

# Edexcel (A) Economics A-level Theme 2: The UK Economy, Performance and Policies

2.2 Aggregate Demand

2.2.5 Net trade (X-M)

Notes

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## The main influences on the (net) trade balances:

• **Exports minus imports:** This is the value of the current account on the balance of payments. A positive value indicates a surplus, whilst a negative value indicates a deficit. The UK has a relatively large trade deficit, which reduces the value of AD.

#### 🧕 Real income

- During periods of economic growth, when consumers have higher incomes and they can afford to consume more, there is a larger deficit on the current account.
- When consumers increase their spending, they consume more domestic products as well as more imports.
- During periods of economic decline, real incomes fall and historically, this has led to improvements in the UK's current account.

#### Exchange rates

- A depreciation of the pound means imports are more expensive, and exports are cheaper, so the current account trade deficit narrows.
- Depreciations make the currency relatively more competitive against other currencies.
- However, it depends on which currency the pound depreciates against. If it is the dollar or euro, it is likely to have a more significant effect, than a currency which is not from one of the UK's major trading partners.
- Moreover, the demand for UK exports has to be price elastic to lead to an increase in exports. If demand is price inelastic, exports will not increase significantly, and the value of exports will decrease.

#### State of the world economy

- A decline in economic growth in one of the UK's export markets means there will be a fall in exports. This is because consumer spending in those economies will fall, due to falling real incomes.
- For example, the UK's largest export market is the EU. If they face an economic downturn then demand for UK goods and services will fall, since consumers in the EU are less able to afford imports.

Degree of protectionism



- Protectionism is the act of guarding a country's industries from foreign competition. It can take the form of tariffs, quotas, regulation or embargoes.
- If the UK employed several protectionist measures, then the trade deficit will reduce. This is because the UK will be importing less due to tariffs and quotas on imports to the UK.
- However, since protectionism leads to retaliation, exports might decrease too, which undoes the effect of reduced imports.

### Non-price factors

- The **competitiveness** of a country's goods and services, which is influenced by supply-side policies, impacts how many exports the country has.
- A country can become more competitive by being innovative, having higher quality goods and services, operating in a niche market, having lower labour costs, being more productive or by having better infrastructure. These increase exports.
- Moreover, trade deals and being part of trading blocs can influence how much a country exports. This either opens up a country to, or closes a country from, significant export opportunities.

▶ Image: Second Second