like government spending on education, may inadvertently increase aggregate demand**, potentially contributing to demand-pull inflation alongside efforts to reduce cost-push inflation.

5. Policies to control inflation and deflation

Deflation: a general and sustained fall in price of goods and services over a period of time.

Policies to counter deflation caused by falling aggregate demand

1. Expansionary fiscal policy:

- **Reduction in income tax** increases consumers' disposable income, stimulating spending, higher consumption, and demand-pull inflation.
- **Government increases spending**, boosting aggregate demand (AD), and contributing to demand-pull inflation.

1. Expansionary monetary policy:

- **Decrease in interest rates** incentivizes spending over saving, leading to higher consumption and AD.
- **Lower interest rates** encourage firms to borrow money for investment, increasing AD.

Limitations of policies to counter deflation caused by falling aggregate demand:

- **Dependency on consumer confidence:** The effectiveness of reducing income tax to boost aggregate demand depends on consumer confidence. If confidence is low, people may choose to save rather than spend, limiting the impact of increasing AD and price level.
- **Policy size matters:** The effectiveness of policies, such as cuts in interest rates, in increasing aggregate demand depends on their scale. Small adjustments may have limited impacts on boosting AD, particularly in challenging economic conditions.

Key takeaways

- **Inflation:** a general and sustained rise in price of goods and services over a period of time.
- **Deflation:** a general and sustained fall in price of goods and services over a period of time.
- **Disinflation:** a fall in the rate of inflation.
- **Consumer Price Index (CPI):** A measure of inflation that tracks the changes in the prices of a basket of goods and services commonly purchased by households.
- **Causes of Inflation:** Can include factors such as increased aggregate demand, cost-push pressures from rising production costs, and money supply growth.
- **Causes of Deflation:** Can stem from decreased aggregate demand and supply-side factors like increased productivity
- **Effects of Inflation:** Can include reduced purchasing power, redistribution of income and wealth, uncertainty in financial planning, and potential impacts on international trade competitiveness.
- **Effects of Deflation:** Can include increased real debt burdens, reduced consumer spending, potential delays in consumption, and increased risk of economic recession.
- **Policies to Reduce Inflation:** May include contractionary fiscal and monetary policies aimed at reducing aggregate demand, supply-side policies to increase productivity and lower production costs, and price controls.
- **Policies to Reduce Deflation:** May involve expansionary fiscal and monetary policies to boost aggregate demand and supply-side policies to stimulate investment and consumer spending.

CHAPTER 32

LIVING STANDARD

Checklist

1. Indicators of living standards
2. Comparing living standards and income distribution

1. Indicators of living standards

Living standards: refer to the overall quality of life enjoyed by individuals or groups within a society.

Living standards encompass a range of factors, including access to basic needs like food, shelter, and healthcare, as well as factors like education, employment opportunities, income levels, and access to amenities and services.

Indicators of living standards

1. Human Development Index (HDI),

which assesses the standard of living based on income, education, and health.

- **Income:** Measured by real GDP per capita (real income per person).
- **Education:** Assessed by mean years of schooling (average education years for individuals aged 25 and above).
- **Health:** Evaluated through life expectancy.

1. Indicators of living standards

Indicators of living standards

2. Real GDP per capita

calculated as real GDP divided by the population, reflects the average real income per person.

A rise in real GDP per capita indicates improved living standards.

- Increasing real GDP per capita signifies higher average income and more production and employment opportunities.
- With more goods and services available, consumers benefit from enhanced living standards.
- Higher tax revenue generated can be allocated to national development projects.

Limitations of real GDP per capita as a measure of living standards:

- Real GDP per capita does not consider income distribution, potentially masking disparities in wealth.
- If real GDP per capita rises due to the production of harmful goods, living standards may not improve.
- The measure overlooks the quality of goods and services, which is crucial for assessing true living standards.
- An increase in real GDP may lead to heightened production and pollution, affecting overall well-being.
- Rising real GDP may be driven by longer working hours, which may not necessarily enhance living standards for individuals.

2. Comparing living standards and income distribution

Purchasing power parity (PPP) serves as an exchange rate used to compare the standard of living between countries.

- It reflects the purchasing power of currencies within their respective countries by considering differences in price levels and relative purchasing power.
 - This approach enables a more accurate comparison of countries' gross domestic product (GDP) per capita and standards of living, adjusting for variations in the cost of living across different countries. As a result, PPP provides a more meaningful basis for international comparisons.
-

Key takeaways

- **Living standards:** refer to the overall quality of life enjoyed by individuals or groups within a society.
- **Indicators of living standards** include the Human Development Index (HDI) and real GDP per capita.
- **Real GDP per capita:** calculated as real GDP divided by the population, reflects the average real income per person.
- **Human Development Index (HDI):** which assesses the standard of living based on income, education, and health.
- **Purchasing power parity (PPP)** is an exchange rate used to compare the standard of living between countries. It provides a more accurate comparison of countries' gross domestic product (GDP) per capita and standards of living by adjusting for variations in the cost of living across different countries.

CHAPTER 33 POVERTY

Checklist

1. Explanation of absolute and relative poverty.
2. Causes of poverty
3. Policies for poverty alleviation
4. Policies for income redistribution.

1. Explanation of absolute and relative poverty

Poverty

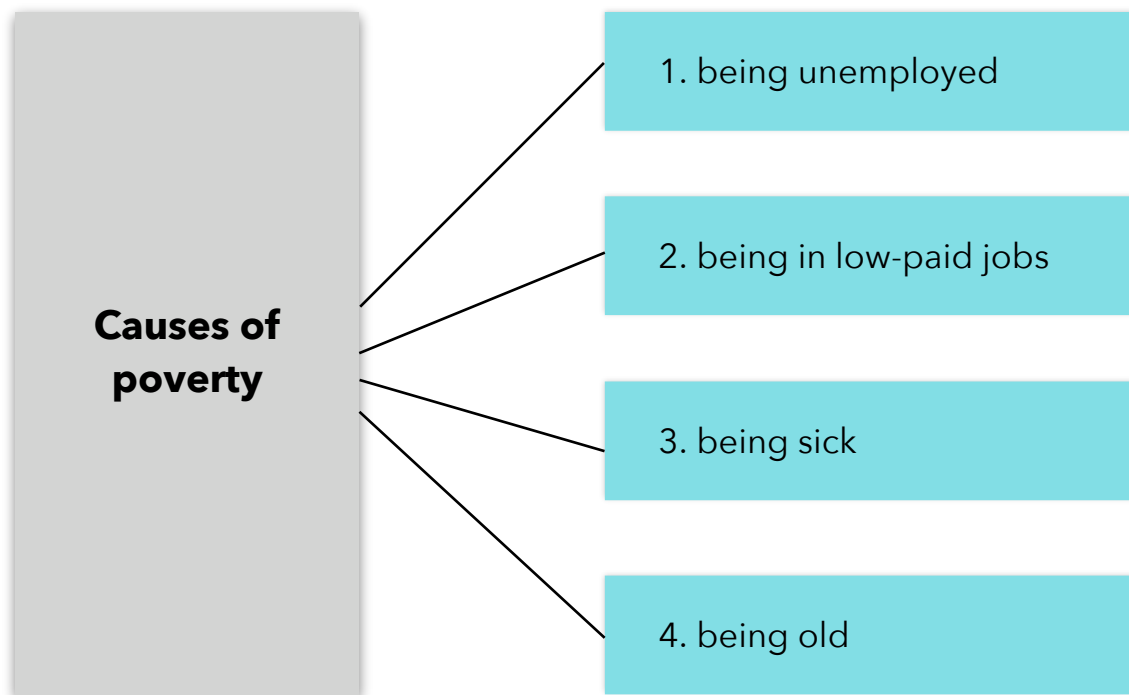
Absolute poverty

- Absolute poverty occurs when individuals do not have enough income to meet basic need such as food, clothing, shelter, and healthcare.
- The extreme poverty line is \$2.15 per person per day (as of September 2022).

Relative poverty

- Relative poverty occurs when individuals have significantly lower income and resources compared to the average standard of living within their country.
- Their income is too low to enable them to enjoy the average standard of living in their country.

2. Causes of poverty



3. Policies for poverty alleviation



4. Policies for income redistribution



Key Takeaways:

- **Absolute poverty** occurs when individuals do not have enough income to meet basic needs such as food, clothing, shelter, and healthcare.
- **Relative poverty** occurs when individuals have significantly lower income and resources compared to the average standard of living within their country.
- **Policies for Poverty Alleviation include:**
 - Imposing direct taxes such as income tax and corporate tax
 - Promoting economic growth to create jobs
 - A rise in minimum wage
 - Encouraging multinational companies to invest in the country
 - Providing benefits such as unemployment benefits
- **Policies for Income Redistribution include:**
 - Imposing direct taxes such as income tax and corporate tax
 - Providing state benefits, e.g., unemployment benefits
 - Providing education and healthcare
 - Implementing a rise in the minimum wage

CHAPTER 34 POPULATION

Checklist

1. Factors influencing population growth
2. Factors contributing to different rates of population growth across countries
3. Impact of population size and structure changes on different countries
4. The effects of an increase in population
5. The effects of an aging population
6. The effects of net emigration

1. Factors influencing population growth

Factors influencing population growth	1. Birth Rate	the number of births in a year per 1,000 population in a year. Birth rate rises => Population rises Birth rate falls => Population falls
	2. Death rate	The number of deaths in a year per 1000 population in a year Death rate rises => Population falls Death rate falls => Population rises
	3. Net migration	The difference between immigration and emigration Net immigration Immigration > emigration => Population rises Net emigration Emigration > immigration => Population falls

2. Factors contributing to different rates of population growth across countries

Factors contributing to high birth rates:

- Early marriages and childbearing among women.
- Lack of access to contraceptives or family planning services.
- Limited education, particularly among women.
- High infant mortality rates, leading to a desire for larger families.
- Government policies or programs that encourage or incentivize childbearing.

Factors contributing to a low death rate include:

- Healthy diets and lifestyles among the population.
- Adequate housing facilities and access to quality healthcare services.

Factors contributing to immigration include:

- Pursuit of job opportunities: Many migrants, often single and of working age, relocate to find employment opportunities in a new country.
- Desire for improved living standards: Some migrants move to another country in search of better quality of life and living standards.

3. Impact of population size and structure changes on different countries

3.1 A country with high development often exhibits a low birth rate and low death rate, potentially leading to **aging population** challenges.

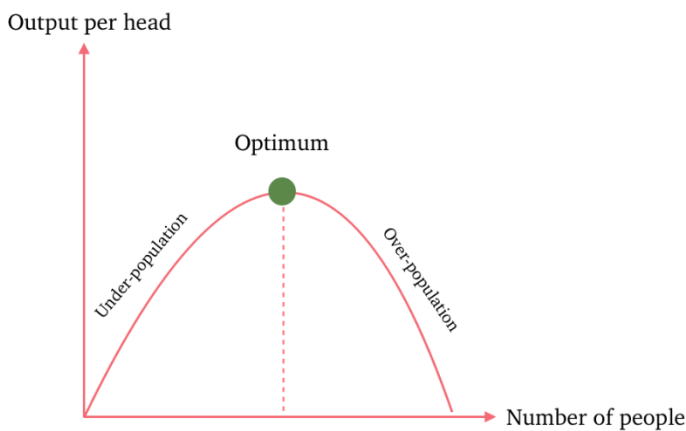
An aging population results from declining birth rates and rising life expectancy, leading to a higher proportion of elderly individuals compared to younger age groups.

3.2 Dependency Ratio:

$$\text{Dependency ratio} = \frac{\text{Number in dependent age groups}}{\text{Number in labour force}} \times 100$$

- Dependent individuals include children and elders.
- A high dependency ratio imposes a heavy tax burden on the working-age population.

3.3 The Optimum Population:



The Optimum Population: This refers to the population size that maximizes national output per capita.

4. The effects of an increase in population

Effects of population growth

Positive effects of population growth

- 1. Increased total spending:** A larger population boosts demand, leading to increased production by firms and higher economic growth.
- 2. Expanded labor supply:** A higher population can provide a larger workforce, potentially enhancing a country's productivity and economic growth.
- 3. Enhanced productivity with educated individuals:** If additional people are well-educated, it can further elevate a country's productivity.

Negative effects of population growth

- 1. Overpopulation:** High population growth can lead to resource scarcity and strains infrastructure.
- 2. Overcrowding:** High population growth may worsen living conditions and urban congestion.
- 3. Limited job opportunities:** High population growth results in fierce labor market competition and higher unemployment rates.
- 4. A higher proportion of dependents, such as elders and children:** High population growth increases the dependency ratio and taxes on the working-age population.
- 5. Resource depletion and environmental degradation:** As the population expands, it leads to increased resource consumption and environmental harm through overexploitation and pollution.

5. The effects of an aging population

An aging population results from declining birth rates and rising life expectancy, leading to a higher proportion of elderly individuals compared to younger age groups.

Effects of aging population

An aging population may not be a significant concern:

- 1. Longer, healthier lives:** An aging population indicates improved healthcare and living standards, resulting in longer lifespans for individuals.
- 2. Valuable experience:** Older adults bring valuable skills and knowledge to the workforce, boosting the economy.
- 3. Productivity of older workers:** Skilled and experienced older workers can remain highly productive.
- 4. Increasing the retirement age:** Allowing elder workers to work longer can increase the labor supply.

Disadvantages of an aging population

- 1. Higher dependency ratio:** An aging population can cause a heavier tax burden on the working-age population.
- 2. Increased government spending on healthcare, welfare services, and pensions:** it diverts funds from other development projects.
- 3. Shortage of necessary skills among older workers:** Older workers lack skills such as computer literacy, leading to decreased national output and income.
- 4. Reduced geographic and occupational mobility:** Older workers are less mobile both geographically and occupationally.

6. The effects of net emigration

Net emigration: occurs when the number of people leaving a country (emigration) exceeds the number of people entering the country (immigration), resulting in a decrease in population.

Effects of net emigration

Positive effects of net emigration

1. **Skill transfer:** Emigrants gain new skills and experiences abroad, which they can then bring back to their home countries, fostering innovation and development.
2. **Remittance inflows:** Emigrants frequently send money back home to support their families, known as workers' remittances.
3. **Positive economic impact:** Emigration can lower unemployment rates and ease strain on social welfare systems in the home country.
4. **Reducing overpopulation problems:** Net emigration can help alleviate issues related to overpopulation.

Negative effects of net emigration

1. **Higher dependency ratio:** Emigrants are likely to be of working age. This causes a higher dependency ratio and tax burden for the remaining workforce in the country.
2. **Loss of skilled labor:** If emigrants are skilled, it reduces the labor supply and productivity of the country.
3. **Economic impact:** A decline in population from net emigration can cause reduced consumer spending, lower tax revenues, and slower economic growth.
4. **Brain drain:** Departure of skilled individuals impedes innovation and development as valuable expertise is lost.
5. **Underpopulation issues and labor underutilization:** Net emigration may worsen underpopulation problems and lead to inefficient use of labor resources.

Key Takeaways:

- **Population growth** is influenced by factors such as birth rate, death rate, and net migration.
- **Developed countries** tend to have lower birth and death rates, potentially leading to aging population issues.
- **Dependency ratio** measures the proportion of dependents to the working-age population.
- **The Optimum Population** refers to the population size that maximizes national output per capita.
- **Aging populations** stem from declining birth rates and increasing life expectancy, leading to a higher average age in the country.
- **Net migration** refers to the difference between the number of immigrants (people moving into a country) and emigrants (people leaving a country) over a specific period.
- **The positive net migration or Net immigration** means that more people are entering a country than leaving, leading to population growth.
- **The negative net migration or Net emigration** means that more people are leaving than entering, resulting in a decrease in population.

CHAPTER 35

DIFFERENCES IN ECONOMIC DEVELOPMENT BETWEEN

Checklist

1. Characteristics of developed and developing countries
2. Causes of differences in economic development between countries
3. Measures to promote economic development

1. Characteristics of developed and developing countries

Economic development refer to an improvement in the economic well-being and quality of life for individuals in a country.

Characteristics of developed countries

(such as the US, UK, Australia and Singapore)

- High income per capita
- Low birth rates
- Low death rates
- Long life expectancies
- High levels of literacy and education provision
- A high proportion of the labor force in the tertiary sector and a low proportion in the primary sector.

Characteristics of developing countries

(such as Thailand, India, Philippines, Nepal)

- Low income per capita
- High birth rates
- High death rates
- Short life expectancy
- Low levels of literacy and education provision
- A high proportion of the labor force in the primary sector and a low proportion in the tertiary sector.

2. Causes of differences in economic development between countries

1. Differences in income per capita:

People in countries with lower GDP per capita tend to have low incomes and suffer from poor living conditions.

2. Differences in saving:

Countries with low incomes tend to have low savings, which leads to a lack of money for investing in capital and education, resulting in low living standards.

3. Differences in investment:

Countries with low investment in capital per worker tend to have low incomes per capita and low living standards.

4. Differences in population growth:

In countries with high population growth, resources might not be sufficient to feed all people, resulting in a low quality of life.

5. Differences in education and healthcare:

People in countries with low quantities and qualities of education and healthcare tend to have low productivity and low living standards.

6. Differences in the size of primary, secondary, and tertiary sectors:

National income and working conditions are low in countries with a large proportion of workers employed in the primary sector.

7. Differences in the concentration on a narrow range of primary exports:

Countries exporting particular primary products tend to have unstable national incomes.

8. Differences in productivity:

Countries with low output per worker per period of time tend to have low incomes per capita and low living standards.

3. Measures to promote economic development

Policies to promote economic development	Limitation of the policies to promote economic development
<p>1. The government protects new domestic industries from foreign competition to foster economic development.</p>	<p>1. Such policies may provoke retaliation from other countries, potentially resulting in decreased export revenue for the nation.</p>
<p>2. Export promotion aims to both generate employment for local residents and increase overall income.</p>	<p>2. Domestic industries might become dependent on government assistance instead of striving to enhance their efficiency independently.</p>
<p>3. Infrastructure improvements are implemented to lower transportation costs for businesses, thus stimulating economic growth.</p>	<p>3. Investing in infrastructure has opportunity costs, diverting resources from other potential uses.</p>
<p>4. Providing education and healthcare services is crucial for enhancing the productivity, thereby contributing to economic</p>	<p>4. Inadequate education hampers skill development and productivity, hindering individuals' ability to secure employment and income.</p>
<p>5. Encouraging multinational corporations (MNCs) to invest in the country stimulates job creation and boosts government tax revenue.</p>	<p>5. Multinational corporations (MNCs) may repatriate profits and engage in tax avoidance, diminishing the revenue gained by the host country.</p>
<p>6. Foreign loans and aid are utilized to facilitate the development of the country's economy.</p>	<p>5. Foreign financial aid may be misallocated towards unprofitable projects and corruption, undermining its intended developmental impact.</p>

Key Takeaways:

- **Economic development** refer to an improvement in the economic well-being and quality of life for individuals in a country.
- **Characteristics of developed countries:** high income per capita, low birth rates, low death rates, long life expectancy, high levels of literacy and education provision, and low proportion of the labor force in the primary sector and a high proportion in the tertiary sector.
- **Characteristics of developing countries:** low income per capita, high birth rates, high death rates, short life expectancy, low levels of literacy and education provision, and high proportion of the labor force in the primary sector and a low proportion in the tertiary sector.
- **Policies to promote economic development** include investment in infrastructure, education and skills development, support MNCs and entrepreneurs, social welfare programs, access to finance, and environmental sustainability measures.

CHAPTER 36

INTERNATIONAL SPECIALISATION

Checklist

1. Specialisation at a national level
2. Advantages and disadvantages of specialisation at a national level
3. Pattern of international trade: understanding absolute advantage and comparative advantage
4. The difference between international and internal trade

1. Specialisation at a national level

Specialisation: occurs when a country focuses on producing products in which it is best at or is most efficient. This allows the country to achieve higher efficiency, productivity, and quality in its products.

2. Advantages and disadvantages of specialisation at a national level

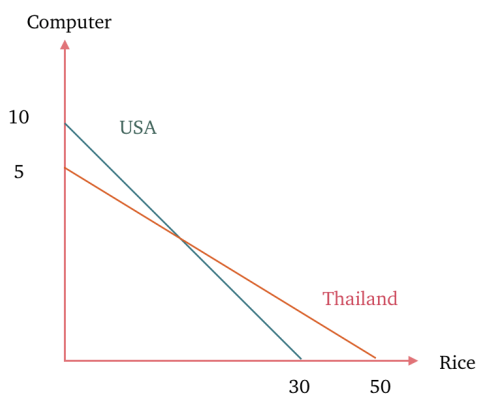
Advantages of specialisation for consumers	Disadvantages of specialisation for consumers
<p>1. Increased Output: Specialisation leads to higher productivity, resulting in a broader range of goods and services available to consumers and improving their standard of living.</p> <p>2. Higher Quality: With specialisation, countries can concentrate on producing products in which they are best at, resulting in higher quality products.</p> <p>3. Lower Prices: Specialisation can lead to increased efficiency and economies of scale, resulting in lower prices for consumers.</p> <p>4. Greater Variety: consumers can access to goods and services from abroad.</p>	<p>1. Import Dependency: Specialisation can lead to heavy reliance on imports, exposing the country to risks from global supply chain disruptions.</p> <p>2. Risk of Monopolies: Specialisation can cause a risk of monopolies emerging, leading to higher prices of products for consumers.</p>
Advantages of specialisation for producers	Disadvantages of specialisation for producers
<p>1. Economies of Scale: Companies can benefit from cost efficiencies, such as bulk purchasing, resulting in lower average cost.</p> <p>2. Technology Transfer: Specialisation allows firms to learn new technologies from overseas products.</p> <p>3. Access to Global Markets: Specialized producers can expand their customer base in the world market, leading to higher sales and profits.</p>	<p>1. Reliance on Exports: Producers might overly rely on specific countries for particular exports, leading to revenue instability and financial vulnerability.</p> <p>2. Dependency on suppliers: Producers may rely heavily on a raw material imports, making them vulnerable to supply chain disruptions, shortages, or price fluctuations.</p>

2. Advantages and disadvantages of specialisation at a national level

Advantages of specialisation for economy	Disadvantages of specialisation for economy
<p>1. Increasing efficiency: Specialisation allows the country to allocate resources towards areas of comparative advantage, leading to increased productivity and economic output.</p> <p>2. Economies of Scale: Specialisation often leads to a lower average cost per unit due to economies of scale. Businesses can spread their fixed costs over a larger number of units, reducing the cost per unit produced.</p> <p>3. Reputation Building: Specialisation fosters expertise in producing specific goods, enhancing reputation.</p>	<p>1. Dependency on Imports: Specialisation may result in dependency on imports for goods or resources that are not produced domestically, resulting in external dependencies.</p> <p>2. Unemployment Risk: Specialisation leaves the economy vulnerable to structural unemployment if the demand for exported goods diminishes, leading to job losses in specialized industries.</p> <p>3. Offsetting Cost Advantage: High transportation costs can offset the cost advantage that a country may have in producing specialized goods, reducing competitiveness in global markets and potentially eroding economic gains from specialisation.</p>

3. Pattern of international trade: understanding absolute advantage and comparative advantage

Absolute advantage : A country can produce a particular good or service more efficiently or using **fewer resources** than another country.



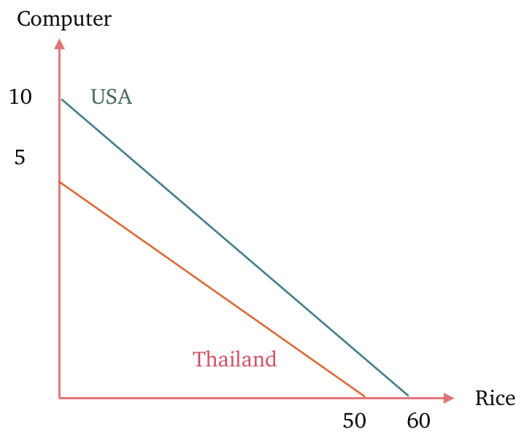
To sum up:

Thailand has an absolute advantage in producing rice.

The USA has the absolute advantage in producing computers.

3. Pattern of international trade: understanding absolute advantage and comparative advantage

Comparative advantage: a country can produce goods at a **lower opportunity cost** compared to others.



Country	Computer : Rice		Computer : Rice
USA	10 : 60	⇒	1 : 6
TH	5 : 50	⇒	1 : 10

In summary, the USA has a comparative advantage in producing computers, as it incurs a lower opportunity cost of 6 units of rice compared to Thailand's 10 units of rice.

Country	Computer : Rice		Computer : Rice
USA	10 : 60	⇒	1/6 : 1
TH	5 : 50	⇒	1/10 : 1

In summary, Thailand has a comparative advantage in producing rice, incurring a lower opportunity cost of 1/10 units of computer compared to the USA's 1/6 units of computer.

4. The difference between international and internal trade

Internal trade

- Exchange goods and services within the country
- Domestic demand
- Same languages, culture and consumer behaviors
- Absence of trade restrictions such as tariffs and quotas
- The use of a common currency

International trade

- Exchange goods and services between countries
- World market demand
- Different languages, culture and consumer behaviors
- Subject to trade restrictions such as tariffs and quotas
- The use of different currencies

Key Takeaways:

- **Specialisation:** occurs when a country focuses on producing products in which it is best at or is most efficient. This allows the country to achieve higher efficiency, productivity, and quality in its products.
- **Absolute advantage:** A country can produce a particular good or service more efficiently or using fewer resources than another country.
- **Comparative Advantage:** Indicates that a country can produce goods at a lower opportunity cost compared to others, emphasizing efficiency in resource allocation.
- **Difference Between International and Internal Trade:**
 - **Internal trade** involves the exchange of goods and services within a country, driven by domestic demand, shared language and culture, absence of trade restrictions, and the use of a common currency.
 - **External trade** entails the exchange of goods and services between countries, influenced by global market demand, involving diverse cultures and consumer behaviors, subject to trade restrictions such as tariffs and quotas, and often involving different currencies.

CHAPTER 37

GLOBALISATION, FREE TRADE AND PROTECTION

Checklist

1. Understanding Globalisation
2. Multinational Companies (MNCs), and Advantages and disadvantages of MNCs
3. Free Trade and Advantages and disadvantages of Free Trade
4. Methods of Protectionism
5. Protectionism and Advantages and Disadvantages of Protectionism.

1. Understanding Globalisation

Globalisation : an increase in interdependence between countries through trade, foreign direct investment, and the movement of labor and capital.

Factors contributing to globalisation :

1. **Decrease in Transportation Costs:** Lower transportation costs have eased the movement of goods and people across borders, enhancing international trade's accessibility and affordability.
2. **Technological Advancements:** Innovations like the internet and telecommunications have transformed global communication and commerce, accelerating globalisation by enabling global business operations.
3. **Reduction in Trade Barriers:** Decreased trade barriers, such as tariffs and quotas, promote free trade and MNCs.

1. Understanding Globalisation

Globalisation : an increase in interdependence between countries through trade, foreign direct investment, and the movement of labor and capital.

Advantages of Globalisation	Disadvantages of Globalisation
<p>1. Enhanced Efficiency: High competition in the world market enhance efficiency and productivity.</p> <p>2. Diverse Product Range at cheap Prices: Globalisation offers consumers a wider selection of products at competitive prices.</p> <p>3. Cost-Efficient Production Locations: Firms can strategically locate production in countries with lower labor costs.</p> <p>4. Economic Growth: Globalisation can stimulate economic growth by increasing trade, investment, and business opportunities, leading to higher productivity and income levels.</p>	<p>1. Global Economic Interconnectedness: A recession in one country can have a substantial impact on other nations.</p> <p>2. Structural Unemployment Risk: The relocation of multinational corporations (MNCs) from a country can lead to structural unemployment.</p> <p>3. Competition Challenges: Domestic companies may struggle to compete with foreign firms, leading to business failures and increased unemployment</p> <p>4. Environmental Degradation: Globalisation may contribute to environmental degradation through increased production and consumption, exploitation of natural resources, and pollution.</p>

2. Multinational Companies (MNCs), and Advantages and disadvantages of MNCs

Multinational Corporation (MNC): A company that operates and produces goods or services in more than one countries, like McDonald’s and Starbucks.

Advantages of Multinational Corporation (MNC)	Disadvantages of Multinational Corporation (MNC)
<p>1. Job Creation: MNCs provide employment opportunities for local residents, leading to increased job availability.</p> <p>2. Economic Output: MNCs contribute to the economy by increasing production outputs, thereby enhancing consumers' living standards.</p> <p>3. Tax Revenue: MNCs contribute tax revenue to the government, which can be allocated towards national development initiatives.</p> <p>4. Technological Innovation: MNCs introduce new technologies and management practices, fostering innovation and economic growth.</p> <p>5. Infrastructure Development: MNCs often invest in infrastructure projects, contributing to the development and improvement of essential facilities within the country.</p>	<p>1. Exploitation of Workers: MNCs may provide low-skilled jobs and exploit workers.</p> <p>2. Market Dominance: MNCs may push domestic firms out of the market, leading to unemployment.</p> <p>3. Tax Avoidance: MNCs may evade taxes, resulting in a loss of tax revenue for the government.</p> <p>4. Profit Repatriation: MNCs may transfer profits back to their home countries instead of reinvesting in the host country.</p> <p>5. Environmental Impact: MNCs may contribute to pollution and resource depletion.</p>

3. Free trade and Advantages and disadvantages of Free Trade

Free trade : international trade without any trade barriers such as tariff, quota, and embargo.

Advantages of Free trade	Disadvantages of Free trade
<p>1. Consumer Choice: Free trade offers consumers access to a wide range of products at competitive prices.</p> <p>2. Increased Revenue for Firms: Businesses can boost their income by exporting goods to foreign markets.</p> <p>3. Economies of Scale: Free trade enables firms to capitalize on economies of scale, leading to reduced costs and lower prices for consumers.</p> <p>4. Technological Innovation: Companies can acquire new technologies from overseas products, driving innovation and competitiveness.</p> <p>5. Resource Optimization: Countries can specialize in producing goods where they have a comparative advantage, promoting efficient resource allocation.</p>	<p>1. Dependency on Exports and Imports: Over-reliance on exports and imports can create economic vulnerability and instability.</p> <p>2. Increased Unemployment: Domestic firms that cannot compete with foreign counterparts may fail, leading to a rise in unemployment.</p> <p>3. Structural Unemployment: A decline in demand for exports can lead to significant job losses and structural unemployment.</p> <p>4. Resource Depletion: Free trade can lead to overproduction and resource depletion, resulting in environmental degradation.</p> <p>5. Economic Inequality: Free trade can increase income inequality by benefiting certain industries or regions while disadvantaging others.</p>

3. Methods of Protectionism

Protectionism : Government policies or actions aimed at protecting domestic industries from foreign competition.

1. Tariff

: Tax on imported goods

Implementing tariffs on imports

=> Tariff increases prices for imported goods.

=> It reduces demand for imported products.

2. Subsidy

: Grant paid by government to producers

Providing subsidies for domestic goods

=> Subsidy reduces prices of domestic goods.

=> Demand for imported products decreases and demand for domestic products increases.

3. Quota

: A limit on the number of imports

Decreasing quotas

=> It restricts on the quantity of certain goods that can be imported into the country.

=> It reduces the quantity of imported goods.

4. Quality standard

Setting high quality standards requirement for import

=> Raises the costs and prices of imports

=> Reduces the demand for imports

5. Expensive paper work

Enforcing costly paperwork requirements

=> Foreign firms face extensive paperwork, leading to increased costs and delays for importers.

=> This discourages their involvement in import activities.

3. Methods of Protectionism

6. Voluntary export Restraints

agreements with other countries to limit their exports to a specific country.

Implementing voluntary export restraints:

- => One country limits its exports to another country voluntarily.
- => The exporting country aims to prevent the imposition of stricter measures, such as tariffs or quotas, by limiting export volumes to the importing country.
- => It reduces export revenue.

7. Embargo

involve a complete ban on imports or exports

Implementing embargo

- => It involves a complete ban on the import of certain goods to countries.
- => It reduces import expense.

8. Exchange rate control

refers to the regulation or management of a country's currency

Implementing exchange rate control

- => Government limit access to foreign currency.
- => It creates difficulties in purchasing imports.

2. Protectionism and Advantages and Disadvantages of Protectionism.

Protectionism : Government policies or actions aimed at protecting domestic industries from foreign competition. These policies can include tariffs (taxes on imports), quotas (limits on the quantity of imports) and subsidies (financial assistance to domestic industries)

Advantages of Protectionism	Disadvantages of Protectionism
<p>1. Supporting Infant Industries: Protectionism can protect infant firms to grow up and take advantages of economies of scales, then they can compete with foreign firms.</p> <p>2. Preventing Dumping: It stops one country from flooding another's market with underpriced products, which could drive local competitors out of business.</p> <p>3. Preventing Trade Deficits: Protectionism helps reducing imports and preventing trade deficits where imports exceed exports.</p> <p>4. Protect Domestic Employment: It safeguards employment within domestic borders by supporting local industries.</p> <p>5. Protecting Strategic Industries: It protects crucial industries like food and national defense, ensuring the country stability.</p> <p>6. Preventing Unemployment from Declining Industries: Protectionism prevents mass job losses by safeguarding declining industries temporarily.</p>	<p>1. Higher Prices for Consumers: Protectionist measures such as tariffs and quotas can lead to higher prices for imported goods, reducing consumer choice.</p> <p>2. Reduced Efficiency: Domestic firms may become reliant on government assistance instead of fostering their own development, resulting in lower productivity and economic growth.</p> <p>3. Retaliation and Trade Wars: Protectionist measures by one country can provoke retaliation from trading partners, leading to trade tensions and potentially escalating into trade wars.</p> <p>4. Resource Misallocation: Protectionism can result in the misallocation of resources, as it may encourage the allocation of resources to less efficient industries that are protected from competition, rather than to industries with comparative advantages.</p>

Key Takeaways:

- **Globalisation:** The rise in interdependence among countries due to trade, foreign direct investment, and the movement of labor and capital.
- **Factors Contributing to Globalisation:** Decrease in transportation and communication costs, and reduction in trade barriers.
- **Multinational Corporation (MNC):** A company that operates and produces goods or services in more than one countries, like McDonald's and Starbucks.
 - **Advantages of Multinational Corporation (MNC):** Job creation, increased economic output, tax revenue generation, technological innovation, and infrastructure development.
 - **Disadvantages of Multinational Corporation (MNC):** Worker exploitation, market dominance, tax avoidance, profit repatriation, and negative environmental impact.
- **Free Trade:** International trade without trade barriers such as tariffs, quotas, and embargoes.
 - **Advantages of Free Trade:** Expanded consumer choice, increased firm revenue, access to economies of scale, technological innovation, and enhanced resource efficiency.
 - **Disadvantages of Free Trade:** Challenges such as overreliance on exports/imports, heightened unemployment from foreign competition, structural unemployment due to reduced export demand, resource depletion, and economic inequality.
- **Protectionism:** Government policies or actions aimed at protecting domestic industries from foreign competition, including tariffs, quotas and subsidies.
 - **Advantages of Protectionism:** Supporting infant industries, preventing dumping, averting trade deficits, protecting domestic employment, safeguarding strategic industries, and preventing unemployment in declining sectors.
 - **Disadvantages of Protectionism:** Higher consumer prices, reduced efficiency, retaliation leading to trade wars, and misallocation of resources.

CHAPTER 38

FOREIGN EXCHANGE RATES

Checklist

1. Foreign exchange rate and foreign exchange rate systems
2. The determination of floating exchange rate system
3. The determination of fixed exchange rate system
4. Factors influence demand and supply of the currency
5. The consequences of currency appreciation
6. The consequences of currency depreciation
7. Advantages and disadvantages of floating exchange rate system
8. Advantages and disadvantages of fixed foreign exchange rate

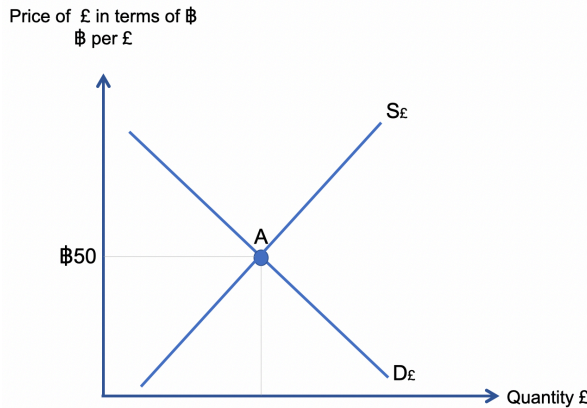
1. Foreign exchange rate and foreign exchange rate systems

Exchange rate : a price of one currency in terms of another currency eg. 1 £ = 50 ₪

Foreign exchange rate systems

<p>1. A fixed exchange rate : the value of a currency is fixed against another currency by the central bank.</p>	<ul style="list-style-type: none"> • Revalued Currency: An increase in the value of a fixed currency. • Devalued Currency: A decrease in the value of a fixed currency
<p>2. A floating exchange rate : the value of a currency is determined by the demand and supply of that currency.</p>	<ul style="list-style-type: none"> • Appreciated Currency: An increase in the value of a floating currency. • Depreciated Currency: A decrease in the value of a floating currency."

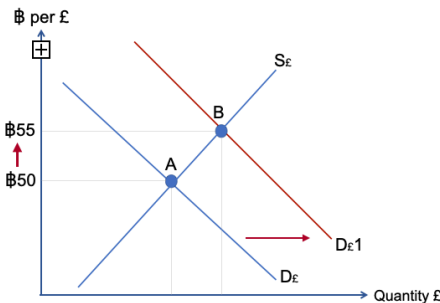
2. The determination of floating exchange rate system



Floating exchange rate system: A system where the value of a currency is determined by demand and supply without government intervention.

- **Demand for £** : Influenced by UK exports and money inflow into the UK.
- **Supply of £** : Influenced by UK imports and money outflow from the UK

Case 1: A higher demand for £ leads to £ appreciation against ₪.



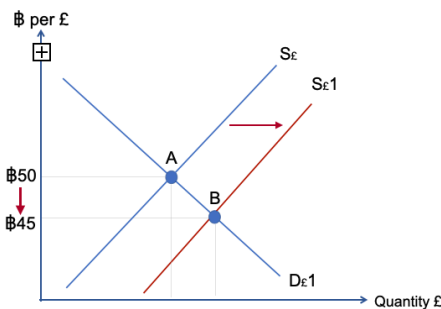
For example:

Original: 1 £ = ₪50

With higher demand for £: 1 £ = ₪55

The value of £ appreciates against ₪ when there is higher demand for £.

Case 2 : A higher supply for £ leads to £ depreciation against ₪.



For example:

Original: 1 £ = ₪50

With higher supply for £: 1 £ = ₪45

The value of £ depreciates against ₪ when there is higher supply for £.

3. The determination of fixed exchange rate system

Fixed exchange rate system : the value of a currency is fixed against another currency by the central bank.

To revalue a currency (by increasing demand for the currency and reducing supply of the currency):

- **Buy the country's currency and sell foreign currency:** This action increases demand for the currency, resulting in a higher value of the currency.
- **Increasing interest rates:** This encourages hot money inflow, as investors seek higher returns by depositing money in the country. Consequently, this results in higher demand for the currency and lower supply of the currency, leading to an increase in the value of the currency

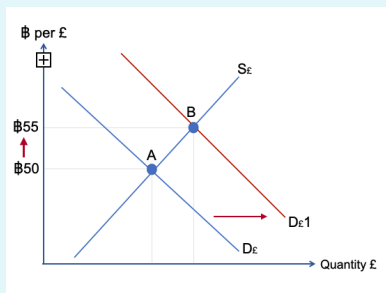
To devalue a currency (by decreasing demand for the currency and increasing supply of the currency):

- **Sell the country's currency and buy foreign currency:** This action increases the supply of the currency, resulting in a lower value of the currency.
 - **Decreasing interest rates:** This encourages hot money outflow, as investors seek higher returns by depositing money abroad. Consequently, this results in lower demand for the currency and higher supply of the currency, leading to a decrease in the value of the currency
-

4. Factors influence demand and supply of the currency

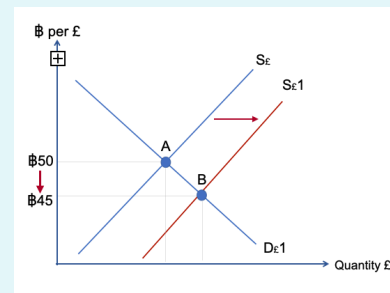
Factors increasing demand for the pound

- 1. Increase in UK exports:**
 - ➔ Leads to higher demand for £ to purchase UK exports.
 - ➔ Results in £ appreciation.
- 2. Higher interest rates in the UK:**
 - ➔ Attract hot money inflow to deposit money in domestic banks for higher returns.
 - ➔ Causes an increase in demand for £, leading to £ appreciation.
- 3. Speculation:**
 - ➔ Speculators anticipate a higher value for £.
 - ➔ Buying £ increases demand for £, resulting in £ appreciation.
- 4. Money inflow into the UK for investment:**
 - ➔ Increase in demand for £ due to investment in the UK.
 - ➔ Leads to £ appreciation.



Factors increasing the supply for the pound

- 1. Increase in UK imports:**
 - ➔ Results in an increase in the supply of £ to purchase imported goods.
 - ➔ Leads to £ depreciation.
- 2. Lower interest rates in the UK:**
 - ➔ Encourage hot money outflow to deposit money abroad for higher returns.
 - ➔ Causes an increase in the supply of £, resulting in £ depreciation.
- 3. Speculation:**
 - ➔ Speculators anticipate a lower value for £.
 - ➔ Selling £ increases the supply of £, leading to £ depreciation.
- 4. Money outflow from the UK to invest abroad:**
 - ➔ Results in an increase in the supply of £ due to investment abroad.
 - ➔ Leads to £ depreciation.



5. The consequences of currency appreciation

Appreciated Currency : An increase in the value of a floating currency.

Advantages of currency appreciation	Disadvantages of currency appreciation
<p>1. Reduced Trade Imbalances: Appreciation of the domestic currency makes exports more expensive for foreign buyers, potentially decreasing trade surpluses.</p>	<p>1. Reduced Competitiveness: Stronger currency makes exports costlier for foreign buyers, decreasing export competitiveness.</p>
<p>2. Lower Prices for Imports: A stronger domestic currency makes imports cheaper for domestic consumers, boosting purchasing power and stimulating consumption.</p>	<p>2. Trade deficit: When the domestic currency appreciates, exports become more expensive for foreign buyers, making them less competitive in international markets. This leads to a decrease in demand for exports, resulting in lower export revenue and potentially causing trade deficit.</p>
<p>3. Cost Reduction for Businesses: Cheaper imports lead to lower production costs for businesses reliant on imported materials, enhancing competitiveness domestically and internationally.</p>	<p>3. Decreased Production and Economic Growth: A decline in demand for exports due to currency appreciation can lead to reduced production in export industries. This contributes to a decrease in national income and output, which in turn slows down economic growth.</p>
<p>4. Inflation Control: Currency appreciation can mitigate cost-push inflation by reducing the cost of imported raw materials, contributing to overall price stability in the economy.</p>	<p>4. Increased Unemployment: The decrease in production for exports can result in job losses, leading to higher unemployment rates.</p>

6. The consequences of currency depreciation

Depreciated Currency: A decrease in the value of a floating currency.

Advantages of currency depreciation	Disadvantages of currency depreciation
<p>1. Export Competitiveness: A fall in the exchange rate makes exports cheaper for foreign buyers, increasing demand for export and export revenue.</p>	<p>1. Reduced Purchasing Power: Depreciation reduces the purchasing power of consumers who need to buy imported goods or travel abroad. It can make imported products less affordable for domestic consumers, leading to a decrease in their standard of living.</p>
<p>2. Improved Balance of Payments: Higher export revenue and reduced import expenses lead to an improvement in the balance of payments.</p>	<p>2. Demand-Pull Inflation: Higher net exports can lead to increased aggregate demand, potentially causing demand-pull inflation as domestic consumers and businesses compete for limited resources.</p>
<p>3. Economic Growth: Increased export production can lead to an expansion of the economy, as more goods and services are produced to meet foreign demand.</p>	<p>3. Cost-Push Inflation: The higher price of imports, due to currency depreciation, can increase the cost of imported raw materials, leading to cost-push inflation as producers pass these higher costs onto consumers.</p>
<p>4. Employment: The increase in production for exports can create job opportunities, reducing unemployment rates.</p>	<p>4. Impact on Foreign Debt: Repaying loans or interest in foreign currency becomes more expensive as the domestic currency weakens, potentially leading to financial strain on the government or businesses.</p>

7. Advantages and disadvantages of floating exchange rate system

A floating exchange rate : the value of a currency is determined by the demand and supply of that currency.

Advantages of a floating exchange rate	Disadvantages of a floating exchange rate
<p>1. Automatic Trade Adjustment: A floating exchange rate facilitates trade balance by automatically adjusting currency values.</p> <ul style="list-style-type: none"> • In the event of a trade deficit (imports exceeding exports), the currency depreciates. • Depreciation makes exports more affordable and imports more expensive, thereby boosting export revenue and reducing import expenditure 	<p>1. Exchange Rate Volatility: Floating exchange rates can be more volatile compared to fixed exchange rates, which can create uncertainty for businesses and investors and lead to increased risk in international trade and investment.</p>
<p>2. Independence of Monetary Policy: Central banks can concentrate on other policy objectives.</p> <ul style="list-style-type: none"> • For instance, during periods of high inflation, central banks can raise interest rates without being concerned about exchange rates. 	<p>2. Reduced Price Stability: Exchange rate volatility can lead to fluctuations in import prices, which can reduce price stability in the economy.</p>
<p>3. Reduced Need for Foreign Reserves: Governments do not need to hold large foreign currency reserves to defend a fixed exchange rate, freeing up funds for country development.</p>	<p>3. Speculative Activities: The absence of fixed exchange rates can attract speculative activities in the foreign exchange market, which can cause exchange rate fluctuations.</p>

8. Advantages and disadvantages of fixed exchange rate system

A fixed exchange rate : the value of a currency is fixed against another currency by the central bank.

Advantages of a fixed exchange rate	Disadvantages of a fixed exchange rate
<p>1. Certainty and Stability: Fixed exchange rates provide certainty for businesses, investors, and consumers. They know the value of the currency which will encourage foreign investment and international trade.</p>	<p>1. Loss of Control over Interest Rates: Fixed exchange rates limit the ability of countries to pursue independent monetary policies to achieve macro aims. For example, when a country experiences inflation, the central bank cannot raise interest rates to reduce it because it could attract hot money inflow, leading to an appreciation of the currency, which contradicts the fixed exchange rate policy.</p>
<p>2. Promotion of Trade and Investment: Fixed exchange rates can encourage international trade and investment by reducing uncertainty related to currency fluctuations. This stability can attract foreign investors and foster economic growth.</p>	<p>2. Need for Foreign Reserves: Maintaining a fixed exchange rate requires holding substantial reserves, which entails opportunity costs.</p>
<p>3. Reduced Speculation: Fixed exchange rates can mitigate speculative activities in the foreign exchange market, as there is less opportunity for traders to profit from short-term fluctuations in currency values.</p>	<p>3. Speculative Attacks: Speculative attacks by traders can deplete foreign exchange reserves and undermine confidence in the currency, leading to financial instability.</p>

Key Takeaways:

- **Foreign exchange rate** is the price of one currency in terms of another currency.
- **Exchange Rate Systems** : a floating exchange rate system, a fixed exchange rate system and managed floating exchange rate system.
- **Floating Exchange Rate System:** exchange rates are determined by market forces such as supply and demand without government intervention.
- **Fixed Exchange Rate System:** governments or central banks set the value of their currency relative to another currency. They may intervene in the foreign exchange market to maintain the fixed rate.
- **Factors Influencing Demand and Supply of Currency:** Demand and supply of a currency are influenced by factors such as export, import, interest rates, and speculation.
- **Consequences of Currency Appreciation:** when a currency increases in value relative to other currencies, it can lead to cheaper imports and reduced export competitiveness and potentially lead to trade deficit.
- **Consequences of Currency Depreciation:** when a currency decreases in value relative to other currencies. It can make exports more competitive, increase import costs, and potentially lead to trade surplus.
- **Advantages and Disadvantages of Floating Exchange Rate System:** Advantages include automatic adjustment to trade imbalances, independence in monetary policy, and reduced need for foreign reserves. Disadvantages include exchange rate volatility and increased speculation.
- **Advantages and Disadvantages of Fixed Exchange Rate System:** Advantages include certainty and stability for trade and investment and reduced speculation. Disadvantages include lack of flexibility in monetary policy, and potential for speculative attacks.

CHAPTER 39

CURRENT ACCOUNT OF BALANCE OF PAYMENT

Checklist

1. Structure of current account of balance of payments
2. Causes of current account deficit
3. Causes of current account surplus
4. Consequences of current account deficit
5. Consequences of current account surplus
6. Policies to reduce trade deficit
7. Policies to reduce trade surplus

1. Structure of current account of balance of payments

The current account is a component of a country's balance of payments, which records all economic transactions between residents of the country and the rest of the world over a specific period.

1. Structure of current account of balance of payments

1. Trade in goods	<p>Trade in goods = Export Revenue in Goods - Import Expense in Goods</p> <ul style="list-style-type: none"> • Trade in goods surplus: when export revenue from goods exceeds its import expenses for goods. • Trade in goods deficit: when import expenses for goods exceed its export revenue from goods.
2. Trade in Services	<p>Trade in services = Export Revenue in Services - Import Expense in Services</p> <ul style="list-style-type: none"> • Trade in service surplus: when export revenue from services exceeds its import expenses from services. • Trade in service deficit: when import expenses from services exceed its export revenue from services.
3. Primary Income	Income inflow and outflow of an economy from interest, profit, dividend and wage
4. Secondary Income (Transfer account)	Money transfer between countries by not return for anything else eg. donation, foreign aid and workers' remittances

Trade deficit ≠ Current account deficit

Trade deficit: occurs when the value of export revenue in goods and services is lower than the value of import expense in goods and services

Current account deficit: occurs when the money outflow for imports of goods and services, primary income (such as interest and dividends), and secondary income (such as remittances and foreign aid) exceed the money inflow from exports of goods and services, primary income receipts, and secondary income receipts.

2. Causes of current account deficit and surplus

Current account deficit: The combined value of the money outflow in the four sections of the current account is greater than the combined value of the money inflow in the four sections. The 4 sections includes trade in goods and services, primary income and secondary income account.

Causes of current account deficit

1) High exchange rate / Relatively higher inflation in the country than others

Price of the exports \uparrow in foreigners' view \Rightarrow Demand for export $\downarrow \Rightarrow$ Export revenue \downarrow

Price of the imports \downarrow in domestic's view \Rightarrow Demand for imports $\uparrow \Rightarrow$ Import expense \uparrow

\Rightarrow Trade balance and current account worsen/deficit

2) Low quality of domestic products

Exports have lower quality \Rightarrow Demand for export $\downarrow \Rightarrow$ Current account worsen/deficit

3) Low income abroad

Foreigners have lower ability to spend and demand for products from the country decreases \Rightarrow The country's export revenue $\downarrow \Rightarrow$ Current account worsen/deficit

4) High cost of production

Prices of export are less competitive in the world market \Rightarrow Demand for export $\downarrow \Rightarrow$

Current account worsen/deficit

5) Low investment income earned abroad.

Decreased income earned abroad from interest, profit and dividend \Rightarrow Lower money inflow in primary income account \Rightarrow Current account worsen/deficit

6) The money transfer out of a country from workers' remittances

Money outflows from the country, such as workers' remittances sent abroad

\Rightarrow Money outflow in secondary income account \Rightarrow Current account worsen /deficit

3. Causes of current account surplus

Current account surplus: The combined value of the money inflow in the four sections of the current account is greater than the combined value of the money outflow in the four sections. The 4 sections includes trade in goods and services, primary income and secondary income account.

Causes of current account surplus

1) Low exchange rate / relatively lower inflation in the country than others

Price of the exports ↓ in foreigners' view ⇒ Demand for export ↑ ⇒ Export revenue ↑

Price of the imports ↑ in domestic's view ⇒ Demand for imports ↓ ⇒ Import expense ↓

⇒ Trade balance and current account surplus

2) High quality of domestic products

High-quality domestic products can attract greater demand from international markets

⇒ Demand for export ↑ ⇒ Current account surplus

3) High income abroad

Higher purchasing power among foreign consumers can lead to increased demand for products from the country ⇒ Export revenue ↑ ⇒ Current account surplus

4) Low cost of production

Prices of export are more competitive in the world market ⇒ Demand for export ↑

⇒ Current account surplus

5) High investment income earned abroad

Increased income earned abroad from sources like interest, profit, and dividends leads to higher money inflows into the country ⇒ Money inflow into primary income account

⇒ Current account surplus

6) The receipt of high workers' remittances

Money inflow into the country from workers' remittances received from abroad

⇒ Money inflow into secondary income account ⇒ Current account surplus

4. Consequences of current account deficit

Current account deficit: The combined value of the money outflow in the four sections of the current account is greater than the combined value of the money inflow in the four sections.

Advantages of current account deficit	Disadvantages of current account deficit
<p>1. Reduced Exports, Lower Inflation Risk: A current account deficit, often linked to lower exports, can lower aggregate demand. This can help reduce demand-pull inflationary pressures and promoting price stability.</p>	<p>1. Slowed Economic Growth: Decreased export revenue associated with a current account deficit can lead to a decline in economic growth, as it reduces the national income generated from international trade.</p>
<p>2. Less Domestic Production, Reduced Pollution: Lower domestic production, a result of decreased exports or increased imports from a deficit, can lower pollution by reducing emissions and resource usage.</p>	<p>2. Risk of Balance of Payments Deficit: A current account deficit may contribute to a balance of payments deficit.</p>
<p>3. Currency Depreciation Benefits: In countries with floating exchange rates, a deficit can lead to currency depreciation, boosting export competitiveness and reducing import demand, ultimately helping to rebalance trade over time.</p>	<p>3. Job Losses and Unemployment: Lower exports and increased imports, typical outcomes of a deficit, can result in job losses and increased unemployment.</p>
<p>4. Import of Capital and Technology: Deficits allow countries to import capital and technology from abroad, which can contribute to economic growth in the future.</p>	<p>4. Potential Increase in Poverty: Job losses due to a current account deficit can lead to an increase in poverty levels and income inequalities.</p>

5. Consequences of current account surplus

Current account surplus: The combined value of the money inflow in the four sections of the current account is greater than the combined value of the money outflow in the four sections.

Advantages of current account surplus	Disadvantages of current account surplus
<p>1. Boosts Economic Growth: Increased export revenue contributes to higher national income and output.</p>	<p>1. Inflationary Pressures: Increased net exports can stimulate aggregate demand, leading to demand-pull inflation and higher price levels, potentially worsening the standard of living for consumers.</p>
<p>2. Facilitates Balance of Payment Surplus: A current account surplus may contribute to a balance of payments surplus. Inflow of money into the country strengthens national reserves and reduces national debt.</p>	<p>2. Environmental Impact: Increased production for exports may lead to higher levels of pollution and environmental degradation, impacting public health and quality of life.</p>
<p>3. Enhances Employment Opportunities: Higher exports lead to increased domestic production, thereby creating more job opportunities.</p>	<p>3. Currency Appreciation: A surplus can lead to appreciation of the country's currency, making exports more expensive and potentially reducing competitiveness in international markets.</p>
<p>4. Improves Government Finances: The surplus results in higher tax revenue for the government and reduces expenditure on unemployment benefits. It provides opportunities for the country to invest in its development.</p>	<p>4. Trade Imbalances: Persistent surpluses can cause trade tensions and retaliatory measures from trading partners.</p>

6. Policies to reduce trade deficit

1. Tariffs:

- Implementing taxes on imports increases their prices, thereby reducing demand for imported goods, which can improve trade balance and the current account.

2. Quotas:

- Setting limits on the quantity of imports can also decrease import expenses, contributing to an improvement in trade balance and the current account.

3. Subsidies:

- Providing subsidies to domestic producers lowers the prices of domestic products, potentially decreasing demand for imports and thus improving trade balance and the current account.

4. Currency Devaluation:

- Depreciating the currency can make exports cheaper and imports more expensive, stimulating demand for exports while reducing demand for imports, leading to improvements in export revenue and trade balance.

5. Increasing Income Tax and Interest Rates:

- Raising income tax reduces disposable income, potentially reducing spending on imports, while higher interest rates can encourage saving rather than spending on imports, both contributing to reducing import expense and current account deficits.

6. Supply-Side Policies:

- Investing in education and training to enhance skills and productivity can lead to better-quality exports and lower production costs, thereby increasing export revenue and improving trade balance and the current account.

Trade deficit: occurs when the value of export revenue in goods and services is lower than the value of import expense in goods and services

7. Policies to reduce trade surplus

1. Currency Revaluation:

- Increasing the value of the currency can reduce demand for exports by making them more expensive for foreign buyers, while making imports cheaper, thus decreasing export revenue and increasing import expenses.

2. Expansionary Fiscal and Monetary Policy:

- **Reducing income tax** can boost disposable income and consumer spending, leading to increased imports and potentially reducing the current account surplus.
- **Decreasing interest rates** can encourage borrowing and spending rather than saving, resulting in increased imports and contributing to a reduction in the current account surplus.

Trade surplus: occurs when the value of export revenue in goods and services is higher than the value of import expense in goods and services

Key Takeaways:

- **Structure of Current Account of Balance of Payments:** The current account includes the balance of trade in goods and services (exports minus imports), primary income (net income from abroad), and secondary income account (net transfers such as foreign aid and remittances).
- **Trade deficit:** occurs when the value of export revenue in goods and services is lower than the value of import expense in goods and services
- **Current account deficit:** occurs when the money outflow for imports of goods and services, primary income (such as interest and dividends), and secondary income (such as remittances and foreign aid) exceed the money inflow from exports of goods and services, primary income receipts, and secondary income receipts.
- **Causes of Current Account Deficit:** Imports exceed exports, often due to a high exchange rate or inflation; low domestic product quality reduces competitiveness, reduced income from foreign investments, high domestic production costs hinder exports, and outflow of money from workers' remittances.
- **Causes of Current Account Surplus:** Exports exceed imports, driven by a low exchange rate or inflation, high-quality products increase international demand, increased income from foreign investments, low production costs enhance export competitiveness, and inflow of money from workers' remittances.
- **Consequences of Current Account Deficit:** Slowed economic growth and risk of payment deficits, job losses in export industries, currency depreciation, and loss of competitiveness in export industries.
- **Consequences of Current Account Surplus:** Boosts economic growth and facilitates a balance of payment surplus, enhances employment opportunities, accumulation of foreign reserves, currency appreciation and potential trade tensions with surplus-receiving countries.
- **Policies to Reduce Trade Deficit:** Implementing tariffs, quotas, and subsidies to reduce imports, currency appreciation to enhance export competitiveness, and fiscal and monetary policies to reduce spending on imports.
- **Policies to Reduce Trade Surplus:** Currency revaluation to make exports more expensive and imports cheaper, and expansionary fiscal and monetary policies to boost spending on imports.