**4.3 Balance of payments, exchange rates and international competitiveness**

**1 Balance of payments**

a) Components of the balance of payments:

• the current account

• the capital and financial accounts.

b) Causes of deficits and surpluses on the current account.

c) Measures to reduce a country’s imbalance on the current account.

d) The significance of global trade imbalances.

**2 Exchange rates**

a) The distinction between fixed, managed and floating exchange rates.

b) Government intervention in currency markets through:

• foreign currency transactions

• the use of interest rates

• quantitative easing.

c) Factors influencing floating exchange rates:

• relative interest rates

• relative inflation rates (purchasing power parity theory)

• current account of the balance of payments

• strength of the economy

• capital flight

• expectations and speculation

• global factors, e.g. falls in commodity prices.

d) The distinction between revaluation and appreciation of a currency.

e) The distinction between devaluation and depreciation of a currency.

f) The impact of changes in exchange rates on:

• the current account of the balance of payments (with reference to Marshall-Lerner condition and to the J-curve effect)

• the capital and financial accounts of the balance of payments

• economic growth

• employment and unemployment

• rate of inflation

• FDI flows.

g) Competitive depreciations/devaluations and their consequences.

**3 International competitiveness**

a) Measures of international competitiveness:

• relative productivity rates

• relative unit labour costs

• relative export prices.

b) Factors influencing international competitiveness:

• productivity

• quality of human capital

• exchange rate

• wage and non-wage costs

• regulations

• quality of infrastructure

• non-price factors.

c) Measures to increase international competitiveness:

• policies to improve education and training

• investment incentives

• privatisation and deregulation

• measures to reduce the exchange rate of the currency

• trade liberalisation.

d) The significance of international competitiveness:

• advantages for an economy of being internationally competitive

• problems for an economy of being internationally uncompetitive.