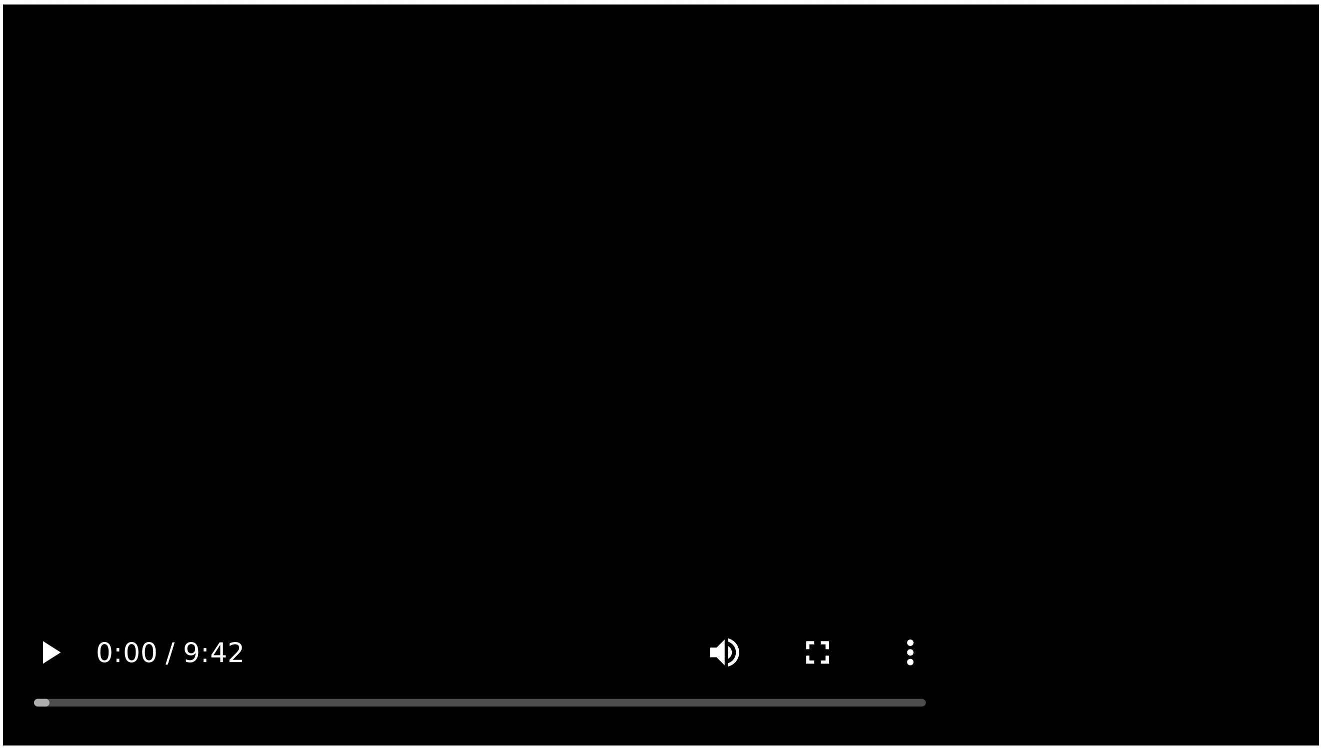
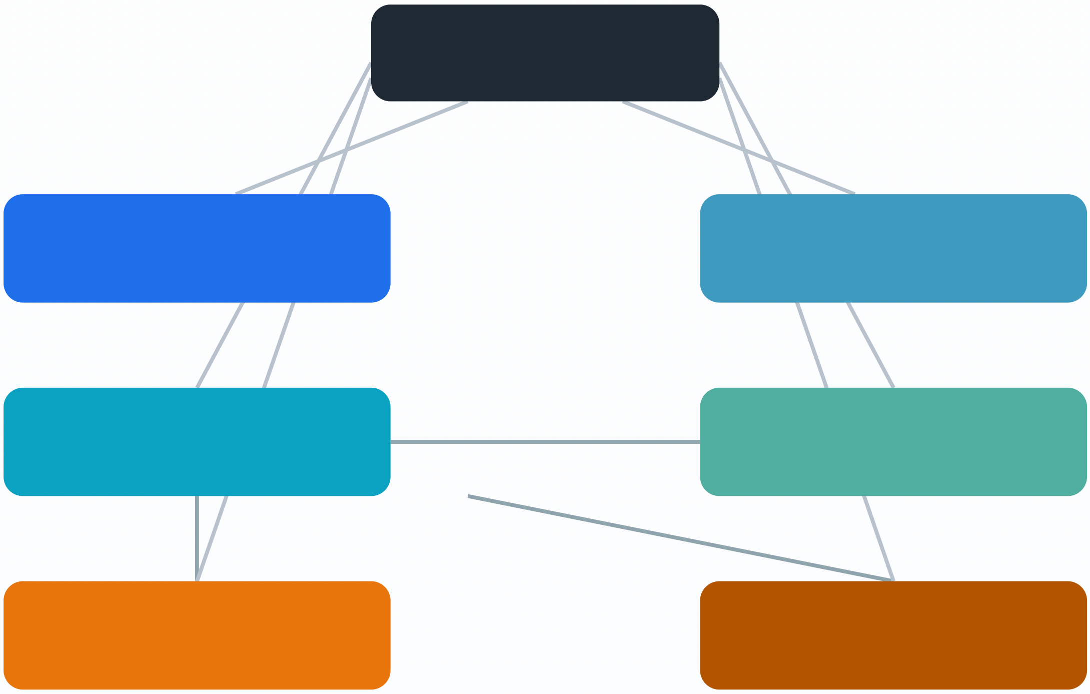
Unit 3 Study Guide — Australia and the Global Economy

A consolidated, student-facing revision guide for Unit 3. Synthesises the six topics (international trade and linkages; free trade and protection; the balance of payments; the terms of trade; exchange rates; foreign investment) into one resource, showing how they connect, with a synthesis diagram, key terms, must-know diagrams, and common exam traps. Designed for end-of-unit revision before the Unit 3 examination (Task 4).



Unit 3 is one connected story: Australia is a medium-sized, open economy whose prosperity depends on its links to the rest of the world. Every topic in this unit describes one part of that connection — and they feed into each other. Use this guide to pull the six topics together before the Unit 3 examination.

Unit 3: how Australia connects to the global economy



The six Unit 3 topics interlock: trade and protection determine the real flows; those flows are recorded in the balance of payments; the terms of trade and exchange rate set their value; and foreign investment links the financial account back to the current account.

1. International trade & linkages

Australia links to the world through trade in goods and services, investment, tourism and migration. You should be able to **describe** the extent and importance of trade (a high trade-to-GDP ratio), the **composition** (commodity-heavy exports; manufactured and capital imports) and **direction** (concentrated on Asian trading partners), and **outline** trade policy including bilateral and regional free trade agreements.

2. Free trade & protection

The case for trade rests on comparative advantage — specialise where your opportunity cost is lowest, then trade. You should be able to demonstrate the gains from trade using the PPF and the demand & supply model, and **analyse** the effects of a tariff or subsidy on price, quantity, efficiency and the macroeconomy.

3. The balance of payments

The balance of payments records all transactions between Australia and the world, split into the current account (trade balance + primary and secondary income) and the capital and financial account. You should be able to **explain** the double-entry rule (the two accounts mirror each other), the drivers of the current account balance, and the savings–investment gap that underlies a persistent current account deficit.

4. The terms of trade

The **terms of trade** is an index of export prices relative to import prices. A commodity-price boom raises it, lifting national income. You should be able to **analyse** what shifts the terms of trade and trace the effects of a rise or fall through income, the exchange rate and the current account.

5. Exchange rates

The **exchange rate** is the price of the dollar, set by demand for and supply of $A in the foreign-exchange market. You should be able to show an **appreciation** or **depreciation** on a demand & supply diagram, explain the factors that move it (interest differentials, the terms of trade, commodity prices, capital flows), and trace the effects on exports, imports and the current account.

6. Foreign investment

Foreign investment is recorded in the financial account and splits into **foreign direct investment** (a lasting management interest) and **portfolio investment** (financial assets). You should be able to **evaluate** its benefits and costs, explain the link to the current account through income flows, and describe Australia's net-debtor **international investment position**.

> **The through-line.** Trade and protection set the real flows → those flows are recorded in the balance of payments → the terms of trade and exchange rate set their value → foreign investment funds the current account deficit and creates the income flows that feed back into it. If you can narrate that chain, you understand Unit 3.

Must-know diagrams

- PPF and the gains from specialisation and trade.
- Tariff and subsidy on the demand & supply model.
- The structure tree of the balance of payments.
- The terms of trade index over time.
- Exchange-rate appreciation/depreciation on $A demand & supply.

> **Common exam traps.** (1) Confusing the terms of trade (a price ratio) with the trade balance (a value). (2) Forgetting the double-entry rule — a current account deficit is matched by a financial account surplus. (3) Mislabelling exchange-rate axes (price of $A on the vertical, quantity of $A on the horizontal). (4) Treating a current account deficit as automatically "bad" without discussing the savings–investment gap and the use of the borrowed funds.