

CA14 ECONOMICS

SECTION 12: INTERNATIONAL ECONOMICS

Syllabus references: INT-01 to INT-07

Purpose. Original DatalytlQs Academy teaching notes aligned to the KASNEB Revised Syllabus (June 2024).
Suggested study time: 12-15 hours. **Assessment threshold:** 70%. **No KASNEB endorsement is implied.**

Learning outcomes

After this section, the learner should be able to explain trade theories and gains; calculate comparative advantage and terms of trade; analyse tariffs, quotas and export measures; account for balance-of-payments transactions; explain exchange-rate determination and adjustment; and evaluate integration and international institutions.

Contents

1. Why economies trade
2. Comparative advantage and terms of trade
3. Protection and trade policy
4. Balance of payments
5. Exchange-rate determination
6. Exchange rates and adjustment
7. Regional integration
8. International institutions and policy evaluation

1. Why economies trade

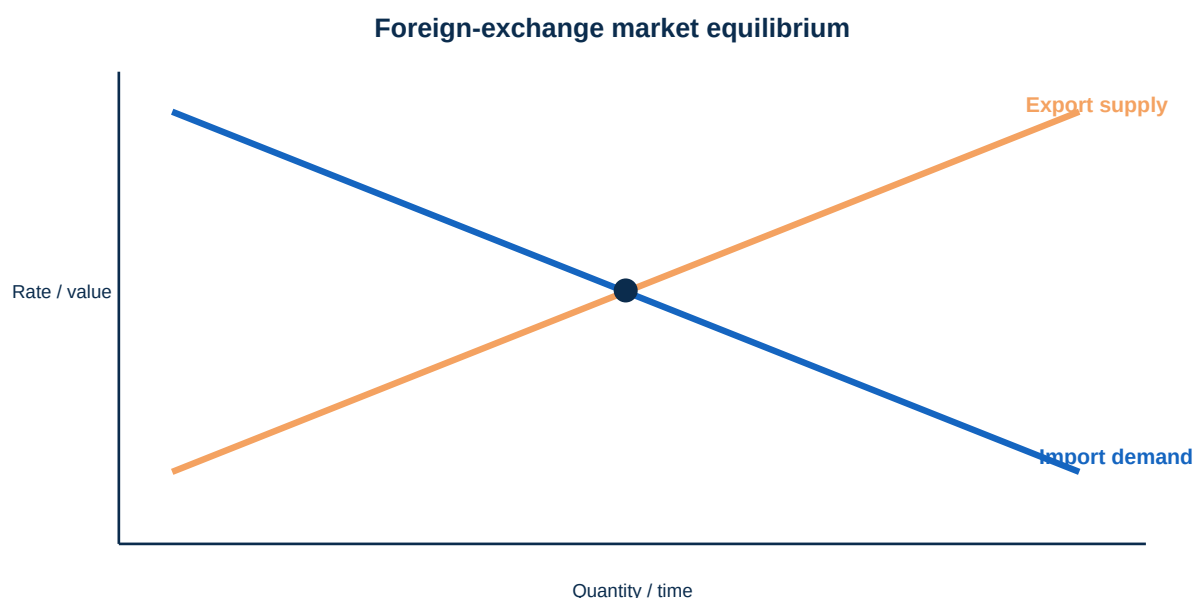
Trade permits specialisation, access to variety, scale, competition, technology transfer and use of different factor endowments. Absolute advantage means producing with fewer resources. Comparative advantage means lower opportunity cost and can generate gains even when one country has absolute advantage in both products. Gains depend on feasible terms of trade and adjustment costs.

One input per product	Tea	Software units
Country A	12	6
Country B	8	8
Opportunity cost of 1 software: A	2 tea	-
Opportunity cost of 1 software: B	1 tea	-

Examination technique: State the proposition, explain the mechanism, apply it to the question and qualify the conclusion where assumptions or context matter.

2. Comparative advantage and terms of trade

Country A sacrifices 2 tea for one software; B sacrifices 1 tea, so B has comparative advantage in software and A in tea. Mutually beneficial terms for one software lie between 1 and 2 tea, ignoring transport and other frictions. Comparative advantage is not a claim that every worker or industry benefits immediately; distribution and adjustment policy remain relevant.



Examination technique: State the proposition, explain the mechanism, apply it to the question and qualify the conclusion where assumptions or context matter.

3. Protection and trade policy

A tariff raises the domestic price of an import when the country is a price taker, reducing consumption, increasing domestic production and imports falling. Government gains revenue, protected producers gain surplus, consumers lose and deadweight losses arise. A quota restricts quantity; quota rents accrue to licence holders or exporters depending on allocation. Other measures include standards, subsidies, procurement and export restrictions.

Examination technique: State the proposition, explain the mechanism, apply it to the question and qualify the conclusion where assumptions or context matter.

4. Balance of payments

The current account records goods, services, primary income and secondary income. The capital account records capital transfers and non-produced non-financial assets. The financial account records cross-border acquisition of financial assets and liabilities, with reserve assets treated consistently under the official convention. Accounting entries balance in principle; errors and omissions reconcile measured discrepancies.

Transaction	Balance-of-payments effect
Export of services	Current-account credit.
Import of machinery	Current-account debit for goods.
Foreign purchase of domestic equity	Financial inflow/liability increase.
Resident buys foreign bond	Financial outflow/asset increase.
Debt forgiveness	Capital transfer, subject to official classification.

Examination technique: State the proposition, explain the mechanism, apply it to the question and qualify the conclusion where assumptions or context matter.

5. Exchange-rate determination

In a floating market, demand for foreign currency arises from imports, outward investment and transfers; supply arises from exports, inward investment and transfers. A depreciation is a market fall under floating rates; devaluation is an official downward change under a fixed regime. Appreciation and revaluation are the corresponding increases. Expectations, inflation, interest differentials, risk, trade and intervention affect rates.

Examination technique: State the proposition, explain the mechanism, apply it to the question and qualify the conclusion where assumptions or context matter.

6. Exchange rates and adjustment

Depreciation raises the domestic-currency price of imports and can improve export competitiveness, but the trade balance response depends on elasticities, invoicing, capacity, imported inputs and time. The Marshall-Lerner condition states that depreciation tends to improve the trade balance when the sum of absolute export and import demand elasticities exceeds one. The J-curve describes an initial deterioration before quantities adjust.

Examination technique: State the proposition, explain the mechanism, apply it to the question and qualify the conclusion where assumptions or context matter.

7. Regional integration

Integration can proceed through preferential trade area, free-trade area, customs union, common market, monetary union and deeper economic union. Trade creation replaces higher-cost domestic output with lower-cost partner imports; trade diversion replaces lower-cost rest-of-world imports with higher-cost partner imports because of preferences. Net welfare depends on their relative size and dynamic effects.

Examination technique: State the proposition, explain the mechanism, apply it to the question and qualify the conclusion where assumptions or context matter.

8. International institutions and policy evaluation

Institutions support trade rules, finance, surveillance, development and dispute resolution, but mandates differ. Appraisal should distinguish stabilisation from development lending and rules from financing. Evaluate conditionality, governance, policy space, moral hazard and distribution using official institutional documents; do not infer endorsement from these teaching notes.

Examination technique: State the proposition, explain the mechanism, apply it to the question and qualify the conclusion where assumptions or context matter.

Worked examples

Worked example 1

Country A can make 12 tea or 6 software; B can make 8 tea or 8 software. A opportunity cost of software=2 tea; B=1 tea. At 1.5 tea per software, both can gain from specialisation and exchange before transport/adjustment costs.

Reasonableness check: Confirm the direction, units and economic interpretation before finalising the answer.

Worked example 2

World price=100 and tariff=20%. Domestic price becomes 120 if fully passed through. If imports after tariff are 50,000 units, revenue=20x50,000=1,000,000 currency units. Welfare analysis additionally needs supply/demand responses.

Reasonableness check: Confirm the direction, units and economic interpretation before finalising the answer.

Worked example 3

An exporter earns USD 25,000. At KES 145/USD receipts are KES 3,625,000; at KES 150/USD, KES 3,750,000. The currency depreciation raises shilling receipts by KES 125,000 before cost and hedging effects.

Reasonableness check: Confirm the direction, units and economic interpretation before finalising the answer.

Common errors and corrections

Error	Correction
Giving a definition without mechanism	Explain the causal link and apply it to the facts.
Using accounting language for an economic concept	Identify opportunity cost, implicit cost or real/nominal basis explicitly.
Drawing an unlabeled diagram	Label axes, curves, initial position, change and result.
Treating a historical pattern as a guarantee	Use it only to guide emphasis; cover the full syllabus.

Original DatalytiQs examination-style practice

Question 1 - Calculate

A produces 10 maize or 5 textiles; B produces 6 maize or 6 textiles. Identify comparative advantage.

DatalytiQs model answer: A opportunity cost of textile=2 maize; B=1 maize. B has comparative advantage in textiles; A in maize.

Question 2 - Illustrate

Show the welfare effects of an import tariff.

DatalytiQs model answer: Draw domestic demand/supply with world price and tariff price; identify consumer loss, producer gain, revenue and two deadweight triangles.

Question 3 - Classify

Classify an export, an import and foreign acquisition of domestic shares.

DatalytiQs model answer: Exports are current-account credits; imports current-account debits; foreign purchase of domestic shares is a financial inflow/liability increase under the stated convention.

Question 4 - Evaluate

Will depreciation always correct a trade deficit?

DatalytiQs model answer: No. Analyse elasticities, J-curve, capacity, imported inputs, invoicing, inflation and financing; use Marshall-Lerner condition conditionally.

Question 5 - Distinguish

Trade creation and trade diversion.

DatalytlQs model answer: Creation replaces high-cost domestic production with lower-cost partner imports; diversion replaces lower-cost external imports with higher-cost partner imports because of preference.

Revision summary

Core rule: Reconstruct the model from definitions, assumptions, relationships and diagrams. Memorised labels without mechanism do not earn strong analytical marks.

Evidence requirements

Code	Learning objective	Assessment criteria
E12.1	Solve comparative-advantage and terms-of-trade exercises.	Correct method, complete interpretation, labelled working and original learner submission.
E12.2	Draw and explain tariff welfare effects.	Correct method, complete interpretation, labelled working and original learner submission.
E12.3	Complete a balance-of-payments classification ledger.	Correct method, complete interpretation, labelled working and original learner submission.
E12.4	Analyse foreign-exchange shifts and depreciation terminology.	Correct method, complete interpretation, labelled working and original learner submission.
E12.5	Evaluate a regional-integration scenario for creation/diversion.	Correct method, complete interpretation, labelled working and original learner submission.
E12.6	Prepare a cumulative trade, exchange-rate and policy response.	Correct method, complete interpretation, labelled working and original learner submission.

Mastery checklist

Criteria	Teacher
I can solve comparative-advantage and terms-of-trade exercises..	
I can draw and explain tariff welfare effects..	
I can complete a balance-of-payments classification ledger..	
I can analyse foreign-exchange shifts and depreciation terminology..	
I can evaluate a regional-integration scenario for creation/diversion..	
I can prepare a cumulative trade, exchange-rate and policy response..	
Progression rule: Complete E12.1-E12.6 before the section quiz. A score below 70% triggers targeted remediation.	

References and version

KASNEB. *Certified Public Accountants (CPA) Revised Syllabus, June 2024*, Paper No. 4: Economics. Version 1.0, revised 18 October 2026. This is original DatalytlQs Academy instructional content.

Source links: <https://www.kasneb.or.ke/cpa/> | <https://sgb.ac.ke/wp-content/uploads/2024/12/CPA-Syllabus-Reviewed-June-2024.pdf>