Section #3: International Economics—25 Hours for SL and 45 Hours for HL

*3.1 International Trade (One Topic HL Extension, Plus One Topic HL Only)*

| Subtopic | IB Points to Understand (for both SL and HL unless otherwise noted) |
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| The benefits of trade | • Explain that gains from trade include lower prices for consumers, greater choice for consumers, the ability of producers to benefit from economies of scale, the ability to acquire needed resources, a more efficient allocation of resources, increased competition, and a source of foreign exchange. |
| **Absolute and comparative advantage (HL ONLY)** | • **Explain the theory of absolute advantage.**<br>• **Explain, using a diagram, the gains from trade arising from a country's absolute advantage in the production of a good.**<br>• **Explain the theory of comparative advantage.**<br>• **Describe the sources of comparative advantage, including the differences between countries in factor endowments and the levels of technology.**<br>• **Draw a diagram to show comparative advantage.**<br>• **Calculate opportunity costs from a set of data in order to identify comparative advantage.**<br>• **Draw a diagram to illustrate comparative advantage from a set of data.**<br>• **Discuss the real-world relevance and limitations of the theory of comparative advantage, considering factors including the assumptions on which it rests, and the costs and benefits of specialization (a full discussion must take into account arguments in favour and against free trade and protection—see below).** |
| The World Trade Organization (WTO) | • Describe the objectives and functions of the WTO. |
| Types of trade protection | • Explain, using a tariff diagram, the effects of imposing a tariff on imported goods on different stakeholders, including domestic producers, foreign producers, consumers and the government.<br>• Explain, using a diagram, the effects of setting a quota on foreign producers on different stakeholders, including domestic producers, foreign producers, consumers and the government.<br>• Explain, using a diagram, the effects of giving a subsidy to domestic producers on different stakeholders, including domestic producers, foreign producers, consumers and the government.<br>• Describe administrative barriers that may be used as a means of protection.<br>• Evaluate the effect of different types of trade protection.<br>• **Calculate from diagrams the effects of imposing a tariff on imported goods on different stakeholders, including domestic producers, foreign producers, consumers and the government. (HL ONLY)**<br>• **Calculate from diagrams the effects of setting a quota on foreign producers on different stakeholders, including domestic producers, foreign producers, consumers and the government. (HL ONLY)**<br>• **Calculate from diagrams the effects of giving a subsidy to domestic producers on different stakeholders, including domestic producers, foreign producers, consumers and the government. (HL ONLY)** |

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| Arguments for and against trade protection (arguments against and for free trade) | • Discuss the arguments in favour of trade protection, including the protection of domestic jobs, national security, protection of infant industries, the maintenance of health, safety and environmental standards, anti-dumping and unfair competition, a means of overcoming a balance of payments deficit and a source of government revenue.<br>• Discuss the arguments against trade protection, including a misallocation of resources, the danger of retaliation and "trade wars", the potential for corruption, increased costs of production due to lack of competition, higher prices for domestic consumers, increased costs of imported factors of production and reduced export competitiveness. |

*3.2 Exchange Rates (Some Topics HL Extension)*

| Subtopic | IB Points to Understand (for both SL and HL unless otherwise noted) |
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| Determination of freely floating exchange rates | • Explain that the value of an exchange rate in a floating system is determined by the demand for, and supply of, a currency.<br>• Draw a diagram to show determination of exchange rates in a floating exchange rate system.<br>• **Calculate the value of one currency in terms of another currency. (HL ONLY)**<br>• **Calculate the exchange rate for linear demand and supply functions. (HL ONLY)**<br>• **Plot demand and supply curves for a currency from linear functions and identify the equilibrium exchange rate. (HL ONLY)**<br>• **Using exchange rates, calculate the price of a good in different currencies. (HL ONLY)** |
| Causes of changes in the exchange rate | • Describe the factors that lead to changes in currency demand and supply, including foreign demand for a country's exports, domestic demand for imports, relative interest rates, relative inflation rates, investment from overseas in a country's firms (foreign direct investment and portfolio investment) and speculation.<br>• Distinguish between a depreciation of the currency and an appreciation of the currency.<br>• Draw diagrams to show changes in the demand for, and supply of, a currency.<br>• **Calculate the changes in the value of a currency from a set of data. (HL ONLY)** |
| The effects of exchange rate changes | • Evaluate the possible economic consequences of a change in the value of a currency, including the effects on a country's inflation rate, employment, economic growth and current account balance. |
| Fixed exchange rates | • Describe a fixed exchange rate system involving commitment to a single fixed rate.<br>• Distinguish between a devaluation of a currency and a revaluation of a currency. |

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| | • Explain, using a diagram, how a fixed exchange rate is maintained. |
| Managed exchange rates (managed float) | • Explain how a managed exchange rate operates, with reference to the fact that there is a periodic government intervention to influence the value of an exchange rate.<br>• Examine the possible consequences of overvalued and undervalued currencies |
| Evaluation of different exchange rate systems | • Compare and contrast a fixed exchange rate system with a floating exchange rate system, with reference to factors including the degree of certainty for stakeholders, ease of adjustment, the role of international reserves in the form of foreign currencies and flexibility offered to policy makers. |

*3.3 The Balance of Payments (One Topic HL Extension, Plus Some Topics HL Only)*

| Subtopic | IB Points to Understand (for both SL and HL unless otherwise noted) |
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| The meaning of the balance of payments | • Outline the role of the balance of payments.<br>• Distinguish between debit items and credit items in the balance of payments. |
| The components of the balance of payments accounts | • Explain the four components of the current account, specifically the balance of trade in goods, the balance of trade in services, income and current transfers.<br>• Distinguish between a current account deficit and a current account surplus.<br>• Explain the two components of the capital account, specifically capital transfers and transaction in non-produced, non-financial assets.<br>• Explain the three main components of the financial account, specifically, direct investment, portfolio investment and reserve assets<br>• **Calculate elements of the balance of payments from a set of data. (HL ONLY)** |
| The relationships between the accounts | • Explain that the current account balance is equal to the sum of the capital account and financial account balances (see the appendix, "The balance of payments").<br>• Examine how the current account and the financial account are interdependent. |
| The relationship between the current account and the exchange rate | • Explain why a deficit in the current account of the balance of payments may result in downward pressure on the exchange rate of the currency. |
| **Implications of a persistent current account deficit (HL ONLY)** | • **Discuss the implications of a persistent current account deficit, referring to factors including foreign ownership of domestic assets, exchange rates, interest rates, indebtedness, international credit ratings and demand management.** |
| **Methods to correct a persistent current** | • **Explain the methods that a government can use to correct a persistent current account deficit, including expenditure switching** |

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| **account deficit (HL ONLY)** | **policies, expenditure reducing policies and supply-side policies, to increase competitiveness.**<br>• **Evaluate the effectiveness of the policies to correct a persistent current account deficit.** |
| **The Marshall-Lerner condition and the J-curve effect (HL ONLY)** | • **State the Marshall-Lerner condition and apply it to explain the effects of depreciation/devaluation.**<br>• **Explain the J-curve effect, with reference to the Marshall-Lerner condition.** |
| The relationship between the current account and the exchange rate | • Explain why a surplus in the current account of the balance of payments may result in upward pressure on the exchange rate of the currency |
| Implications of a persistent current account surplus | • Discuss the possible consequences of a rising current account surplus, including lower domestic consumption and investment, as well as the appreciation of the domestic currency and reduced export competitiveness. |

*3.4 Economic Integration (One Topic HL Extension)*

| Subtopic | IB Points to Understand (for both SL and HL unless otherwise noted) |
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| Preferential trade agreements | • Distinguish between bilateral and multilateral (WTO) trade agreements.<br>• Explain that preferential trade agreements give preferential access to certain products from certain countries by reducing or eliminating tariffs, or by other agreements relating to trade. |
| Trading blocs | • Distinguish between a free trade area, a customs union and a common market.<br>• Explain that economic integration will increase competition among producers within the trading bloc.<br>• Compare and contrast the different types of trading blocs.<br>• **Explain the concepts of trade creation and trade diversion in a customs union. (HL ONLY)**<br>• **Explain that different forms of economic integration allow member countries to gain from economies of scale. (HL ONLY)** |
| Monetary union | • Explain that a monetary union is a common market with a common currency and a common central bank.<br>• Discuss the possible advantages and disadvantages of a monetary union for its members |

*3.5 Terms of Trade (HL Only)*

| Subtopic | IB Points to Understand (for both SL and HL unless otherwise noted) |
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| **Measurement<br>(HL ONLY)** | • **Explain the meaning of the terms of trade.**<br>• **Explain how the terms of trade are measured.**<br>• **Distinguish between an improvement and a deterioration in the terms of trade.**<br>• **Calculate the terms of trade using the equation: Index of average export prices/index of average import prices x 100.** |
| **Causes of changes in the terms of trade<br>(HL ONLY)** | • **Explain that the terms of trade may change in the short term due to changes in demand conditions for exports and imports, changes in global supply of key inputs (such as oil), changes in relative inflation rates and changes in relative exchange rates.**<br>• **Explain that the terms of trade may change in the long term due to changes in world income levels, changes in productivity within the country and technological developments.** |
| **Consequences of changes in the terms of trade<br>(HL ONLY)** | • **Explain how changes in the terms of trade in the long term may result in a global redistribution of income.**<br>• **Examine the effects of changes in the terms of trade on a country's current account, using the concepts of price elasticity of demand for exports and imports.**<br>• **Explain the impacts of short-term fluctuations and long-term deterioration in the terms of trade of economically less developed countries that specialize in primary commodities, using the concepts of price elasticity of demand and supply for primary products and income elasticity of demand.** |