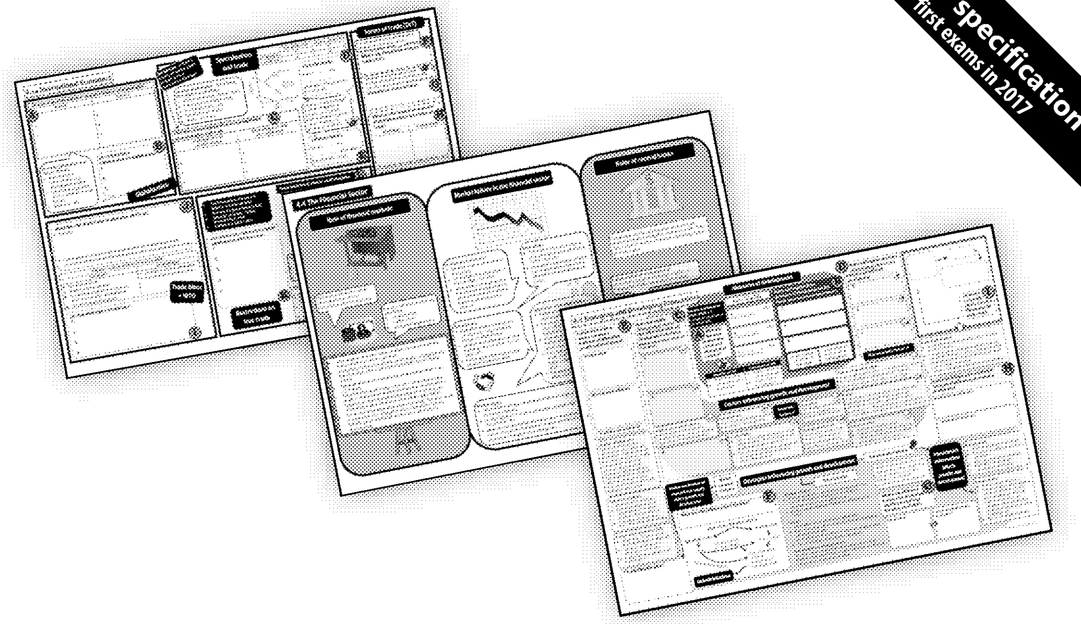


2015 specification
first exams in 2017

Topic on a Page

For A Level Edexcel Economics A:

Theme 4

Z Mujib

zigzageducation.co.uk

POD
7435

Contents

Thank You for Choosing ZigZag Education

Teacher Feedback Opportunity

Terms and Conditions of Use

Teacher's Introduction

A3 Activity Pages

- 4.1a: International Economics
- 4.1b: International Economics
- 4.2: Poverty and Inequality (A4)
- 4.3: Emerging and Developing Economies
- 4.4: The Financial Sector
- 4.5: Role of the State in the Macroeconomy

A3 Summary Pages

- All Topics

A4 Summary Pages

- All Topics

Teacher's Introduction

This resource covers the Economics A Level Edexcel A Specification for Theme 4:
6 A3 posters, each covering all the sub-themes.

It is intended as a summary of the material and focuses on the main points rathe
areas are covered, without going into too much depth.

The posters could be displayed on classroom walls, or given to students to learn

The resource can be used to help students to revise at the end of a topic, or befo

Activity versions of the posters are also included, where some of the sections are
test their knowledge by completing [illegible]

Different styles and [illegible] are used to help to make the information interesting
with the information in a productive way.

If teachers wished to add extra annotations to clarify or add further information,

Some of the subtopics are linked, and it will be helpful for students to view the w
to make connections between concepts. However, posters have clear-cut divisio
teacher could choose to give students part of a poster, if they wished to focus o

The symbol  is used to denote quantitative skills.

4.1a International Economics

Globalisation

A

Give three positive and three negative impacts of globalisation.

Positive	Negative
•	•
•	•
•	•

Increased globalisation over the last 50 years due to:
- Better means of communication (e.g. internet) and transport
- World Trade Organisation (WTO) – reduction in trade barriers
- Creation of TNCs

B

List at least three characteristics of globalisation.

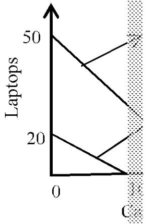
3.

Specialisation and trade

Specialisation is about a country producing goods in which it has a comparative advantage.

Cou
Cou

Assumptions/limitations of the theory of comparative advantage:
- All countries produce identical goods
- Free movement of factor inputs
- Zero transport costs
- Zero economies of scale
- Perfect information



C

Give three advantages and three disadvantages of specialisation and trade.

Advantages of trade and specialisation	Disadvantages of tr and specialisati
•	•
•	•
•	•

Trade blocs + WTO

J

What does the World Trade Organisation (WTO) do?
- *The WTO…*
- Conflict between WTO and regional trade agreements → latter lead to trade diversion, which decreases trade elsewhere and undermines comparative advantage.

Regional trade agreements / monetary unions:	
Advantages	**Disadvantages**
• No transaction costs • Greater price transparency • No need to account for ER fluctuations, which hurt countries' competitiveness • Attract FDI → good for growth	• Transition costs, e.g. menu costs • No control over monetary policy

I

List four main types of

1.

2.

3.

4.

Restrictions on free trade

- Tariff increase on the price of imports → lower demand
- Revenue for government (ABCD)
- Domestic consumer surplus increased by P_1P_2DE
- Welfare loss (ADE + BCF)

Draw

K

List at least five reasons of a country wanting to restrict free trade.

1.

2.

3.

4.

5.

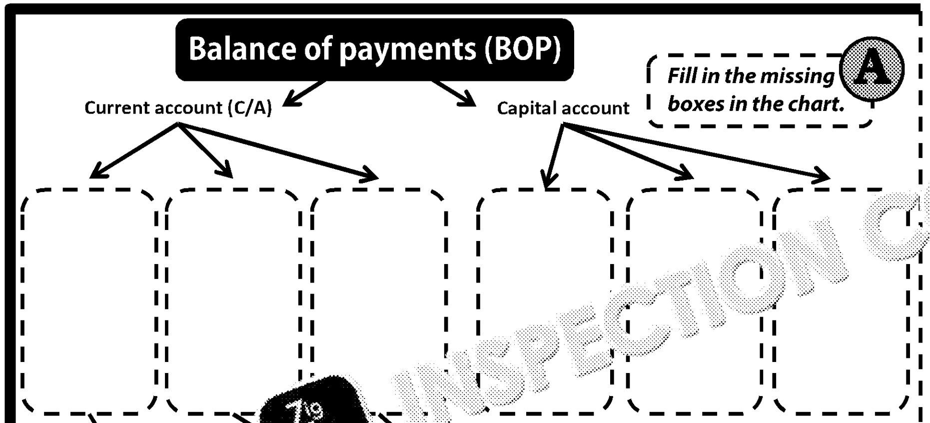
Types of
- Tariffs
- Quotas
- Subsi
- Non-ta

Impacts of

Adv
• Revenu from ta • Local fi profits • Local jo

4.1b International Economics

Balance of payments (BOP)

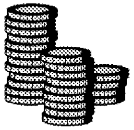


Fill in the missing boxes in the chart. **A**

Exports minus imports

Inflow of [illegible] minus outflow of income

Loans/grants received and/or given out by governments



Significance of trade imbalances:

- As a negative trade balance increases, it becomes more and more difficult to finance. Hence, loans have to be taken out. This is because a negative current account [illegible] a positive capital account.
- Government spending may fall significantly to repay those loans.
- Also, if exports outstrip imports, domestic consumers may be faced with limited choice.
- Trade imbalances also lead to massive currency fluctuations → affects global trade.

B *Explain two causes of current account deficit and two causes of current account surplus.*

Causes of C/A deficit	Causes of C/A surplus
1.	*1.*
2.	*2.*

C *Explain any two measures used for correcting current account imbalances.*

1.

2.

International competitiveness

Ability to sell domestic goods abroad

International competitiveness:

Benefits
• Creates jobs in the export industry • Export-led growth • Improves trade deficit
Costs
• Over-reliance on exports can become a problem if the world economy experiences recession → massive job losses

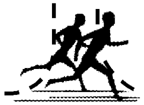
I *List four factors that affect international competitiveness of a [illegible]*

1.

2.

3.

4.



J *[illegible] an[illegible] the two main measures of international competitiveness.*

1.

2.

E+ F: W
referri
the va

E *...Fl*

Value de

Value in

Forces of d
the value o

Factors i

- **Relati**
  If rela
  encou
  get a
  dema
- **Relati**
  If rela
  appea
  export
- **Specu**
  If peo
  fall, th
  curren
  £ decr
  proph
- **State**
  Econo
  invest
  → de
  £ appr

Impa
cha

Growt
ER dep
creatio

4.2 Poverty and Inequality

A

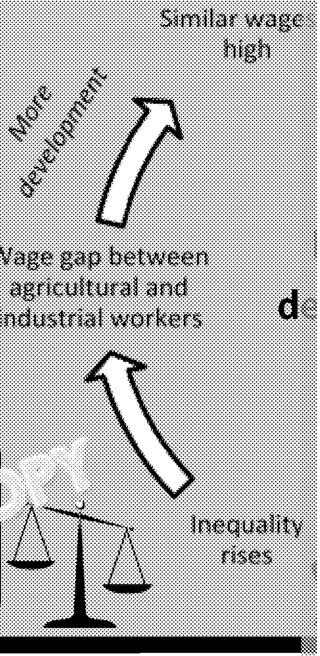
List four causes of inequality.

1.

2.

3.

4.



Capitalism and inequality:
Capitalism allows individuals to pursue their own goals. For firms this means profit maximisation. Th[illegible] highly skilled labour, who demand high wages, while low-skilled workers earn much less. This creates inequality.

B

What is meant by absolute poverty?

Causes of changes in poverty:

- High growth → decreases absolute poverty due to creation of jobs
- High growth → increases average income → possible increase in relative poverty
- More FDI → more jobs → decreases absolute poverty
- More trade → more jobs → decreases absolute poverty
- Increased income tax → reduces relative poverty

What is meant by relative poverty?

Wealth = stock concept
asset, e.g. house
Income = flow concept
liquid money

Draw and clearly label the Lorenz curve using explanation next to the axes.

E

What is the Gini coe

Using your answer t
formula for the Gini

4.3 Emerging and Developing Economies

E *Explain the following market orientated strategies of influencing growth and development.*

Privatisation:

Microfinance schemes:

**Trade liberalisation (bottom)*

C *Name and explain three economic factors that influence growth and development in the boxes below. (Some of them have already been filled in.)*

1.

3.

Measures of development

Human development index (HDI) is a composite measure of development.

$$\text{HDI} = \sqrt[3]{a \times b \times c}$$

a_______________ index
which measures...

b___________
which me[illegible]

_______________ index
which measures...

A *What are the three components of HDI and what do they measur[illegible]*

ZBenefits of HDI	Drawbacks of HDI
Multidimensional Uses two measures for education	Ignores inequality, as it uses averages Missing factors, e.g. happiness

Name and explain three measures of development in boxes. (Two of them have already be

1.

2.

3.

Number of people with ***access to clean water***

Number o with ac ***mobile***

Ab
Fr
fo
de

Factors influencing growth and development

Economic factors ✓

Volatility of commodity prices:
Inelastic demand and supply price instability → overall economic instability (high inflation, unemployment, etc.)

Infrastructure:
Poor infrastructure makes trading very costly → discourages FDI

Education:
Developing countries tend to lack the appropriate educational infrastructure

Capital flight:
- This is about people saving their money in foreign banks, which are more secure and/or have a higher interest rate
- Thus, developing countries are deprived of savings → lack of investment in capital → low growth

Demographic factors:
Developing countries tend to have large populations →increases dependency ratio →low income per head

Floating exchange rate:
Countries tend to peg their currency value at a higher rate. Switching to a floating regime will demand that demand and supply will decide the value of the currency, which means the currency is likely to depreciate. Thus, imports become expensive while exports become cheap. Thus, local industries will flourish, leading to higher growth.

Removal of subsidies:
- Subsidies lead to inefficiency
- Removing subsidies increases competitiveness → increases productive/allocative efficiency
- Competitiveness means lower prices → more consumer spending

Foreign direct investment (FDI):
- Creates jobs → more consumer spending → higher AD → grow
- Countries can benefit from expertise of other nations
- Foreign firms may spend on lo infrastructure

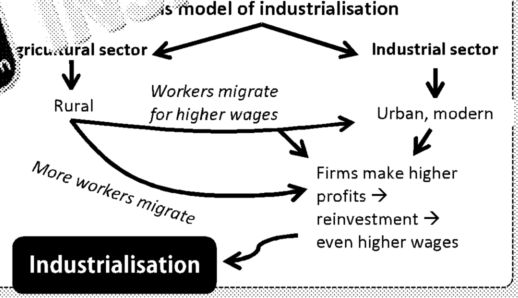
Market mechanism of demand and supply affect growth and development

Market orientated strategies

Strategies infl[illegible] and development

Other strategies

F *What does the following ch[illegible]*


[illegible]s model of industrialisation
gricultural sector → Rural
Industrial sector → Urban, modern
Workers migrate for higher wages
Firms make higher profits → reinvestment → even higher wages
More workers migrate
Industrialisation

**Trade liberalisation:*

Fairtrade schemes:
- Developed countries exercise monopsony power. T poor countries get unfair prices for their exports
- Fair trade ensures farmers get a fair price
- But the need for middlemen eliminate some benefit to farmer

Tourism:
- Developing tourism can lead to high growth
- Need to improve infrastructure, facilities and mar
- Will create many jobs
- Demand for currency will rise → increase foreign
- But it can lead to environmental degradation

Development of primary products:
Countries rich in resources should develop their prim industries, especially if they are high-valued goods ar country has a comparative advantage

4.4 The Financial Sector

Role of financial markets

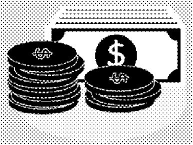
A *What is a financial market?*

B *Name the three forms that the financial markets come in.*

1.

2.

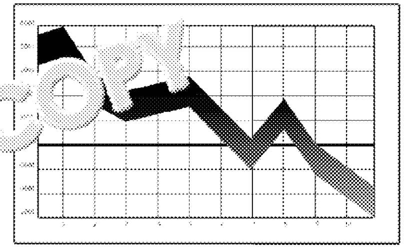
3.



C *Explain two roles of financial markets, other than what has already been stated.*

- Allow people to save their money, so others can borrow while the savers benefit from interest payments.
- Provide funds to those who want to invest. People's savings are used to lend money to others, and the banks facilitate this channelling of funds.
-
-

Market failure in the financial sect



D *Explain how asymmetric information leads to market failure in the financial sector.*

Externalities:

- If financial marke risky practices, th cost the economy.
- For example, every pay for the financ aftermath of the Crash.

E *What type of market failure does the following explanation refer to?*

....

- If people/institutions are insured against losses, they are likely to indulge in risky behaviour.
- So banks tend to feel they can take excessive risks since they are too big to fail.
- For example, in the 2008 recession, the taxpayers bailed out banks.

Explain how spec market bubbles l market failure in sector.

What type of market failure does the following explanation r

....

- This involves the illegal manipulation of something (generally for perso
- Market rigging can take place while setting interest rates or the exch
- Banks can get confidential information about their borrowers and a position to place their orders to benefit from the manipulated chan exchange rate.

4.5 Role of the State in the Macroeconomy

Public expenditure

For each explanation below in the boxes, state what type of public expenditure they are referring to. **A**

……………………………………
Government spending on capital for long-term development

……………………………………
Government spending on the welfare system

……………………………………
Government spending on everyday expenses, e.g. public sector wages

Factors affecting the size and composition of public expenditure:

- **Changes in demographics**: different age structures have different needs. The UK has an ageing population, hence the government spends more on health care and pensions
- **Financial crisis**: following a crisis, government aims to provide more jobs as unemployment rises
- **Changes in income**: when incomes rise, welfare spending tends to decrease
- **Changes in expectations**: an expectation of a baby boom would lead to an increase in the spending on education and health care

Explain three impacts of public expenditure. **B**

1.

2.

3.

Taxation

Define the following types of taxation. **C**

Progressive taxes:

Proportional taxes:

Regressive taxes:

Effect of changes in tax rates on other variables:

- **Incentives to work**: progressive taxes can discourage workers from improving their productivity. This will negatively affect the entire economy. This [illegible] to the creation of tax exiles (i.e. people moving to countries with lower taxes), which would result in a brain drain
- **Tax revenues**: the Laffer curve suggests that as tax rates increase, tax revenue at first increases and thereafter decreases. This may occur due to practices of tax avoidance and evasion.
- **Income distribution**: progressive taxes help redistribute income, while regressive taxes increase inequality.
- **Real output and employment**: taxes reduce disposable incomes, which leads to a fall in real output. This causes unemployment.
- **Price level**: direct taxes decrease inflation as spending goes down. However, indirect taxes increase inflation by directly increasing the prices of goods and services.
- **Trade balance**: increase in direct taxes ➔ reduction in disposable income ➔ less AD ➔ fall in demand for imports ➔ improve trade deficit.
- **FDI flows**: high taxes discourage FDI, as profits will shrink.

Draw and label the Laffer curve. **D**

Macroeconomic policies in a global context

Effects of external shocks to the global economy:

- E.g. a rise in the price of a commodity like oil will lead to cost-push inflation. Deflationary policies, such as raising taxes, [illegible] not work as oil is a necessity [illegible] will be consumed regardless [illegible] level of income tax.
- The Global Financial Crisis began [illegible] USA but soon spread across the globe due to ever-increasing globalisation. Thus, many countries suffered from massive unemployment and economic slowdown.

External shocks may result from sudden changes in global economics or politics.

Explain how government can control transnational companies (TNCs). **I**

Write down the Fisher equation and state which each variable stands for. **J**

State three issues with implementing macroeconomic policies following a shock to the economy. **K**

1.

2.

3.

Use of m
- Up
  arg
- A d
  as d
  edu
- **Sup**
  incr
- **Dire**
  rem
  cert
- Mo
  -
  -

4.1a International Economics

Globalisation

Impacts of globalisation:

Positive	Negative
Increase in consumer choice Low prices for consumers Improved living standards Access to cheap factor inputs for businesses Firms can make higher profits due to access to a bigger market Encourages specialisation → increased efficiency Reduction in unemployment Increased revenue from import tariffs for governments	Increased environmental degradation/pollution Increased interdependence → recession in one country spreads quickly Access to cheap labour abroad → local unemployment will rise

Characteristics of globalisation:
- Increased trade
- Increased interdependence
- More foreign direct investment (and transnational companies (TNCs))
- Easy access to factor inputs

Increased globalisation over last 50 years:
- Better means of communication (e.g. internet) and transport
- World Trade Organisation (WTO) – reduction in trade barriers
- Creation of TNCs

Trade blocs and WTO

- The **World Trade Organisation (WTO)** promotes free trade by following a policy of **trade liberalisation**. It provides a platform for trade negotiations and settlement of any trade issues between member countries.
- Conflict between WTO and regional trade agreements → latter lead to trade diversion, which decreases trade elsewhere and undermines comparative advantage.

Regional trade agreements / monetary unions:

Advantages	Disadvantages
No transaction costs Greater price transparency No need to account for ER fluctuations, which hurt countries' competitiveness Attract FDI → good for growth	Transition costs, e.g. **menu costs** No control over monetary policy

Types of trade blocs:

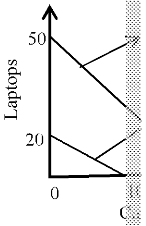
1) **Free Trade Area (these can be bilateral or regional)**
   - Free movement of goods and services
   - Each member can set their own trade policies for non-members
2) **Customs union**
   - Member countries have a common trade policy for all non-members
3) **Common market**
   - Free movement of factors
4) **Monetary Union**
   - Single currency – as in the **Eurozone**
   - Conditions necessary for success include:
     - ➢ Similar growth patterns and **business cycles** of member countries
     - ➢ Similar cultures to decrease barriers to free movement
     - ➢ Increase spending in adversely affected (from this move) areas

Specialisation and trade

Specialisation is about a country producing goods in which it has a comparative advantage.

Co
Co

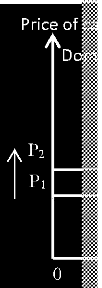
Assumptions/limitations of the theory of comparative advantage:
- All countries produce identical goods
- Free movement of factor inputs
- Zero transport costs
- Zero economies of scale
- Perfect information



Advantages of trade and specialisation	Disadvantages of tra and specialisatio
Greater choice for consumers Cheaper goods for consumers Greater efficiency Firms experience economies of scale Wider market → higher profits Increased growth + higher standards of living	Countries become interdependent Terms of trade may worsen (i.e. th higher-value goods and export low Over-reliance on the production of Countries lacking comparative adv lose out Unwanted goods can be 'dumped' countries at very low prices, which local firms May widen the rich and poor gap Bad for '**infant industries**'

Restrictions on free trade

- Tariff increase on the price of imports → lower demand
- Revenue for government (ABCD)
- Domestic consumer surplus increased by P_1P_2DE
- Welfare loss (ADE + BCF)



Reasons for restrictions on free trade:

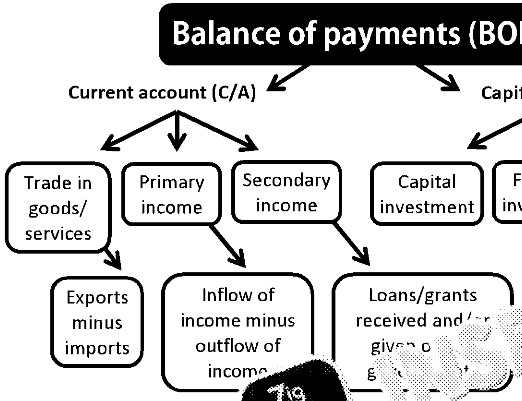
1) Protecting local industries
   - Infant industries are new industries that need time to mature out
   - Sunset industries are firms in decline but they may be useful
   - Countries need to be self-sufficient in industries such as defence and energy
2) Preventing 'dumping' from very cheap imports
3) Protecting jobs
4) Less dependency
5) Correct current account deficit
6) Avoid competition
7) Retaliation

Types of t
- Tariffs
- Quotas
- Subsid
- Non-ta

Impacts of

Ad
Revenu from ta Local fir profits Local jo

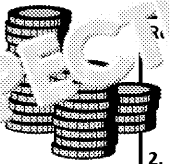
4.1b International Economics



Balance of payments (BOP)

Current account (C/A)
- Trade in goods/services → Exports minus imports
- Primary income → Inflow of income minus outflow of income
- Secondary income → Loans/grants received and/or given o[illegible] g[illegible]

Capital account
- Capital investment
- Financial investment
- Speculative capital flows



Causes of C/A deficit	Causes of C/A surplus
• High inflation rate → cheap imports • Relatively low labour productivity → increased average cost → cheap imports • Higher exchange rate → cheap imports • High domestic growth → increased demand for imports • Growth in large economies → increased demand for imports	• Protectionist measures decrease imports • Low inflation → cheap exports • Lower exchange rate → cheap exports • Low domestic growth → increased demand for exports • Relatively high labour productivity → low average cost → cheap exports

Significance of trade imbalances:
- As a negative trade balance increases, it becomes more and more difficult to finance. Hence, loans have to be taken out. This is because a negative current account implies a positive capital account.
- Government spending may fall significantly to repay those loans.
- Also, if exports outstrip imports, domestic consumers may be faced with limited choice. Trade imbalances also lead to massive currency fluctuations → affects global trade.

Reducing current account imbalances:

1. **Expenditure-reducing policies**
   Policies that reduce AD, e.g. increasing income tax → reduces disposable income → demand for imports decreases.
2. **Expenditure-switching policies**
   Policies that affect demand for imports, i.e. trade barriers, e.g. imposing tariff → imports become expensive → demand for imports falls.
3. **Supply-side policies**
   Policies that affect demand for exports, e.g. increasing spending on education → improves labour productivity → improves quality/quantity of exports → demand for exports rises.
4. **Doing nothing**
   Some of the policies described above have downsides, e.g. raising taxes will also affect domestic demand and imposing trade barriers is often met with retaliation. Thus, some countries may opt to do nothing.

International competitiveness

Ability to sell domestic goods abroad

International competitiveness:

Benefits
• Creates jobs in the export industry • Export-led growth • Improves trade deficit

Costs
• Over-reliance on exports can become a problem if the world economy experiences recession → massive job losses

Measures of international competitiveness:
- **Relative unit labour costs**
  If labour in country A is more productive or gets lower wages than country B, then the former is said to be more internationally competitive (i.e. it can export more)
- **Relative export prices**
  If country A's export prices are lower than country B's, then the former can export more

Factors affecting international competitiveness:
1. **Relative unit labour** [illegible]
2. **Relative level of regu**[illegible]
   If firms in a country fac[illegible]lation, then they are more competitive
3. **Relative inflation**
   Exports from a country with lower inflation compared to others appear cheaper
4. **Relative non-wage costs**
   If other factor inputs in a country are cheaper compared to another country, it will be able to produce goods cheaply → more exports

Value de
Value in

Forces of
supply de
of the cu

Factors

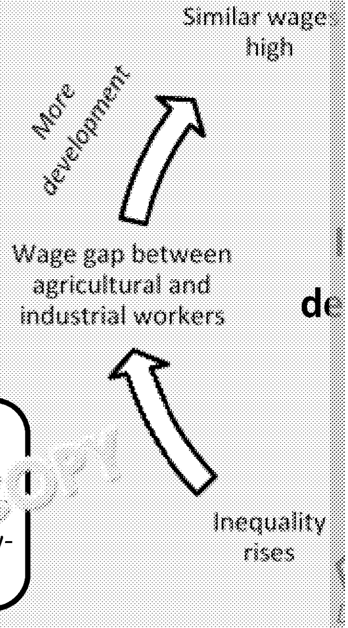
Imp
ch

Growth
ER depre
job creat
more gro

4.2 Poverty and Inequality

Causes of inequality:
- Regressive tax system → more equality
- Weak trade unions → more equality
- Unfair pension scheme → more equality
- Lack of social security → more equality
- Level of education
- Employment/inheritance laws, etc.

Capitalism and inequality:
Capitalism allows individuals to pursue their own goals. For firms this means profit maximisation. Thus, firms hire highly skilled labour, who demand high wages, while low-skilled workers earn much less. This creates inequality.



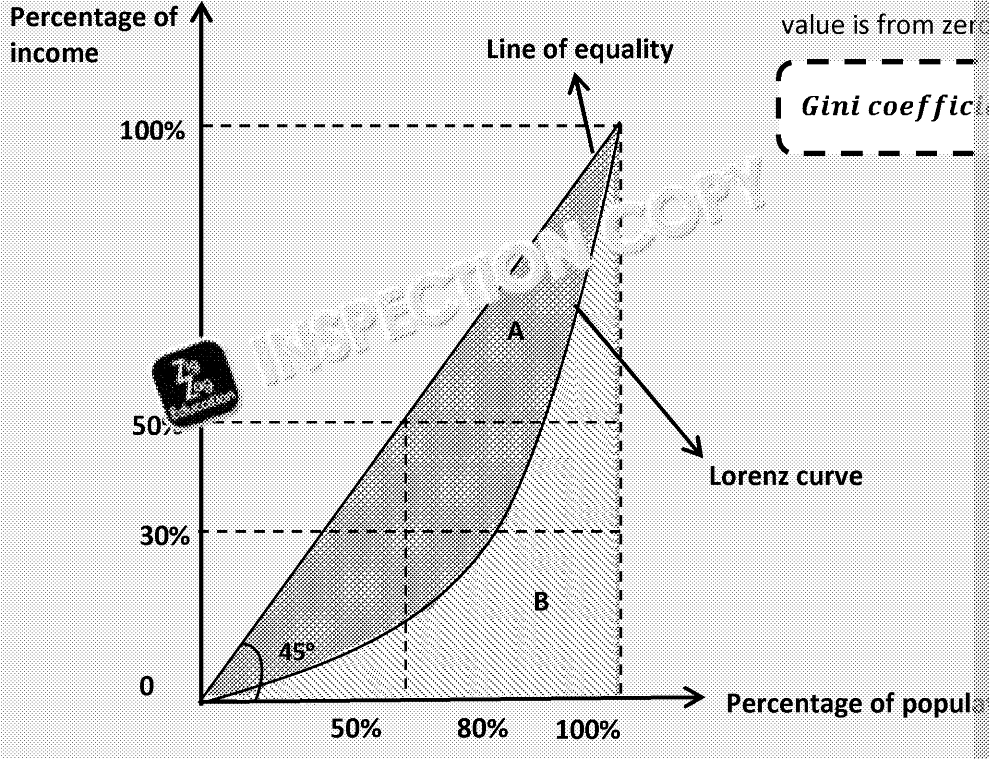
Absolute poverty [illegible] to a situation where a person is denied basic needs over a long period of time (e.g. food, shelter and clothing). Measured by calculating the proportion of people living under some income threshold – around $2 a day.

Causes of changes in poverty:
- High growth → decreases absolute poverty due to creation of jobs
- High growth → increases average income → possible increase in relative poverty
- More FDI → more jobs → decreases absolute poverty
- More trade → more jobs → decreases absolute poverty
- Increased income tax → reduces relative poverty

Relative poverty occur
when a person can me
basic needs but earns
considerably less than
country's average pers

In Britain any person
earning less than 60%
the median income is
considered relatively p

Measuring inequality: the Lorenz curve



The Gini coeffici
which shows the
value is from zer

Gini coeffic

4.3 Emerging and Developing Economies

Privatisation:
- This is about selling state-owned firms to the private sector because the latter is more efficient.
- Efficiency translates into lower prices for consumers and higher profits for firms. This leads to increased consumer spending and investment, which results in higher growth.

Microfinance schemes:
- This is about providing small loans to poor people, who are unlikely to get loans from big banks that require the provision of collateral.
- Loans are given to groups so that repayment is guaranteed.
- This helps poor people escape poverty.

Floating exchange rate:
Countries tend to peg their currency value at a higher rate. Switching to a floating regime will demand that demand and supply will decide the value of the currency, which means the currency is likely to depreciate. Thus, imports become expensive while exports become cheap. Thus, local industries will flourish, leading to higher growth.

Removal of subsidies:
- Subsidies lead to inefficiency
- Removing subsidies increases competitiveness → increases productive/allocative efficiency
- Competitiveness means lower prices → more consumer spending

Foreign direct investment (FDI):
- Creates jobs → more consumer spending → higher AD → growth
- Countries can benefit from expertise of other nations
- Foreign firms may spend on [illegible] infrastructure

Trade liberalisation:
- This is about reducing trade barriers
- Free trade promotes growth by creating jobs
- Free trade leads to greater allocative efficiency
- But this could reduce growth if a country is flooded with cheap imports

Foreign currency gap:
Developing countries tend to face a shortage of foreign currency. This is mainly due to:
- Low export earnings
- Increase in global prices
- Using foreign currency on debt repayment

Harrod-Domar model:
- Model posits that savings level and the capital-output ratio are the main determinants of grow[illegible]
- Developing c[illegible] h[illegible] low l[illegible] lack of [illegible] capital [illegible] low growth

[illegible]ility of commodity prices:
Inelastic demand and supply price instability → overall economic instability (high inflation, unemployment, etc.)

Primary product dependency:
- Primary products = commodities (generally low-valued)
- Hence, countries dependent on primary products tend to remain poor
- Demand is income inelastic, which means rising incomes do not increase demand to the same extent
- Such countries export low-valued goods, while importing high-value goods, leading to falling terms of trade

Measures of development

Human development index (HDI) is a composite measure of development.

HDI =

$$\sqrt[3]{\text{education index x life expectancy index x income index}}$$

Education Index
Average + expected years of schooling

Life expectancy index
Life expectancy at b[illegible]

[illegible]me [illegible]
G[illegible] [illegible]erson

Benefits of HDI	Drawbacks of HDI
Multidimensional Uses two measures for education	Ignores inequality, as it uses averages Missing factors, e.g. happiness

Lorenz curve + Gini coeffici
Measure inequality

Head count ratio:
Counts the number of poor people

Multidimensional poverty (M
Looks at income and things l
crime, sanitation, water, et

*Number of people with **access to clean water***

Number of
with ***acc***
mobile p

Factors influencing growth and development

Infrastructure:
Poor infrastructure makes trading very costly → discourages FDI

Economic factors ✓

Education:
Developing countries tend to lack the appropriate educational infrastructure

Capital flight:
- This is about people saving their money in foreign banks, which are more secure and/or have a higher interest rate
- Thus, developing countries are deprived of savings → lack of investment in capital → low growth

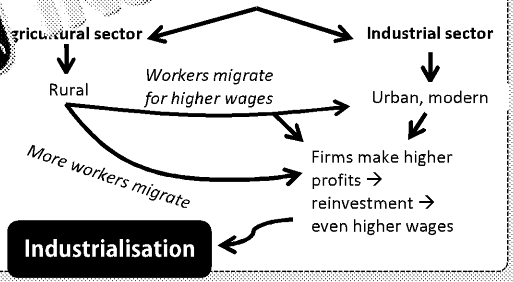
Demographic factors:
Developing countries tend to have large populations →increases dependency ratio →low income per head

Strategies infl[illegible] [illegible]ow[illegible] and development

Market orientated strategies

Market mechanism of demand and s[illegible] affect growth and dev[illegible]ent

[illegible]s model of industrialisation



Other strategies

Fairtrade schemes:
- Developed countries exercise monopsony power. T
poor countries get unfair prices for their exports
- Fair trade ensures farmers get a fair price
- But the need for middlemen eliminate some benefit tc
farmer

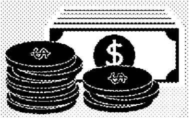
Tourism:
- Developing tourism can lead to high growth
- Need to improve infrastructure, facilities and mar
- Will create many jobs
- Demand for currency will rise → increase foreign
- But it can lead to environmental degradation

Development of primary products:
Countries rich in resources should develop their prim
industries, especially if they are high-valued goods ar
country has a comparative advantage

4.4 The Financial Sector

Role of financial markets

The financial market is a market where people buy and sell commodities, bonds and equities.



Financial markets come in three main forms:
1. money market
2. capital market
3. foreign exchange market

- Allow people to save their money, so others can borrow while the savers benefit from interest payments.
- Provide funds to those who want to invest. People's savings are used to lend money to others, and the banks facilitate this channelling of funds.
- People can also borrow money to buy certain goods and services, e.g. property.
- Assist in the buying and selling of currency. Currencies are often bought in what is known as the forward market. Currency can be bought in the future at a rate decided today for that future sale. This protects buyers and sellers from exchange rate instability.
- Provide market for equities (i.e. shares and bonds). Th[illegible] is where shares can be bought or sold to raise [illegible] turn. Similarly, government bon[illegible] so[illegible] for financing debts.

Market failure in the financial sect

Asymmetric information:
- Borrowers may know more than the lenders.
- For example, they know better if they can repay any loans.
- Lenders may end up giving loans to borrowers who are unable to pay (adverse selection): this will negatively affect the entire economy.

Externalities:
- If financial marke risky practices, th cost the economy
- For example, eve pay for the financ aftermath of the Crash.

Moral hazard:
- If people/institutions are insured against losses, they are likely to indulge in risky behaviour.
- So banks tend to feel they can take excessive risks, since 'they are too big to fail'.
- Following the 2008 recession, taxpayers bailed [illegible] banks.

Speculation and mar
- Excessive lending 'market bubbles'.
- This means that th rises artificially, du expectations (spec
- However, adverse lead to expectatio asset's value.
- Thus, people will t assets, which will supply in the mark price.
- This leads to a neg effect, which caus

Market rigging:
- This involves the illegal manipulation of something (generally for personal benefit).
- Market rigging can take place while setting interest rates or the exchange rate.
- Banks can get confidential information about their borrowers and are in a position to place their orders to benefit from the manipulated changes in the exchange rate.

4.5 Role of the State in the Macroeconomy

Public expenditure

Capital expenditure: Government spending on capital for long-term development

Current expenditure: Government spending on everyday expenses, e.g. public sector wages

Transfer payments: Government spending on the welfare system

Factors affecting the size and composition of public expenditure:

- **Changes in demographics**: different age structures [illegible] different needs. The UK [illegible] ageing population, hence [illegible] government spends more [illegible] care and pensions
- **Financial crisis**: following a crisis, government aims to provide more jobs as unemployment rises
- **Changes in income**: when incomes rise, welfare spending tends to decrease
- **Changes in expectations**: an expectation of a baby boom would lead to an increase in the spending on education and health care

Impacts of public expenditure:

- **Growth**: high level of public expenditure → job creation → increased consumer spending → increased growth. (Note: transfer payments will not increase growth rates.)
- **Living standards**: tra[illegible] improve living [illegible]ds, as no[illegible] live[illegible] [illegible]ove[illegible] [illegible]wever, this [illegible] high [illegible] of taxation, which [illegible] living standards of taxpayers.
- **Crowding out**: increased government spending may require borrowing from the private sector. This causes the private sector to shrink (i.e. crowd out), as interest rates rise, leading to decreased investment.
- **Taxation**: increased public spending → higher taxes.
- **Equality:** transfer payments may improve inequality. However, capital spending initially increases inequality (as transfer payments decrease) but in the long run improves equality as the country develops.

Taxation

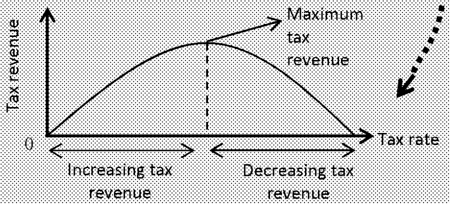
Progressive taxes: Taxes increase as incomes rise

Proportional taxes: Tax rates are fixed: they do not change with income

Regressive taxes: Taxes decrease as incomes rise

Effect of changes in tax rates on other variables:

- **Incentives to work**: progressive taxes can discourage workers from improving productivity. This will negatively affect the entire econom[illegible]s could lead to the creation of tax exiles (i.e. peop[illegible] [illegible]o countries with lower taxes), which wou[illegible] [illegible] brain drain.
- **Tax revenue**: th[illegible] [illegible] curve suggests that as tax rates increase [illegible]nue at first increases and thereafter decreases. This may occur due to practices of tax avoidance and evasion, as well as disincentive effects.
- **Income distribution**: progressive taxes help redistribute income, while regressive taxes increase inequality.
- **Real output and employment**: taxes reduce disposable incomes, which leads to a fall in real output. This causes unemployment.
- **Price level**: direct taxes decrease inflation as spending goes down. However, indirect taxes increase inflation by directly increasing the prices of goods and services.
- **Trade balance**: increase in direct taxes → reduction in disposable income → less AD → fall in demand for imports → improve trade deficit.
- **FDI flows**: high taxes discourage FDI, as profits will shrink.



Macroeconomic policies in a global context

Effects of external shocks to the global economy:

- E.g. a rise in the price of a commodity like oil will lead to cost-push inflation. Deflationary policies, such as raising tax[illegible] not work as oil is a nece[illegible] will be consumed regard[illegible] the level of income tax.
- The Global Financial Crisis [illegible] in USA but soon spread across the globe due to ever-increasing globalisation. Thus, many countries suffered from massive unemployment and economic slowdown.

External shocks may result from sudden changes in global economics or politics.

Measures to control transnational companies (TNCs):

- Governments of recipient countries can make TNCs work in their country conditional on using local factor inputs. This would help create more jobs, leading to higher living standards.
- However, most TNCs are 'footloose' (i.e. the[illegible] [illegible]an easily move to different countries) [illegible] regulating them hard. Anoth[illegible] c[illegible]cern [illegible]oping countries is the TN[illegible] [illegible], which enables the[illegible] [illegible]ver pro[illegible] [illegible]ere taxes are high. All thi[illegible] [illegible] TNCs.

Quantity theory of money (Fisher equation)

[illegible] PT

[illegible]

M = [illegible] supply

[illegible]city of circulation (i.e. number of times the money supply has been used)

P = price level

T = total number of transactions made in a year

Issues of implementing policies:

- **Inaccurate information**: incorrect data on GDP, unemployment, etc. make it hard to adopt the right policies.
- **Risk and uncertainties**: human behaviour is hard to predict, hence, the desired result of a policy can never be guaranteed.
- **Inability to control external shocks:** as countries and markets become interdependent, events in one economy can affect others too. Thus, it is hard to implement the right policies.

Use of ma

- Up u
  argue
- A def
  dispo
  and h
- **Supp**
  incre
- **Direc**
  rema
  certa
- Mon
  -
  -