

МІНІСТЕРСТВО ОСВІТИ І НАУКИ УКРАЇНИ  
ОДЕСЬКИЙ НАЦІОНАЛЬНИЙ МОРСЬКИЙ УНІВЕРСИТЕТ  
НАВЧАЛЬНО-НАУКОВИЙ МОРСЬКИЙ ГУМАНІТАРНИЙ ІНСТИТУТ  
КАФЕДРА «ІНОЗЕМНІ МОВИ ТА ПЕРЕКЛАД»

**Методичні вказівки**

**для практичних занять з дисципліни**

**«Професійна англійська мова»**

**для студентів 4 курсу спеціальності**

**D2 Фінанси, банківська справа, страхування та  
фондовий ринок денної та заочної форм навчання**



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Методичні вказівки для практичних занять з дисципліни «Професійна англійська мова» для студентів 4 курсу спеціальності D2 Фінанси, банківська справа, страхування та фондовий ринок денної та заочної форм навчання. Корнєлаєва Є.В., Корольова Т.М. Одеса: ОНМУ, 2026. 64 с.

**Укладачі:** кандидат філологічних наук, доцент, доцент кафедри «Іноземні мови та переклад» Одеського національного морського університету **Євгенія КОРНЄЛАЄВА** та доктор філологічних наук, професор, професор кафедри «Іноземні мови та переклад» Одеського національного морського університету **Тетяна КОРОЛЬОВА**

**Рецензенти:** доктор філологічних наук, професор, професор кафедри «Іноземні мови та переклад» Одеського національного морського університету **Валерія СМАГЛІЙ** та доктор педагогічних наук, професор, професор кафедри «Іноземні мови та переклад» Одеського національного морського університету **Тетяна ЯБЛОНСЬКА**

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## ПЕРЕДМОВА

Методичні вказівки для практичних занять призначені для студентів 4-го курсу спеціальності D2 «Фінанси, банківська справа, страхування та фондовий ринок» і розроблені відповідно до вимог освітньо-професійної програми та Загальноєвропейських рекомендацій з мовної освіти (CEFR).

Потреба у такому виданні зумовлена об'єктивними реаліями сучасного фінансового ринку. Глобалізація банківської сфери, запровадження міжнародних стандартів фінансової звітності (IFRS), дотримання регуляторних вимог Basel III, Solvency II та MiFID II, участь у міжнародних фінансових організаціях — усе це вимагає від фахівця впевненого володіння англійською мовою не лише на побутовому, а й на високому академічному та діловому рівні. Саме тому методичні вказівки орієнтовані не на загальну мовну підготовку, а на формування предметної комунікативної компетентності — здатності вільно оперувати фаховою термінологією, аналізувати складні тексти та аргументовано викладати власну позицію в контексті конкретних фінансових явищ і процесів.

Методичні вказівки побудовані відповідно до принципів навчання англійської мови для спеціальних цілей (English for Specific Purposes, ESP) із застосуванням комунікативного, когнітивно-дискурсивного та проблемно-орієнтованого підходів. Тематика розділів охоплює весь спектр фінансово-економічної діяльності: від банківської справи, венчурного капіталу, облігацій та похідних фінансових інструментів — через корпоративну звітність, ринкові структури та злиття і поглинання — до макроекономічних тем: бізнес-циклу, обмінних курсів, міжнародної торгівлі та взаємодії економіки й екології. Така послідовність забезпечує системне нарощування знань і лексичного запасу від мікро- до макрорівня.

Кожен розділ має уніфіковану структуру, що забезпечує поступовий перехід від рецепції до продукції мовного матеріалу. Він відкривається автентичним навчальним текстом насиченим актуальною фаховою термінологією. Текст супроводжується шістьма питаннями, які охоплюють усі рівні таксономії Блума — від відтворення фактичного матеріалу до критичного оцінювання та синтезу. Лексичний блок складається з чотирьох вправ: зіставлення термінів і дефініцій, заповнення пропусків з опорним словником, завдань формату True/False або Multiple Choice та завдань на словотворення або перефразування — кожна вправа містить від десяти до п'ятнадцяти речень.

Працюючи з методичними вказівками, студентам рекомендується читати кожен текст двічі: спочатку — для загального розуміння змісту, вдруге — для цілеспрямованого аналізу лексики та пошуку відповідей на питання. Надзвичайно корисним є ведення власного словника фахових термінів із прикладами їх типової сполучуваності, адже саме колокаційний аспект — *issue bonds, raise capital, hedge risk, disclose information* — відрізняє справжню мовну компетентність від поверхового знання слів.

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## UNIT 1. BANKING

Banking is one of the most fundamental pillars of the modern financial system. Commercial banks serve as intermediaries between depositors who have surplus funds and borrowers who require capital for consumption or investment purposes. By accepting deposits and extending credit, banks facilitate economic growth and help channel savings into productive economic activity.

The core business model of a commercial bank relies on the interest rate spread — the difference between the interest charged on loans and the interest paid on deposits. This net interest margin constitutes the primary source of revenue for most retail banks. However, contemporary banking institutions generate substantial income from fee-based services such as wealth management, foreign exchange transactions, trade finance, and advisory services.

Central banks occupy a unique position at the apex of the banking hierarchy. They perform several critical functions: issuing currency, setting benchmark interest rates, acting as lender of last resort to commercial banks, and supervising the financial system to ensure stability. Monetary policy implemented by central banks directly influences inflation, credit availability, and overall macroeconomic conditions.

The concept of fractional reserve banking underpins the modern banking system. Banks are required to hold only a fraction of their deposits as reserves — either in their vaults or with the central bank — and may lend out the remainder. This practice creates money through the credit multiplier effect, expanding the money supply beyond the base money issued by the central bank. However, it also exposes banks to liquidity risk if a large number of depositors simultaneously demand their funds — a phenomenon known as a bank run.

Regulatory frameworks have evolved significantly following the 2008 global financial crisis. Basel III capital adequacy standards require banks to maintain higher capital buffers, improve liquidity ratios, and reduce leverage. Stress testing has become a routine supervisory tool, compelling banks to demonstrate resilience under hypothetical adverse economic scenarios. Additionally, the introduction of deposit insurance schemes in most jurisdictions protects retail depositors up to specified limits, thereby reducing the likelihood of bank runs.

Digital transformation is profoundly reshaping the banking landscape. Online banking, mobile payment platforms, and the emergence of fintech companies are challenging traditional bank business models. Open banking initiatives, which require banks to share customer data with authorised third-party providers via application programming interfaces (APIs), are fostering innovation and intensifying competition. Meanwhile, central bank digital currencies (CBDCs) represent a potential paradigm shift in how money is issued and transacted.

Banks must constantly balance profitability against prudent risk management. Credit risk, market risk, operational risk, and reputational risk all require sophisticated management frameworks. Modern banks employ advanced data analytics, artificial intelligence, and machine learning algorithms to assess creditworthiness, detect fraud, and optimise their asset-liability management. As the financial environment becomes increasingly complex and interconnected, the banking sector must adapt to maintain stability and public trust.

## COMPREHENSION QUESTIONS

1. What is the primary function of commercial banks in the financial system, and how do they generate their main source of revenue?
2. Explain the concept of fractional reserve banking and describe the risks it poses to financial stability.
3. What regulatory measures were introduced following the 2008 financial crisis, and what is the purpose of stress testing?
4. How is digital transformation affecting traditional banking models? Discuss at least three specific developments mentioned in the text.
5. What role do central banks play in the broader financial system, and how does monetary policy influence the economy?
6. Explain the credit multiplier effect and its relationship to the money supply.

### *Exercise 1. Match the terms with their definitions.*

1. net interest margin	a) a system where banks keep only a portion of deposits as reserves
2. lender of last resort	b) simulating adverse conditions to assess a bank's financial resilience
3. fractional reserve banking	c) a guarantee protecting depositors' funds up to a specified limit
4. credit multiplier effect	d) a situation when many depositors withdraw funds simultaneously
5. Basel III	e) a system allowing third parties to access bank customer data via APIs
6. stress testing	f) a digital form of a country's fiat currency issued by the central bank
7. bank run	g) the difference between interest earned on loans and interest paid on deposits
8. deposit insurance	h) the process by which bank lending expands the money supply
9. open banking	i) international regulatory framework setting capital requirements for banks
10. CBDC	j) a central bank's role in providing emergency funds to banks facing liquidity crisis

### *Exercise 2. Fill in the blanks with the correct word from the box.*

#### **Word box:**

*intermediaries · benchmark · surplus · leverage · liquidity · collateral · prudent · resilience · capital buffers · adverse*

1. Commercial banks act as \_\_\_\_\_ between savers and borrowers in the economy.
2. The central bank raised its \_\_\_\_\_ interest rate by 25 basis points at the last meeting.
3. Households with \_\_\_\_\_ income often place their savings in term deposit accounts.

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4. Higher \_\_\_\_\_ requirements mean banks must hold more equity against their risk-weighted assets.
  5. The borrower provided real estate as \_\_\_\_\_ to secure the mortgage loan.
  6. Excessive \_\_\_\_\_ amplifies both potential gains and losses for financial institutions.
  7. A bank's \_\_\_\_\_ position determines its ability to meet short-term obligations.
  8. \_\_\_\_\_ management requires balancing growth objectives with sound risk controls.
  9. The regulator designed \_\_\_\_\_ scenarios to include a 30% drop in property values.
  10. Adequate \_\_\_\_\_ help banks absorb unexpected losses without becoming insolvent.

**Exercise 3. Choose the correct option (A, B, or C) to complete each sentence.**

1. Banks \_\_\_\_\_ deposits and \_\_\_\_\_ loans to generate income.  
*A) accept / extend B) issue / receive C) withdraw / collect*
2. The Basel III accord requires banks to \_\_\_\_\_ their capital ratios.  
*A) reduce B) strengthen C) ignore*
3. A bank run occurs when depositors lose \_\_\_\_\_ in the bank's solvency.  
*A) interest B) capital C) confidence*
4. Central banks \_\_\_\_\_ monetary policy to control inflation.  
*A) implement B) borrow C) deposit*
5. Fintech companies are \_\_\_\_\_ the dominance of traditional banks.  
*A) supporting B) challenging C) replacing*
6. The net interest \_\_\_\_\_ is the key profitability metric for retail banks.  
*A) spread / margin B) ratio C) rate*
7. Open banking requires banks to share data through secure \_\_\_\_\_.  
*A) vaults B) APIs C) reserves*
8. Machine learning is used to improve credit \_\_\_\_\_ accuracy.  
*A) scoring / assessment B) issuance C) withdrawal*
9. The lender of last resort function prevents \_\_\_\_\_ from spreading through the system.  
*A) deposits B) panics C) profits*
10. CBDCs represent a digital \_\_\_\_\_ of national fiat currencies.  
*A) substitute B) equivalent / version C) alternative*

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**Exercise 4. Rewrite the sentences using the given word without changing the meaning.**

**1.** Banks borrow money from depositors and lend it to borrowers at a higher rate. (SPREAD)

\_\_\_\_\_

**2.** The central bank may provide emergency funding to banks that cannot meet withdrawals. (RESORT)

\_\_\_\_\_

**3.** Only a small portion of deposits must be kept in reserve under current regulations. (FRACTIONAL)

\_\_\_\_\_

**4.** The 2008 crisis prompted stricter regulations on bank capital and liquidity. (TIGHTEN)

\_\_\_\_\_

**5.** Digital platforms are making it easier for customers to switch between providers. (COMPETITION)

\_\_\_\_\_

**6.** Banks must regularly simulate worst-case economic situations. (STRESS TEST)

\_\_\_\_\_

**7.** Regulators protect retail customers by guaranteeing their deposits up to a limit. (INSURANCE)

\_\_\_\_\_

**8.** The bank's ability to repay short-term debts deteriorated sharply. (LIQUIDITY)

\_\_\_\_\_

**9.** Artificial intelligence helps banks identify suspicious transactions. (DETECT)

\_\_\_\_\_

**10.** Too much borrowing relative to equity can make a bank vulnerable. (LEVERAGE)

\_\_\_\_\_

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## UNIT 2. VENTURE CAPITAL

Venture capital (VC) is a form of private equity financing provided to early-stage, high-growth potential companies in exchange for an equity stake. Unlike traditional bank lending, venture capital investors — commonly known as venture capitalists — accept significant risk with the expectation of earning substantial returns upon a successful exit, typically through an initial public offering (IPO) or an acquisition by a larger company.

The venture capital investment process is structured around distinct funding rounds. The earliest stage, known as seed funding, is typically provided by angel investors or early-stage VC funds and is used to validate a business concept and develop an initial product. As the start-up demonstrates traction, it may raise Series A, Series B, and subsequent rounds, each representing a larger investment at a higher company valuation. At each stage, investors receive preferred shares, which carry specific rights such as anti-dilution protections and liquidation preferences.

Due diligence is a critical component of the venture capital investment process. Before committing capital, VC firms conduct thorough assessments of the target company's business model, addressable market, competitive landscape, intellectual property, financial projections, and management team. The quality of the founding team is often considered the most decisive factor, as early-stage companies frequently pivot their strategy in response to market feedback.

Venture capitalists actively add value beyond capital provision. They typically join the board of directors, providing strategic guidance, introductions to potential customers and partners, and assistance with subsequent fundraising. This hands-on involvement differentiates VC-backed companies from those relying solely on debt financing. The collaborative relationship between founders and investors is governed by a term sheet, which outlines the key commercial and legal terms of the investment.

The risk profile of venture capital is inherently high. Studies indicate that a significant proportion of VC-backed start-ups fail entirely, with returns concentrated in a small number of exceptional performers — often referred to as 'unicorns' when they reach a valuation of one billion dollars or more. Venture capital fund managers therefore adopt a portfolio approach, investing in numerous companies with the expectation that a few outstanding successes will more than compensate for multiple write-offs.

The venture capital ecosystem is closely intertwined with the broader innovation economy. Silicon Valley in California remains the most prominent VC hub globally, although thriving ecosystems have emerged in cities such as London, Berlin, Tel Aviv, Beijing, and Bangalore. Governments in many countries have introduced tax incentives, co-investment programmes, and regulatory frameworks designed to stimulate start-up activity and attract private venture capital.

Recent trends in venture capital include the rise of corporate venture arms, increased participation by sovereign wealth funds and family offices, and the growing prominence of impact investing — where financial returns are pursued alongside measurable social or environmental benefits. The sector continues to evolve rapidly, playing a pivotal role in financing the technologies and business models that shape the future global economy.

## COMPREHENSION QUESTIONS

1. How does venture capital differ from traditional bank lending in terms of risk, return expectations, and the nature of financing?
2. Describe the stages of a typical venture capital funding cycle, from seed round to Series B, and explain what each stage represents.
3. What factors do venture capitalists consider during due diligence, and why is the management team considered particularly important?
4. Explain the portfolio approach adopted by VC fund managers. What is a 'unicorn' and why is it significant?
5. How do venture capitalists add value to the companies they invest in, beyond simply providing capital?
6. What recent trends are shaping the venture capital industry, including new types of investors and new investment approaches?

**Exercise 1. Match each venture capital term with its correct definition.**

1. seed funding	a) a provision that protects investors from having their ownership percentage reduced
2. due diligence	b) a privately held start-up valued at over one billion US dollars
3. term sheet	c) a plan for investors to realise returns, typically via IPO or acquisition
4. preferred shares	d) a comprehensive appraisal of a business before an investment decision
5. anti-dilution protection	e) a non-binding document outlining the key terms of a proposed investment
6. unicorn	f) a percentage ownership interest in a company
7. exit strategy	g) early evidence that a product or service is gaining market acceptance
8. equity stake	h) a business in which a fund has invested capital
9. portfolio company	i) initial capital used to validate a business concept at the earliest stage
10. traction	j) equity shares with special rights such as priority in liquidation

**Exercise 2. Fill in the blanks with the appropriate term.**

**Word box:**

valuation · liquidation preference · pivot · angel investor · carry · runway · cap table · dilution · co-investment · write-off

1. The company's pre-money \_\_\_\_\_ was set at \$10 million before the Series A round closed.
2. After the new shares were issued, existing founders faced significant ownership \_\_\_\_\_.

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3. A \_\_\_\_\_ is a high-net-worth individual who invests personal funds in early-stage companies.
  4. The start-up decided to \_\_\_\_\_ from a B2B model to a direct-to-consumer approach after poor sales.
  5. The \_\_\_\_\_ programme allowed government funds to match private sector investments pound for pound.
  6. Investors holding preferred shares have a \_\_\_\_\_ that ensures they are repaid before common shareholders in a wind-up.
  7. The fund manager earns a \_\_\_\_\_ interest — typically 20% of profits — as performance compensation.
  8. At the current burn rate, the company had only six months of \_\_\_\_\_ left before it needed new funding.
  9. The \_\_\_\_\_ document shows the ownership structure and all classes of shares issued by the company.
  10. After the start-up ceased operations, the fund recorded the investment as a complete \_\_\_\_\_.

**Exercise 3. Complete each sentence by choosing the correct word or phrase.**

1. Venture capitalists typically seek to \_\_\_\_\_ their investment through an IPO or trade sale.  
*A) repay B) exit C) recover*
2. The founding team's ability to \_\_\_\_\_ to changing market conditions is crucial at the seed stage.  
*A) adapt B) resist C) expand*
3. VC firms take an equity \_\_\_\_\_ in the companies they fund, rather than receiving interest payments.  
*A) loan B) stake C) bond*
4. A term sheet is typically \_\_\_\_\_, meaning it does not legally obligate either party.  
*A) non-binding B) contractual C) regulatory*
5. Impact investing seeks both financial returns and positive \_\_\_\_\_ or environmental outcomes.  
*A) social B) operational C) structural*
6. Series A funding usually follows proof of \_\_\_\_\_ in the target market.  
*A) concept B) traction C) valuation*
7. The VC fund adopted a \_\_\_\_\_ approach by spreading investment across 30 companies.  
*A) concentrated B) portfolio C) balanced*
8. Corporate venture arms invest on \_\_\_\_\_ of large established companies.  
*A) behalf B) account C) request*
9. The management team must present a credible \_\_\_\_\_ demonstrating a path to profitability.  
*A) roadmap B) vision C) balance sheet*

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10. Silicon Valley remains the world's most prominent venture capital \_\_\_\_\_.

A) market B) hub C) fund

**Exercise 4. Correct the factual or terminological errors in the following sentences.**

1. Venture capital is a form of debt financing provided to mature, stable companies seeking growth capital.

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2. Seed funding typically comes after Series A and is used to scale operations internationally.

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3. A unicorn is a start-up that has completed an initial public offering and is listed on a stock exchange.

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4. Preferred shares carry fewer rights than ordinary shares and have no priority in liquidation.

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5. Due diligence is performed after an investment is made to monitor portfolio company performance.

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6. The term sheet is a fully binding legal contract that immediately obliges both parties to complete the deal.

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7. Venture capitalists usually remain entirely passive after investing, leaving management decisions to founders.

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8. Anti-dilution provisions protect the founder from losing board control during subsequent funding rounds.

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9. The carried interest is the fixed management fee charged annually by the fund manager.

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10. Impact investing deliberately sacrifices financial returns in order to achieve social outcomes.

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## UNIT 3. BONDS

A bond is a fixed-income financial instrument representing a loan made by an investor to a borrower — typically a corporation, a government, or a supranational institution. The issuer of the bond agrees to pay the holder periodic interest payments, known as coupon payments, and to repay the principal — also called the face value or par value — at a specified future date, known as the maturity date. Bonds are a cornerstone of global capital markets, enabling issuers to raise large amounts of long-term debt financing efficiently.

Bonds are classified according to several criteria. Government bonds, such as US Treasury securities or UK gilts, are issued by sovereign governments and are generally considered low-risk, as they are backed by the full taxing power of the state. Corporate bonds are issued by companies to fund expansion, acquisitions, or refinancing of existing debt. Municipal bonds are issued by local authorities, often carrying tax advantages for investors. Supranational bonds are issued by international organisations such as the World Bank or the European Investment Bank to finance development projects.

The yield of a bond — the effective annual return to the investor — is inversely related to its market price. When interest rates in the broader economy rise, newly issued bonds offer higher coupons, making existing lower-coupon bonds less attractive; their prices fall and their yields rise accordingly. This inverse price-yield relationship is one of the most fundamental concepts in fixed-income investing.

Credit ratings assigned by agencies such as Moody's, Standard and Poor's, and Fitch play a central role in the bond market. Investment-grade bonds — those rated BBB- or above by S&P — are considered relatively safe, whereas high-yield bonds, colloquially known as 'junk bonds', carry a higher default risk and consequently offer higher yields to compensate investors. The spread between high-yield and investment-grade bond yields — known as the credit spread — reflects the market's collective assessment of credit risk.

The duration of a bond measures its sensitivity to changes in interest rates. A bond with a longer duration will experience a more pronounced price change for a given shift in interest rates than a bond with a shorter duration. Portfolio managers actively manage duration to align the interest rate risk of their holdings with their investment mandate and market outlook.

Specialised bond instruments include zero-coupon bonds, which are issued at a discount to par and pay no periodic interest; inflation-linked bonds, whose principal and coupons are adjusted in line with an inflation index; convertible bonds, which can be exchanged for equity in the issuing company under specified conditions; and green bonds, which are earmarked to fund environmentally sustainable projects. The green bond market has expanded dramatically in recent years, reflecting growing investor demand for sustainable finance instruments.

The sovereign bond market also serves as a key transmission mechanism for monetary policy. When central banks engage in quantitative easing — purchasing government bonds in the secondary market — they inject liquidity into the financial system, compress long-term yields, and encourage investment and consumption. Conversely, quantitative tightening — reducing the central bank's bond holdings — tends to put upward pressure on yields and tighten financial conditions.

## COMPREHENSION QUESTIONS

1. Explain the fundamental structure of a bond, including the roles of the issuer and the bondholder, and describe the key features: coupon, face value, and maturity date.
2. Describe the inverse relationship between bond prices and interest rates, and explain why this relationship exists.
3. How do credit rating agencies influence the bond market? Explain the difference between investment-grade and high-yield bonds.
4. What is bond duration and why is it an important concept for portfolio managers?
5. Describe at least three specialised types of bonds and explain the purpose of each.
6. How do central banks use the bond market as a tool of monetary policy? Explain both quantitative easing and quantitative tightening.

**Exercise 1. Match each bond market term with its definition.**

1. coupon rate	a) the yield difference between a corporate bond and a risk-free government bond
2. maturity date	b) a high-yield bond with a speculative credit rating below investment grade
3. yield to maturity	c) a measure of a bond's price sensitivity to interest rate changes
4. credit spread	d) a bond rating indicating relatively low risk of default
5. duration	e) a bond that pays no periodic interest but is issued at a discount
6. investment grade	f) a debt instrument whose proceeds are exclusively used for environmental projects
7. junk bond	g) the date on which the bond issuer repays the principal to the bondholder
8. zero-coupon bond	h) a monetary policy involving central bank purchases of government bonds
9. green bond	i) the annual interest rate paid on the face value of a bond
10. quantitative easing	j) the total return anticipated on a bond if held until it matures

**Exercise 2. Fill in the blanks with an appropriate word or phrase.**

**Word box:**

*par value · default · secondary market · callable · yield curve · gilt · coupon · convertible · premium · accrued interest*

1. UK government bonds are known as \_\_\_\_\_, while US equivalents are called Treasury securities.
2. The bond pays a semi-annual \_\_\_\_\_ of 3.5% on its face value of \$1,000.
3. If the issuer fails to make scheduled payments, it is said to be in \_\_\_\_\_.

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4. A \_\_\_\_\_ bond allows the issuer to redeem the bond before its scheduled maturity.
  5. The \_\_\_\_\_ depicts yields across different maturities and is closely watched by economists.
  6. Investors can trade bonds on the \_\_\_\_\_ without waiting for the maturity date.
  7. A bond trading above its \_\_\_\_\_ value is said to be trading at a \_\_\_\_\_.
  8. The \_\_\_\_\_ bond can be exchanged for company shares at the bondholder's discretion.
  9. When purchasing a bond between coupon dates, the buyer must pay the seller for \_\_\_\_\_ since the last payment.
  10. The bond's \_\_\_\_\_ is \$1,000, which is the amount returned to the holder at maturity.

***Exercise 3. Decide whether each statement is TRUE or FALSE and correct the false ones.***

1. Bond prices and interest rates move in the same direction. [ T / F ]
2. Government bonds are generally considered safer than corporate bonds of the same maturity. [ T / F ]
3. A high credit rating from Moody's or S&P indicates a higher risk of default. [ T / F ]
4. Green bonds must be used to finance projects with positive environmental outcomes. [ T / F ]
5. Duration measures how long it takes to recover the cost of a bond through its cash flows. [ T / F ]
6. A zero-coupon bond pays interest every six months until maturity. [ T / F ]
7. Quantitative easing tends to push long-term interest rates lower. [ T / F ]
8. The yield to maturity takes into account both coupon income and any capital gain or loss. [ T / F ]
9. Junk bonds offer lower yields than investment-grade bonds to reflect their higher risk. [ T / F ]
10. Municipal bonds are issued by central governments to finance national infrastructure. [ T / F ]

***Exercise 4. Complete the sentences with the correct form of the word in brackets.***

1. The bond was \_\_\_\_\_ (ISSUE) at a discount of 5% to its face value.  
\_\_\_\_\_
2. Rising inflation typically leads to \_\_\_\_\_ (INCREASE) bond yields.  
\_\_\_\_\_
3. Investors sought higher \_\_\_\_\_ (YIELD) bonds to offset low returns in other asset classes.

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4. The central bank announced the \_\_\_\_\_ (PURCHASE) of \$50 billion of government bonds.

5. Bonds with longer \_\_\_\_\_ (MATURE) dates are more sensitive to interest rate changes.

6. A \_\_\_\_\_ (CONVERT) bond gives holders the option to exchange it for equity.

7. The \_\_\_\_\_ (INVERT) yield curve has historically preceded economic recessions.

8. The company faced \_\_\_\_\_ (DOWNGRADE) of its credit rating following a profit warning.

9. Portfolio \_\_\_\_\_ (MANAGE) adjust duration in response to changing rate expectations.

10. The spread between high-yield and investment-grade bonds \_\_\_\_\_ (WIDEN) during the crisis.

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## UNIT 4. STOCKS AND SHARES

Stocks and shares represent ownership interests in a corporation. When a company issues shares, it divides its ownership into small, equal units that can be purchased by investors on public exchanges or, prior to a listing, through private placements. Shareholders become part-owners of the company, entitled to a proportionate share of its assets and earnings. The terms 'stock' and 'share' are often used interchangeably, although 'stock' typically refers to the ownership in a company in general, while 'share' denotes a specific unit of that ownership.

Companies issue two principal classes of shares: ordinary (common) shares and preference shares. Ordinary shareholders have voting rights at annual general meetings and receive dividends — distributions of a portion of the company's profit — after all obligations to creditors and preference shareholders have been met. Preference shareholders receive a fixed dividend and have a prior claim over ordinary shareholders in the event of liquidation, but generally do not have voting rights.

The process by which a private company makes its shares available to the general public for the first time is called an Initial Public Offering (IPO). Through an IPO, the company raises primary capital, while early investors and founders may partially or fully realise their investment. Underwriting banks play a crucial role in this process, advising on valuation, marketing the offering to institutional investors through a roadshow, and guaranteeing that all shares will be sold.

Once listed, shares are traded on stock exchanges such as the New York Stock Exchange (NYSE), the London Stock Exchange (LSE), or the NASDAQ. The price of a share is determined by market forces — the interaction of supply and demand — and fluctuates continuously during trading hours in response to new information, including earnings announcements, macroeconomic data, and geopolitical developments. Market capitalisation — calculated by multiplying the share price by the total number of shares outstanding — provides a measure of a company's total market value.

Fundamental analysis is the dominant approach to equity valuation. Analysts examine a company's financial statements, competitive position, management quality, and growth prospects to estimate its intrinsic value. Key valuation metrics include the price-to-earnings (P/E) ratio, price-to-book (P/B) ratio, dividend yield, and discounted cash flow (DCF) analysis. Technical analysis, by contrast, focuses on historical price patterns and trading volume to identify trends and timing signals.

Market indices such as the S&P 500, the FTSE 100, and the Dow Jones Industrial Average serve as benchmarks for overall market performance. Index funds and exchange-traded funds (ETFs) allow investors to gain diversified exposure to these indices at low cost, reflecting the growing influence of passive investment strategies. The debate between active and passive portfolio management remains one of the most contentious issues in investment management.

Corporate governance is closely linked to share ownership structures. Concentrated share ownership, where a single shareholder or a small group controls a majority stake, can create agency problems — situations where the interests of controlling shareholders diverge from those of minority investors. Strong governance frameworks, including independent boards, audit committees, and transparent disclosure requirements, are essential to protecting the interests of all shareholders.

## COMPREHENSION QUESTIONS

1. What is the difference between ordinary (common) shares and preference shares? Describe the rights associated with each type.
2. Explain the process of an Initial Public Offering (IPO) and describe the role of underwriting banks.
3. How is the market price of a share determined, and what factors cause share prices to fluctuate?
4. Distinguish between fundamental analysis and technical analysis as approaches to equity valuation.
5. What are market indices, and why are index funds and ETFs becoming increasingly popular?
6. What is meant by 'agency problems' in corporate governance, and how can strong governance frameworks address them?

**Exercise 1. Match each stock market term with its correct definition.**

1. market capitalisation	a) the first sale of a company's shares to the public
2. dividend yield	b) a fund traded on an exchange that tracks an index or asset class
3. P/E ratio	c) an equity share carrying voting rights and residual profit claims
4. IPO	d) a share carrying a fixed dividend and priority in liquidation
5. ETF	e) annual dividend per share expressed as a percentage of the share price
6. roadshow	f) selling borrowed shares with the intention of buying them back at a lower price
7. ordinary share	g) shares in a large, stable, well-established company with strong financials
8. preference share	h) a series of presentations to institutional investors before a share offering
9. short selling	i) total market value of a company's outstanding shares
10. blue-chip stock	j) share price divided by earnings per share

**Exercise 2. Fill in the blanks with the correct word from the box.**

**Word box:**

*listing · underwriter · earnings per share · bear market · bull market · dilution · float · proxy · shareholder · equity*

1. A \_\_\_\_\_ is defined as a sustained rise in stock prices of 20% or more from a recent low.
2. Conversely, a sustained decline of 20% or more from a recent peak is called a \_\_\_\_\_.
3. A \_\_\_\_\_ votes on behalf of shareholders who cannot attend a general meeting in person.

- 
4. The bank acted as the lead \_\_\_\_\_, guaranteeing to purchase any unsold shares in the IPO.
  5. \_\_\_\_\_ is calculated by dividing the company's net profit by the number of shares outstanding.
  6. The issue of new shares reduced existing investors' ownership percentage, causing \_\_\_\_\_.
  7. The company's \_\_\_\_\_ on the London Stock Exchange was the largest in the financial sector that year.
  8. The free \_\_\_\_\_ refers to the proportion of shares available for trading in the open market.
  9. Any \_\_\_\_\_ holding more than 5% of shares must disclose this position to the regulator.
  10. Return on \_\_\_\_\_ measures how efficiently a company generates profit from shareholders' capital.

**Exercise 3. Choose the best word or phrase (A, B or C) to complete each sentence.**

1. The discounted cash flow model estimates a stock's \_\_\_\_\_ value.  
*A) market B) intrinsic C) book*
2. The FTSE 100 serves as a \_\_\_\_\_ for the performance of UK large-cap equities.  
*A) target B) benchmark C) standard*
3. Passive investment strategies aim to \_\_\_\_\_ market returns rather than outperform them.  
*A) replicate B) exceed C) forecast*
4. A rights issue allows existing shareholders to purchase additional shares at a \_\_\_\_\_.  
*A) premium B) discount C) profit*
5. Short sellers profit when share prices \_\_\_\_\_ after their initial sale.  
*A) rise B) fall C) stabilise*
6. The annual general meeting gives shareholders the opportunity to \_\_\_\_\_ on key resolutions.  
*A) decide B) vote C) appeal*
7. Insider trading involves buying or selling shares based on \_\_\_\_\_ information.  
*A) public B) confidential / material non-public C) historical*
8. The company's share price \_\_\_\_\_ sharply following the release of disappointing earnings.  
*A) surged B) plummeted C) stabilised*
9. A P/E ratio of 25 suggests investors are paying \$25 for each \$1 of the company's \_\_\_\_\_.  
*A) assets B) earnings C) dividends*
10. Corporate \_\_\_\_\_ frameworks are designed to protect minority shareholders from abuse.  
*A) governance B) taxation C) strategy*

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**Exercise 4. Rewrite each sentence using the word given in brackets.**

**1.** The company's total shares multiplied by the share price equals \$5 billion.  
(CAPITALISATION)

\_\_\_\_\_

**2.** New shares were issued, reducing the ownership percentage of existing shareholders.  
(DILUTION)

\_\_\_\_\_

**3.** The bank managed the process of selling the company's shares to the public for the first time. (UNDERWRITE)

\_\_\_\_\_

**4.** Investors who buy shares become part-owners of the corporation. (EQUITY STAKE)

\_\_\_\_\_

**5.** The fund tracks the S&P 500 index and charges very low management fees. (PASSIVE)

\_\_\_\_\_

**6.** Analysts predicted the company would exceed profit expectations, causing the share price to rise. (SURGE)

\_\_\_\_\_

**7.** Directors who own shares may have a conflict of interest when making certain decisions.  
(GOVERNANCE)

\_\_\_\_\_

**8.** The preference shareholders will be paid before ordinary shareholders if the company is wound up. (PRIORITY)

\_\_\_\_\_

**9.** The company plans to pay a dividend of \$2 per share to its shareholders this year.  
(DISTRIBUTION)

\_\_\_\_\_

**10.** The technical analyst studied past price movements to predict future stock behaviour.  
(PATTERN)

\_\_\_\_\_

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## UNIT 5. DERIVATIVES

Derivatives are financial contracts whose value is derived from the performance of an underlying asset, index, interest rate, currency, or commodity. Rather than owning the underlying asset directly, the buyer and seller of a derivative agree to exchange cash flows based on future changes in the asset's value. Derivatives serve two primary economic functions: risk management (hedging) and speculative investment. The global derivatives market is enormous, with notional outstanding values estimated in the hundreds of trillions of dollars.

Futures contracts are standardised agreements to buy or sell a specified quantity of an underlying asset at a predetermined price on a future date. They are traded on organised exchanges such as the Chicago Mercantile Exchange (CME) and the Intercontinental Exchange (ICE). Because futures are exchange-traded, counterparty risk is mitigated through centralised clearing, margin requirements, and daily mark-to-market settlements. Participants include hedgers — such as farmers locking in prices for their harvest — and speculators seeking to profit from price movements.

Options give the holder the right, but not the obligation, to buy (a call option) or sell (a put option) an underlying asset at a specified strike price before or at expiry. The buyer pays a premium for this right. Options are versatile instruments used for hedging downside risk, generating income (through covered call strategies), and expressing complex directional or volatility views. The Black-Scholes model, developed in 1973, provides a widely used theoretical framework for pricing European-style options.

Swap agreements involve two parties exchanging cash flows based on different financial instruments. Interest rate swaps — the most common type — allow a party paying variable (floating) interest to exchange payments with a counterparty paying fixed interest. This enables companies to manage their interest rate exposure without refinancing existing debt. Currency swaps facilitate the exchange of principal and interest payments denominated in different currencies, useful for multinational corporations managing cross-border cash flows.

Credit default swaps (CDS) are instruments that function like insurance against the default of a specified borrower. The protection buyer pays periodic premiums to the protection seller, who in turn agrees to compensate the buyer if the reference entity defaults. CDS became highly controversial during the 2008 financial crisis, when massive unhedged CDS exposure at institutions such as AIG threatened systemic financial stability, ultimately requiring government intervention.

The regulatory landscape for derivatives has changed dramatically since the 2008 crisis. The Dodd-Frank Act in the United States and the European Market Infrastructure Regulation (EMIR) in the EU mandated central clearing of standardised over-the-counter (OTC) derivatives, increased reporting requirements, and imposed margin requirements for uncleared trades. These reforms aimed to reduce systemic risk and improve transparency in derivatives markets.

While derivatives provide essential tools for risk management, they also introduce significant risks when misused or inadequately understood. Leverage amplifies both gains and losses; complex structured products can obscure true risk exposures; and the interconnectedness of derivative counterparties can rapidly transmit shocks across the financial system. Prudent risk management, regulatory oversight, and financial literacy are essential to harnessing the benefits of derivatives while containing their potential dangers.

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## COMPREHENSION QUESTIONS

1. Define derivatives and explain the two primary economic functions they serve in financial markets.
2. Describe how futures contracts work and explain how exchange trading mitigates counterparty risk.
3. What is the difference between a call option and a put option? Explain the concept of an option premium.
4. How do interest rate swaps work, and why would a company use one?
5. Explain what a credit default swap (CDS) is and describe the role they played in the 2008 financial crisis.
6. What regulatory reforms were introduced after the 2008 crisis to improve the safety of derivatives markets?

***Exercise 1. Match each derivatives term with its definition.***

1. underlying asset	a) the right to buy an underlying asset at a specified strike price
2. futures contract	b) the price paid by an option buyer for the right to buy or sell
3. call option	c) an instrument that provides protection against borrower default
4. put option	d) the face amount on which derivative payments are calculated
5. premium	e) the financial instrument from which a derivative's value is derived
6. interest rate swap	f) a privately negotiated contract traded outside formal exchanges
7. credit default swap	g) daily revaluation of a position to reflect current market prices
8. mark-to-market	h) the right to sell an underlying asset at a specified strike price
9. notional value	i) an agreement to exchange fixed and floating interest rate cash flows
10. OTC derivative	j) a standardised exchange-traded agreement to buy/sell an asset at a future date

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**Exercise 2. Fill in the blanks with the correct word.**

**Word box:**

<i>hedge · leverage · margin · expiry · counterparty · strike price · floating rate · clearing house · systemic risk · speculator</i>
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1. A farmer who sells wheat futures to lock in a guaranteed price is using derivatives to \_\_\_\_\_ production risk.
2. A \_\_\_\_\_ takes on risk in the hope of profiting from future price movements.
3. The \_\_\_\_\_ acts as the buyer to every seller and the seller to every buyer in exchange-traded derivatives.
4. Trading on \_\_\_\_\_ magnifies potential gains and losses relative to the initial capital invested.
5. All exchange-traded futures require participants to deposit an initial \_\_\_\_\_ as a performance bond.
6. The option holder must exercise the contract before or at its \_\_\_\_\_ date.
7. The \_\_\_\_\_ is the price at which an option holder can buy or sell the underlying asset.
8. A company swapping its \_\_\_\_\_ mortgage payments for fixed payments gains greater certainty over debt servicing.
9. AIG's CDS exposure contributed to \_\_\_\_\_ by threatening to bring down interconnected institutions.
10. OTC derivatives carry \_\_\_\_\_ risk, as there is no exchange to guarantee the other side's performance.

**Exercise 3. Decide whether the sentences are TRUE or FALSE and correct the false ones.**

1. A futures contract obliges both parties to complete the transaction at the agreed price. [ T / F ]
2. The buyer of an option has no obligation to exercise the contract if it is not profitable. [ T / F ]
3. Options buyers pay a premium, but their maximum loss is limited to the premium paid. [ T / F ]
4. An interest rate swap eliminates a company's underlying debt obligation. [ T / F ]
5. CDS contracts functioned exactly as intended during the 2008 financial crisis. [ T / F ]
6. The Black-Scholes model is used to price interest rate swaps. [ T / F ]
7. EMIR and Dodd-Frank increased transparency by mandating central clearing of OTC derivatives. [ T / F ]
8. Leverage in derivatives means that large gains can be achieved with no corresponding risk of loss. [ T / F ]
9. Currency swaps allow companies to manage cross-border cash flow exposures effectively. [ T / F ]

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10. Derivatives can only be used for speculation and do not serve any legitimate risk management purpose. [ T / F ]

**Exercise 4. Complete the sentences with the correct form of the word in brackets.**

1. The manufacturer entered into a futures contract to \_\_\_\_\_ (HEDGE) against rising raw material costs.

\_\_\_\_\_

2. Central \_\_\_\_\_ (CLEAR) of OTC derivatives reduces counterparty risk significantly.

\_\_\_\_\_

3. The investor exercised the call option when the share price exceeded the \_\_\_\_\_ (STRIKE) price.

\_\_\_\_\_

4. Unregulated CDS trading \_\_\_\_\_ (CONTRIBUTE) to the collapse of several financial institutions in 2008.

\_\_\_\_\_

5. Daily mark-to-market \_\_\_\_\_ (SETTLE) requires margin calls when positions move against the holder.

\_\_\_\_\_

6. The \_\_\_\_\_ (NOTIFY) outstanding value of global derivatives exceeds \$600 trillion.

\_\_\_\_\_

7. A \_\_\_\_\_ (CONVERT) bond contains an embedded option allowing conversion to equity.

\_\_\_\_\_

8. Risk \_\_\_\_\_ (MANAGE) is the primary justification for using derivative instruments in corporate treasury.

\_\_\_\_\_

9. The regulator \_\_\_\_\_ (IMPOSE) stricter margin requirements on uncleared derivative contracts.

\_\_\_\_\_

10. Derivatives markets \_\_\_\_\_ (TRANSMIT) financial shocks rapidly across interconnected institutions.

\_\_\_\_\_

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## UNIT 6. ACCOUNTING AND FINANCIAL STATEMENTS

Accounting is the systematic process of recording, classifying, summarising, and reporting financial transactions of a business entity. Financial statements — the primary output of the accounting process — provide essential information to a wide range of stakeholders, including investors, creditors, regulators, employees, and management. The three core financial statements are the income statement (profit and loss account), the balance sheet (statement of financial position), and the cash flow statement.

The income statement reports a company's revenues, expenses, and resulting profit or loss over a defined accounting period — typically a quarter or a year. Revenues represent the total value of goods sold or services rendered, while expenses encompass all costs incurred in generating that revenue, including cost of goods sold, operating expenses, depreciation, interest, and taxation. The net income — sometimes called the 'bottom line' — is the residual profit after all expenses have been deducted. Earnings before interest, taxes, depreciation, and amortisation (EBITDA) is widely used as a proxy for operational cash generation.

The balance sheet provides a snapshot of a company's financial position at a specific point in time. It is structured around the fundamental accounting equation:  $\text{Assets} = \text{Liabilities} + \text{Equity}$ . Assets encompass everything the company owns or controls, including current assets (cash, receivables, inventory) and non-current assets (property, equipment, intangibles). Liabilities represent the company's obligations to external parties — both current liabilities (payables, short-term debt) and long-term liabilities (bonds, deferred tax). Shareholders' equity reflects the residual interest of the owners after all liabilities have been settled.

The cash flow statement reconciles the change in a company's cash balance over a period. It is divided into three sections: operating activities (cash generated from core business operations), investing activities (capital expenditure and asset acquisitions), and financing activities (debt issuance, repayments, and dividend payments). Free cash flow — operating cash flow minus capital expenditure — is a critical metric for assessing a company's ability to self-finance growth and return capital to shareholders.

Financial analysis relies heavily on ratio analysis to evaluate performance, liquidity, solvency, and efficiency. Liquidity ratios, such as the current ratio and the quick ratio, assess a company's ability to meet short-term obligations. Profitability ratios, including return on assets (ROA) and return on equity (ROE), measure how effectively management generates profit. Leverage ratios, such as the debt-to-equity ratio, indicate the extent of financial risk. Efficiency ratios, such as the asset turnover ratio, reveal how productively resources are deployed.

Financial reporting is governed by standardised accounting frameworks. Most countries either apply International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB), or US Generally Accepted Accounting Principles (US GAAP). While these frameworks share broad similarities, they differ in areas such as inventory valuation, revenue recognition, and treatment of financial instruments. Convergence between IFRS and US GAAP has been an ongoing international objective.

The integrity of financial statements is assured by independent auditors, who examine the accounts and issue an audit opinion. A clean (unqualified) audit opinion indicates that the statements present a true and fair view of the company's financial position. Weaknesses in internal controls, accounting irregularities, or departures from accounting standards may result in a qualified or adverse opinion, raising concerns among investors and regulators.

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## COMPREHENSION QUESTIONS

1. Identify and briefly explain the three core financial statements. What question does each one answer?
2. Explain the fundamental accounting equation and describe the three main components of the balance sheet.
3. What is free cash flow, and why is it considered a more reliable indicator of financial health than reported net income?
4. Describe four categories of financial ratios and explain what each category measures.
5. What are IFRS and US GAAP, and why is the convergence between them considered important?
6. What is the purpose of an external audit, and what is the difference between an unqualified and a qualified audit opinion?

## LEXICAL EXERCISES

*Exercise 1. Match each accounting term with its correct definition.*

1. EBITDA	a) operating cash flow minus capital expenditure
2. balance sheet	b) the systematic allocation of a tangible asset's cost over its useful life
3. free cash flow	c) amounts owed to the company by customers for goods or services delivered
4. ROE	d) current assets divided by current liabilities
5. depreciation	e) intangible asset arising from paying more than net asset value in an acquisition
6. current ratio	f) earnings before interest, taxes, depreciation and amortisation
7. accounts receivable	g) a liability arising from temporary differences between tax and accounting rules
8. goodwill	h) net income divided by shareholders' equity
9. deferred tax	i) an auditor's formal conclusion on the fairness of financial statements
10. audit opinion	j) a statement showing assets, liabilities and equity at a point in time

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**Exercise 2. Fill in the blanks with the correct accounting term.**

**Word box:**

*accruals · amortisation · working capital · impairment · revenue recognition · going concern · inventory · intangible asset · leverage · retained earnings*

1. The principle of \_\_\_\_\_ determines when income should be recorded in the financial statements.
2. Patents, trademarks, and customer relationships are examples of \_\_\_\_\_ assets.
3. The \_\_\_\_\_ principle assumes the company will continue to operate for the foreseeable future.
4. \_\_\_\_\_ is the process of allocating the cost of intangible assets over their useful economic life.
5. When the recoverable amount of an asset falls below its carrying value, an \_\_\_\_\_ charge is recognised.
6. \_\_\_\_\_ refers to current assets minus current liabilities and measures short-term financial health.
7. The company's \_\_\_\_\_ balance rose as profits were retained rather than paid out as dividends.
8. The \_\_\_\_\_ basis requires expenses to be recorded when incurred, not when cash is paid.
9. Rising \_\_\_\_\_ ratios indicate the company is financing more of its assets with debt.
10. The auditor noted that the \_\_\_\_\_ level had increased significantly due to slow-moving stock.

**Exercise 3. Classify each item as an ASSET (A), LIABILITY (L), or EQUITY (E) item on the balance sheet.**

1. Cash and cash equivalents held in the current account  
\_\_\_\_\_
2. Long-term bank loan repayable in five years  
\_\_\_\_\_
3. Retained earnings accumulated over the company's history  
\_\_\_\_\_
4. Trade payables owed to suppliers for goods received  
\_\_\_\_\_
5. Goodwill arising from a recent acquisition  
\_\_\_\_\_
6. Ordinary share capital contributed by shareholders  
\_\_\_\_\_
7. Deferred tax liability arising from accelerated depreciation  
\_\_\_\_\_
8. Trade receivables owed by customers for services rendered  
\_\_\_\_\_

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9. Property, plant, and equipment net of accumulated depreciation

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10. Share premium account from issuing shares above par value

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**Exercise 4. Choose the correct option (A, B, or C) to complete each sentence.**

1. Revenue is recognised when it is \_\_\_\_\_, regardless of when cash is received.  
A) *earned* B) *invoiced* C) *budgeted*
2. A company with a current ratio below 1.0 may struggle to meet its \_\_\_\_\_ obligations.  
A) *long-term* B) *short-term* C) *tax*
3. Net income is reported on the \_\_\_\_\_ statement.  
A) *balance sheet* B) *income* C) *cash flow*
4. An auditor issues an \_\_\_\_\_ opinion when statements are fairly presented in all material respects.  
A) *adverse* B) *unqualified* C) *qualified*
5. Capital expenditure on new equipment is classified as an \_\_\_\_\_ activity in the cash flow statement.  
A) *operating* B) *financing* C) *investing*
6. IFRS is issued by the \_\_\_\_\_ and applied in over 140 countries.  
A) *SEC* B) *IASB* C) *FASB*
7. Depreciation is added back in operating cash flow because it is a \_\_\_\_\_ expense.  
A) *cash* B) *non-cash* C) *tax*
8. A high debt-to-equity ratio indicates significant financial \_\_\_\_\_.  
A) *strength* B) *leverage* C) *diversification*
9. Working capital = current assets \_\_\_\_\_ current liabilities.  
A) *plus* B) *minus* C) *divided by*
10. Free cash flow is regarded as a more reliable measure of financial health than net \_\_\_\_\_.  
A) *revenue* B) *income* C) *assets*

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## UNIT 7. MARKET STRUCTURE AND COMPETITION

Market structure describes the organisational and competitive characteristics of a market, determining how firms interact and how prices and output are determined. Economists traditionally identify four primary market structures along a spectrum from perfect competition to pure monopoly: perfect competition, monopolistic competition, oligopoly, and monopoly. Each structure has distinct implications for pricing behaviour, firm profitability, and consumer welfare.

Perfect competition is a theoretical model characterised by a large number of buyers and sellers, homogeneous products, perfect information, free entry and exit, and no single firm possessing pricing power. In this idealized model, firms are price takers — they must accept the market price and earn only normal profits in the long run, as excess profits attract new entrants who drive prices down to the level of average cost. While few real markets match this description precisely, commodity markets such as wheat or copper approach this model.

Monopolistic competition combines features of both perfect competition and monopoly. Many firms compete, but each sells a differentiated product — meaning buyers perceive differences in quality, branding, design, or other attributes. Each firm has some degree of pricing power over its differentiated product, but faces elastic demand due to the availability of close substitutes. Industries such as retail clothing, restaurants, and personal care products typically exhibit monopolistic competition.

An oligopoly is characterised by a small number of large firms that collectively dominate the market. Oligopolists are mutually interdependent — each firm's pricing and output decisions significantly affect, and are influenced by, the decisions of rivals. Game theory, and in particular the concept of the Nash equilibrium, provides a framework for analysing strategic behaviour in oligopolistic markets. Tacit collusion — where firms coordinate behaviour without formal agreement — is common in oligopolies, often resulting in prices that are higher and output lower than would prevail under perfect competition.

A monopoly exists when a single firm is the sole supplier of a good or service for which there are no close substitutes. Monopolists are price makers, able to set price above marginal cost and earn sustained supernormal profits — an outcome that typically reduces consumer surplus and creates a deadweight welfare loss for society. Monopolies may arise from natural causes (economies of scale that make it inefficient for multiple firms to operate), legal barriers (patents, licences), or strategic behaviour (acquiring competitors).

Competition policy — also known as antitrust law in the United States — aims to prevent anti-competitive practices and promote consumer welfare. Regulatory authorities such as the European Commission's Directorate-General for Competition (DG COMP) and the US Federal Trade Commission (FTC) scrutinise mergers and acquisitions, investigate allegations of price-fixing and market abuse, and may impose fines, force divestitures, or block transactions deemed harmful to competition.

Digital markets have introduced new complexities for competition analysis. Platform businesses benefit from powerful network effects — the value of the platform increases as more users join — and often tend towards winner-takes-all outcomes. The dominance of large technology companies in search, social media, and e-commerce has prompted intense regulatory debate about the adequacy of existing competition frameworks to address new forms of market power.

## COMPREHENSION QUESTIONS

1. Describe the four main market structures and explain what distinguishes each from the others.
2. What is meant by a 'price taker' and a 'price maker'? Under which market structure does each apply?
3. Explain the concept of Nash equilibrium and its relevance to oligopolistic market behaviour.
4. What is a deadweight welfare loss, and how does it arise in a monopoly market?
5. What are the objectives of competition policy, and what tools do regulators use to enforce it?
6. Why do digital platform markets tend towards monopoly or oligopoly, and what challenges does this create for regulators?

**Exercise 1. Match each market structure concept with its definition.**

1. price taker	a) a situation where no firm can improve its outcome by unilaterally changing strategy
2. price maker	b) the reduction in total welfare caused by output being below the competitive level
3. natural monopoly	c) a good or service perceived by buyers as distinct from rivals' offerings
4. Nash equilibrium	d) a firm that must accept the prevailing market price without influence over it
5. tacit collusion	e) the phenomenon where a product becomes more valuable as more people use it
6. deadweight loss	f) a formal agreement between competing firms to fix prices or divide markets
7. network effect	g) the ability of a firm to raise prices above the competitive level
8. differentiated product	h) a firm with sufficient market power to set its own price
9. market power	i) informal coordination of behaviour without an explicit agreement
10. cartel	j) a monopoly arising from economies of scale making a single provider most efficient

**Exercise 2. Fill in the blanks with the correct term.**

**Word box:**

*barriers to entry · supernormal profit · elastic demand · concentration ratio · predatory pricing · divestiture · duopoly · homogeneous · marginal cost · consumer surplus*

1. In perfect competition, all firms sell a \_\_\_\_\_ product, making branding irrelevant.
2. A monopolist earns \_\_\_\_\_ in the long run because new entrants are blocked.
3. The difference between what consumers are willing to pay and what they actually pay is called \_\_\_\_\_.
4. High \_\_\_\_\_ such as large capital requirements or proprietary technology protect incumbent firms.

- 
5. A market dominated by only two firms is called a \_\_\_\_\_.
  6. A firm engages in \_\_\_\_\_ when it cuts prices below cost to eliminate a rival, intending to raise them later.
  7. The four-firm \_\_\_\_\_ measures the combined market share of the four largest producers.
  8. A monopolist maximises profit by setting price above \_\_\_\_\_ and producing below the competitive output level.
  9. The regulator ordered a \_\_\_\_\_ — requiring the merged company to sell off specific business units.
  10. Products with close substitutes face \_\_\_\_\_ — consumers switch readily when prices rise.

***Exercise 3. Identify the market structure (Perfect Competition, Monopolistic Competition, Oligopoly, or Monopoly) best described by each statement.***

1. A large number of firms sell slightly differentiated products such as coffee shops in a city centre.  
\_\_\_\_\_
2. A single utility company supplies electricity to an entire region with no alternative supplier.  
\_\_\_\_\_
3. Four major airlines control over 80% of domestic routes and closely watch each other's pricing.  
\_\_\_\_\_
4. Thousands of wheat farmers each sell identical grain at the prevailing global market price.  
\_\_\_\_\_
5. Three major mobile network operators compete for subscribers and match each other's tariff changes.  
\_\_\_\_\_
6. A pharmaceutical company holds a patent on a life-saving drug and faces no competition for ten years.  
\_\_\_\_\_
7. Many hair salons compete in a town, each with slightly different services and reputation.  
\_\_\_\_\_
8. A national rail operator is the only provider of passenger services on a specific route.  
\_\_\_\_\_
9. The soft drinks industry is dominated by two giant companies that carefully monitor each other's promotions.  
\_\_\_\_\_

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10. Thousands of sellers list identical products on a commodity exchange at transparent market prices.

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***Exercise 4. Complete the sentences with the correct form of the word in brackets.***

1. Oligopolistic firms are \_\_\_\_\_ (MUTUAL) interdependent, meaning each firm's decisions affect others.

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2. Regulatory authorities have the power to block \_\_\_\_\_ (MERGE) that would significantly reduce competition.

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3. Strong network effects create \_\_\_\_\_ (SUSTAIN) competitive advantage for dominant platforms.

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4. The \_\_\_\_\_ (COLLUDE) behaviour of the firms resulted in artificially high prices for consumers.

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5. Entry into a perfectly competitive market is \_\_\_\_\_ (FREE), ensuring long-run normal profits only.

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6. The regulator found evidence of \_\_\_\_\_ (ABUSE) of a dominant market position.

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7. Firms in monopolistic competition engage in \_\_\_\_\_ (PRODUCT) differentiation to attract customers.

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8. The antitrust investigation resulted in a substantial \_\_\_\_\_ (FINE) for the market-leading company.

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9. Price \_\_\_\_\_ (FIX) among competitors is illegal in most jurisdictions and attracts heavy penalties.

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10. Digital platforms benefit from \_\_\_\_\_ (INCREASE) returns to scale as user numbers grow.

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## UNIT 8. TAKEOVERS

A takeover, or acquisition, occurs when one company — the acquirer — purchases a controlling interest in another company — the target. Takeovers are a central mechanism of corporate restructuring and capital allocation, enabling companies to grow rapidly, enter new markets, acquire technologies, and achieve synergies that would be difficult or time-consuming to replicate through organic growth. They represent one of the most complex and consequential transactions in corporate finance.

Takeovers may be friendly or hostile. In a friendly takeover, the boards of both companies negotiate and agree on the terms of the transaction before the offer is presented to shareholders. In a hostile takeover, the acquirer makes a direct offer to the target company's shareholders, bypassing or overriding the opposition of the target's board. Hostile bids often trigger defensive measures from the target's management, including poison pills — rights that allow existing shareholders to purchase additional shares at a discount — and 'white knight' strategies, where a more acceptable acquirer is sought.

Acquirers may offer cash, shares, or a combination of both as consideration to target shareholders. A cash offer provides certainty of value, while a share offer means target shareholders exchange their shares for shares in the combined entity, thereby participating in any future upside. The choice of consideration affects the acquirer's capital structure, tax position, and the dilution of existing shareholders.

The primary motivation for most takeovers is the creation of value through synergies — the expectation that the combined entity will be worth more than the sum of its parts. Cost synergies arise from eliminating duplicated functions, rationalising operations, and achieving greater purchasing power. Revenue synergies may result from cross-selling products to a larger customer base, expanding into new geographies, or leveraging complementary capabilities. However, extensive academic research has demonstrated that a majority of acquisitions fail to create value for the acquirer, largely due to overpaying, integration difficulties, and cultural misalignment.

Valuation is a critical challenge in any takeover. Acquirers typically pay a control premium — an amount above the target's pre-announcement market price — to persuade shareholders to tender their shares. Common valuation methodologies include comparable companies analysis (trading multiples), precedent transactions analysis (acquisition multiples from similar deals), and discounted cash flow (DCF) analysis. The advisors to both parties — typically investment banks — play a central role in establishing fair value.

Regulatory scrutiny is an integral feature of the takeover landscape. Competition authorities — such as the European Commission and the US Department of Justice — review significant transactions to assess their likely impact on market competition. Transactions that would create or entrench a dominant position may be blocked outright or approved subject to remedies such as divestitures. In strategic sectors, national governments may also assert foreign investment screening powers to block transactions on national security grounds.

Post-merger integration (PMI) is widely regarded as the most challenging phase of any acquisition. Failure to integrate IT systems, organisational structures, and corporate cultures quickly and effectively destroys anticipated synergies and destabilises both businesses. Research consistently highlights cultural incompatibility as the leading cause of acquisition failure, underscoring the importance of due diligence into the human dimension of any proposed combination.

## COMPREHENSION QUESTIONS

1. What is the difference between a friendly and a hostile takeover? Describe two defensive tactics a target company might use against a hostile bid.
2. Explain the different forms of consideration that an acquirer can offer in a takeover, and discuss the advantages and disadvantages of each.
3. What are synergies, and why do many acquisitions fail to deliver the synergies that were anticipated?
4. Describe three methods used to value a target company in an acquisition. Which is considered most rigorous and why?
5. What is a control premium, and why is it paid by acquirers?
6. Why is post-merger integration considered the most challenging phase of an acquisition, and what are the main causes of integration failure?

**Exercise 1. Match each takeover term with its correct definition.**

1. control premium	a) a comprehensive investigation of the target before completing the acquisition
2. poison pill	b) a penalty payable if one party withdraws from a signed deal
3. white knight	c) a payment tied to the target's future financial performance post-acquisition
4. due diligence	d) a defensive strategy allowing existing shareholders to buy shares at a discount
5. synergy	e) a deal that increases the acquirer's earnings per share
6. tender offer	f) a friendly acquirer sought by a target under threat of a hostile bid
7. earnout	g) a tactic where the target attempts to acquire the hostile bidder
8. break-up fee	h) the amount paid above the target's market price to gain a controlling stake
9. PAC-MAN defence	i) a direct public offer made to shareholders to purchase their shares at a premium
10. accretive acquisition	j) the additional value created by combining two businesses beyond their separate values

**Exercise 2. Fill in the blanks with the correct word or phrase.**

**Word box:**

*hostile bid · divestiture · leveraged buyout · goodwill · integration · offer document · cross-border · shareholder approval · lock-up agreement · merger of equals*

1. A \_\_\_\_\_ occurs when both companies are of similar size and merge as equal partners.
2. The target company's board unanimously rejected the \_\_\_\_\_ as significantly undervaluing the business.
3. The acquirer's advisors were instructed to prepare the \_\_\_\_\_ within 28 days of the announcement.

- 
4. In a \_\_\_\_\_, the acquisition is financed primarily with debt secured against the target's assets.
  5. The deal required \_\_\_\_\_ from shareholders holding more than 75% of the target's voting shares.
  6. The regulator required the acquirer to complete a \_\_\_\_\_ of overlapping business units within 12 months.
  7. The difference between the acquisition price and the net asset value was recorded as \_\_\_\_\_ on the balance sheet.
  8. \_\_\_\_\_ acquisitions face additional complexity due to currency, legal, and cultural differences.
  9. Post-merger \_\_\_\_\_ proved challenging because the two companies had incompatible IT systems.
  10. Key executives signed \_\_\_\_\_ agreements preventing them from selling their shares for 12 months post-deal.

***Exercise 3. Correct the error in each of the following sentences.***

1. In a hostile takeover, the target's board supports the acquisition and recommends it to shareholders.  
\_\_\_\_\_
2. A poison pill allows the acquiring company to purchase new shares at a discount to increase its stake.  
\_\_\_\_\_
3. Cost synergies arise from selling the combined company's products to a larger customer base.  
\_\_\_\_\_
4. A cash offer means target shareholders receive shares in the acquirer rather than an agreed sum.  
\_\_\_\_\_
5. The control premium is paid to the target's board as compensation for agreeing to the deal.  
\_\_\_\_\_
6. Post-merger integration is considered the simplest and least risky phase of the acquisition process.  
\_\_\_\_\_
7. A break-up fee is paid to the target's lawyers for their work on the transaction documentation.  
\_\_\_\_\_
8. Discounted cash flow analysis uses comparable company trading multiples to estimate value.  
\_\_\_\_\_
9. The European Commission reviews takeovers to ensure they benefit competition by reducing market power.

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10. An earnout structure means the acquirer pays the full purchase price upfront regardless of future results.

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**Exercise 4. Complete the sentences with a preposition or particle from the box.**

**Word box:**

*through · by · against · into · in · on · for · between · at · above*

1. The acquirer made an offer \_\_\_\_\_ £4.50 per share, representing a 25% premium to the market price.

2. The board voted \_\_\_\_\_ the proposed merger, citing concerns about cultural compatibility.

3. The regulator launched an in-depth investigation \_\_\_\_\_ the proposed combination's impact on competition.

4. The company grew primarily \_\_\_\_\_ acquisitions rather than organic expansion.

5. The offer document was sent directly to shareholders, bypassing the target board's opposition.

6. Integration risks must be factored \_\_\_\_\_ the bidder's valuation model from the outset.

7. Competition concerns can be addressed \_\_\_\_\_ offering remedies such as asset disposals.

8. The deal ultimately collapsed due to a disagreement \_\_\_\_\_ the two parties over the valuation.

9. The combined entity will be headquartered \_\_\_\_\_ London following the completion of the merger.

10. The final offer price was fixed \_\_\_\_\_ a 30% premium to the undisturbed share price.

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## UNIT 9. THE ROLE OF GOVERNMENT

Governments play a multifaceted role in modern economies, acting simultaneously as regulator, tax authority, service provider, stabiliser, and redistributor of income and wealth. The appropriate scope of government intervention in the economy is one of the most enduring debates in economics and political philosophy, reflecting deep differences in values regarding efficiency, equity, liberty, and social responsibility.

One of the most widely accepted rationales for government intervention is the correction of market failures. Markets fail to allocate resources efficiently when externalities are present — situations where the production or consumption of a good imposes costs or confers benefits on third parties not reflected in the market price. Negative externalities, such as industrial pollution, lead to overproduction relative to the social optimum. Positive externalities, such as vaccination, lead to underproduction. Governments address these failures through taxes and subsidies, regulation, and the direct provision of public goods.

Public goods — characterised by non-excludability (no one can be prevented from benefiting) and non-rivalry (one person's use does not diminish availability to others) — are subject to the free-rider problem: rational individuals have no incentive to pay voluntarily for benefits they can enjoy without contributing. National defence, street lighting, and flood defences are canonical examples. Because markets will systematically underprovide public goods, government provision is generally justified on efficiency grounds.

Fiscal policy — the use of government expenditure and taxation to influence aggregate demand — is a key macroeconomic tool. During recessions, governments may adopt expansionary fiscal policy, increasing spending or cutting taxes to stimulate demand and employment. During periods of overheating, contractionary fiscal policy — reducing spending or raising taxes — may be used to cool inflation. The efficacy of fiscal policy is debated, with economists divided over the size of the fiscal multiplier and the long-term consequences of government borrowing.

Governments also regulate markets to protect consumers, workers, and the environment, and to ensure that markets function competitively. Financial regulation — overseen by agencies such as the Financial Conduct Authority (FCA) in the UK or the Securities and Exchange Commission (SEC) in the US — aims to prevent fraud, ensure transparency, and maintain systemic stability. Labour market regulation sets minimum wages, employment standards, and health and safety requirements. Environmental regulation internalises negative externalities by imposing costs on polluters.

The welfare state — encompassing social insurance, healthcare, education, and income support programmes — represents the redistributive dimension of government. By taxing higher incomes and providing transfers and services to lower-income households, governments seek to reduce inequality, provide social insurance against risks such as unemployment and illness, and ensure access to merit goods (goods whose consumption is deemed socially valuable regardless of ability to pay). The design of efficient and equitable welfare systems remains a central challenge of public policy.

Globalisation has complicated the role of government, constraining its ability to tax capital and corporations without triggering capital flight, and reducing its capacity to regulate labour and environmental standards unilaterally. International cooperation — through bodies such as the WTO, IMF, G20, and the OECD — has become increasingly important in addressing global market failures and coordinating macroeconomic policy responses.

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## COMPREHENSION QUESTIONS

1. What is a market failure, and why is it considered a justification for government intervention in the economy?
2. Explain the concepts of positive and negative externalities and describe the government policies used to address each.
3. What are public goods, and why will the private market systematically underprovide them?
4. Describe fiscal policy and distinguish between expansionary and contractionary approaches. When is each appropriate?
5. What is the welfare state, and how does it fulfil the government's redistributive function?
6. How has globalisation affected the ability of individual governments to intervene in their economies?

## LEXICAL EXERCISES

*Exercise 1. Match each economic concept with its correct definition.*

1. market failure	a) the tendency to benefit from a good without contributing to its cost
2. externality	b) the rapid movement of financial assets out of a country in response to adverse conditions
3. public good	c) the ratio of a change in national income to the change in government spending that caused it
4. free-rider problem	d) a cost or benefit affecting a party not directly involved in a transaction
5. fiscal multiplier	e) a good the government deems socially valuable and encourages consumption of
6. merit good	f) a system providing social insurance, healthcare, and income support to citizens
7. automatic stabiliser	g) a tax equal to the marginal social cost of a negative externality
8. welfare state	h) a situation where the free market allocates resources inefficiently
9. capital flight	i) a fiscal mechanism that smooths economic cycles without explicit policy action
10. pigouvian tax	j) a non-excludable, non-rival good that private markets underprovide

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**Exercise 2. Fill in the blanks with the correct word or phrase.**

**Word box:**

<i>progressive taxation · subsidy · privatisation · nationalisation · public debt · income redistribution · deregulation · fiscal deficit · Keynesian · crowding out</i>
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1. \_\_\_\_\_ economists argue that government spending can stimulate demand and employment during a recession.
2. The government's \_\_\_\_\_ policy taxes higher earners at a greater rate to reduce inequality.
3. A \_\_\_\_\_ occurs when government spending exceeds tax revenue in a given fiscal year.
4. The cumulative \_\_\_\_\_ represents the total amount the government owes to its creditors.
5. The transfer of state-owned enterprises to private ownership is known as \_\_\_\_\_.
6. Conversely, \_\_\_\_\_ involves the state taking ownership of previously private companies.
7. A \_\_\_\_\_ is a payment by the government to reduce the cost of a specific good or industry.
8. Critics of expansionary fiscal policy argue that government borrowing causes \_\_\_\_\_, raising interest rates and reducing private investment.
9. The government's \_\_\_\_\_ of the financial sector contributed to the conditions that led to the 2008 crisis.
10. Welfare transfers and progressive taxation are the primary instruments of \_\_\_\_\_ in mixed economies.

**Exercise 3. Decide if each statement is TRUE (T) or FALSE (F) and correct the false statements.**

1. National defence is a private good because only taxpayers who contribute can benefit from it. [ T / F ]
2. A carbon tax is an example of a Pigouvian tax designed to internalise the negative externality of pollution. [ T / F ]
3. Positive externalities cause markets to overproduce the relevant good relative to the social optimum. [ T / F ]
4. Expansionary fiscal policy involves cutting government spending and raising taxes. [ T / F ]
5. The free-rider problem means individuals have little incentive to voluntarily pay for public goods. [ T / F ]
6. Globalisation makes it easier for individual governments to regulate capital and corporations unilaterally. [ T / F ]
7. Automatic stabilisers reduce government spending and raise taxes without explicit legislative action. [ T / F ]

- 
8. Merit goods are defined as goods whose consumption the government deems socially undesirable. [ T / F ]
  9. The IMF and WTO facilitate international cooperation on economic and trade matters. [ T / F ]
  10. A welfare state provides no benefit to the economy beyond direct income transfers to individuals. [ T / F ]

**Exercise 4. Complete each sentence with the correct form of the word in brackets.**

1. The government \_\_\_\_\_ (INTERVENE) in the market to correct a significant negative externality.

\_\_\_\_\_

2. Increasing public spending during a recession is known as \_\_\_\_\_ (EXPAND) fiscal policy.

\_\_\_\_\_

3. High levels of public \_\_\_\_\_ (BORROW) may crowd out private investment.

\_\_\_\_\_

4. Environmental \_\_\_\_\_ (REGULATE) requires firms to internalise the costs of pollution.

\_\_\_\_\_

5. The welfare state aims to \_\_\_\_\_ (REDUCE) poverty and inequality through targeted transfers.

\_\_\_\_\_

6. National \_\_\_\_\_ (DEFEND) is the classic example of a non-excludable and non-rival public good.

\_\_\_\_\_

7. A \_\_\_\_\_ (SUBSIDY) to renewable energy encourages production of a good with positive externalities.

\_\_\_\_\_

8. The \_\_\_\_\_ (GLOBAL) of markets constrains individual countries' ability to set tax policy independently.

\_\_\_\_\_

9. Fiscal \_\_\_\_\_ (STIMULUS) packages were deployed by most governments during the COVID-19 pandemic.

\_\_\_\_\_

10. The regulator has the authority to impose \_\_\_\_\_ (FINE) on companies that breach competition law.

\_\_\_\_\_

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## UNIT 10. THE BUSINESS CYCLE

The business cycle refers to the recurring pattern of expansion and contraction in economic activity observed in market economies over time. Rather than growing at a smooth, steady rate, real GDP fluctuates around its long-run trend, oscillating through phases of expansion, peak, contraction (or recession), and trough before recovering and beginning a new cycle. Understanding the business cycle is fundamental to macroeconomic policy, financial market analysis, and corporate strategic planning.

During the expansion phase, real GDP grows, employment rises, consumer spending and business investment increase, and credit conditions ease. Confidence is high, asset prices tend to rise, and inflationary pressures may gradually build. The peak represents the highest point of the cycle — the point at which growth transitions from acceleration to deceleration, and capacity utilisation and employment reach their maximum levels.

A contraction — formally defined as two or more consecutive quarters of declining real GDP — constitutes a recession. During a recession, unemployment rises, consumer confidence falls, businesses reduce investment and cut costs, and credit conditions tighten. Corporate earnings fall, asset prices decline, and governments typically experience a deterioration in their fiscal positions as tax revenues fall and welfare expenditures increase automatically. Severe or prolonged contractions are referred to as depressions.

The trough marks the bottom of the cycle, after which the economy begins to recover. The recovery phase is often gradual, as businesses and households remain cautious, credit supply is constrained, and balance sheets require repair. Leading indicators — such as new orders, building permits, and financial market performance — typically begin to improve before the official statistical confirmation of recovery. Lagging indicators, such as the unemployment rate, often continue to deteriorate for some time after the trough.

Business cycles are driven by a complex interaction of demand-side and supply-side forces. Demand shocks — changes in consumption, investment, exports, or government spending — can trigger expansions or contractions. Supply shocks — such as oil price spikes, technological disruption, or pandemics — can simultaneously raise prices and reduce output, creating stagflation. Monetary and fiscal policy can moderate the amplitude of cycles, but cannot eliminate their fundamental occurrence.

Central banks play a critical stabilising role through the management of interest rates. During expansions, raising rates cools demand and contains inflationary pressure; during recessions, cutting rates stimulates borrowing, investment, and consumption. However, interest rates cannot fall below zero (or only marginally so) — a constraint known as the zero lower bound — forcing central banks to resort to unconventional tools such as quantitative easing during severe downturns.

For businesses and investors, cycle awareness is essential. Companies in cyclically sensitive sectors — construction, automotive, luxury goods, and financial services — experience sharp earnings volatility across the cycle, while defensive sectors — utilities, healthcare, and consumer staples — tend to be more resilient. Active investors seek to anticipate cycle turning points, positioning portfolios accordingly through tactical asset allocation, rotation between cyclical and defensive equities, and adjustments to fixed-income duration.

## COMPREHENSION QUESTIONS

1. Describe the four phases of the business cycle and explain the key economic characteristics of each phase.
2. What is a recession, and how does it affect businesses, consumers, and government finances?
3. Distinguish between leading indicators, lagging indicators, and coincident indicators. Give one example of each.
4. What is stagflation, and what type of economic shock typically causes it?
5. How do central banks attempt to stabilise the business cycle using monetary policy? What is the zero lower bound constraint?
6. Why is cyclical awareness important for businesses and investors? How do cyclical and defensive sectors differ?

**Exercise 1. Match each business cycle term with its definition.**

1. expansion	a) a combination of stagnant growth and high inflation
2. trough	b) a central bank policy of buying assets to inject money into the economy
3. stagflation	c) the constraint preventing nominal interest rates from falling below zero
4. leading indicator	d) the lowest point of the business cycle before recovery begins
5. lagging indicator	e) a fiscal mechanism that automatically cushions economic downturns
6. capacity utilisation	f) a phase of rising GDP, employment, and economic activity
7. zero lower bound	g) two or more consecutive quarters of declining real GDP
8. recession	h) an economic variable that changes after the cycle has already turned
9. quantitative easing	i) the proportion of potential output that an economy is currently producing
10. automatic stabiliser	j) an economic variable that changes before the cycle turns

**Exercise 2. Fill in the blanks with the correct word or phrase.**

**Word box:**

*output gap · overheating · deleveraging · animal spirits · monetary transmission · double dip · inventory cycle · credit crunch · secular stagnation · soft landing*

1. The \_\_\_\_\_ refers to the difference between actual GDP and its potential (trend) level.
2. Keynes used the term \_\_\_\_\_ to describe the role of confidence and sentiment in driving investment.
3. A \_\_\_\_\_ recession occurs when the economy briefly recovers before contracting again.
4. The \_\_\_\_\_ mechanism describes how interest rate changes eventually affect spending and inflation.

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5. Excessive borrowing followed by forced \_\_\_\_\_ by households is a major drag on recovery.
  6. An \_\_\_\_\_ economy is growing unsustainably fast, generating inflationary pressure.
  7. Some economists warn of \_\_\_\_\_ — a prolonged period of weak growth and low inflation.
  8. A \_\_\_\_\_ occurs when a central bank successfully raises rates to slow inflation without causing a recession.
  9. A \_\_\_\_\_ involves sharp swings in business production as companies build and liquidate stock.
  10. A \_\_\_\_\_ — a sudden tightening of bank lending conditions — sharply amplifies economic downturns.

**Exercise 3. Choose the correct word or phrase (A, B, or C) to complete each sentence.**

1. During a recession, governments typically experience a \_\_\_\_\_ as revenues fall and spending rises.  
*A) surplus B) deficit C) balance*
2. Building permits are considered a \_\_\_\_\_ indicator because they predict future construction activity.  
*A) lagging B) coincident C) leading*
3. Central banks typically \_\_\_\_\_ interest rates to stimulate the economy during a downturn.  
*A) raise B) cut C) fix*
4. Defensive sectors such as healthcare tend to be \_\_\_\_\_ than cyclical sectors during downturns.  
*A) more volatile B) more resilient C) less profitable*
5. The \_\_\_\_\_ phase is characterised by peak employment and full capacity utilisation.  
*A) trough B) recovery C) expansion peak*
6. Stagflation presents a policy dilemma because the usual tools for fighting \_\_\_\_\_ worsen the other.  
*A) recession B) inflation and recession C) surplus*
7. Quantitative easing was introduced as an alternative when \_\_\_\_\_ rates reached their lower bound.  
*A) exchange B) interest C) inflation*
8. The unemployment rate is a \_\_\_\_\_ indicator as it often continues rising after the trough.  
*A) coincident B) leading C) lagging*
9. An oil price spike is an example of a \_\_\_\_\_ shock that raises costs and reduces output.  
*A) demand B) supply C) monetary*

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10. Tactical asset \_\_\_\_\_ involves shifting portfolio weights in response to expected cycle conditions.

A) management B) allocation C) rotation

**Exercise 4. Complete the sentences with the correct form of the word in brackets.**

1. Economic \_\_\_\_\_ (EXPAND) in the post-pandemic period was faster than most forecasters predicted.

\_\_\_\_\_

2. The central bank raised rates three times in a year to prevent the economy from \_\_\_\_\_ (OVERHEAT).

\_\_\_\_\_

3. Businesses in \_\_\_\_\_ (CYCLE) sectors suffer the sharpest earnings declines during recessions.

\_\_\_\_\_

4. Household \_\_\_\_\_ (BORROW) fell sharply as consumers attempted to repair their balance sheets.

\_\_\_\_\_

5. The government's \_\_\_\_\_ (AUTOMATIC) stabilisers provided support without any new legislation.

\_\_\_\_\_

6. Policy \_\_\_\_\_ (MAKE) struggled to respond effectively to the combination of inflation and stagnation.

\_\_\_\_\_

7. Emerging from the trough requires confidence to return and \_\_\_\_\_ (INVEST) to pick up.

\_\_\_\_\_

8. The \_\_\_\_\_ (RECOVER) was described as 'job-poor' because unemployment remained high despite rising output.

\_\_\_\_\_

9. Quantitative \_\_\_\_\_ (EASE) was first deployed by the Bank of Japan in the early 2000s.

\_\_\_\_\_

10. The severity of the recession prompted calls for greater international fiscal \_\_\_\_\_ (COORDINATE).

\_\_\_\_\_

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## UNIT 11. CORPORATE SOCIAL RESPONSIBILITY

Corporate Social Responsibility (CSR) refers to the commitment of businesses to conduct their operations ethically and to contribute positively to social and environmental goals beyond the minimum requirements of law. CSR encompasses a broad spectrum of activities, including environmental stewardship, fair labour practices, community investment, ethical supply chain management, anti-corruption measures, and transparent corporate governance. Over the past two decades, CSR has evolved from a peripheral philanthropic activity to a core element of corporate strategy and stakeholder management.

The theoretical foundation for CSR is contested. The traditional shareholder primacy view, most famously articulated by economist Milton Friedman, holds that the sole social responsibility of a business is to maximise profits for its shareholders within the rules of the law. By contrast, the stakeholder theory of the firm, advanced by Edward Freeman, argues that companies have obligations to a much wider constituency — employees, customers, suppliers, communities, and the environment — and that long-term value creation requires addressing the interests of all these groups.

Environmental, Social, and Governance (ESG) investing has emerged as the dominant framework through which institutional investors evaluate non-financial corporate performance. Environmental criteria assess a company's carbon footprint, resource efficiency, climate risk management, and biodiversity impact. Social criteria examine labour standards, diversity and inclusion, human rights, and community relations. Governance criteria evaluate board composition, executive remuneration, shareholder rights, and anti-corruption policies. Major index providers such as MSCI and FTSE Russell now publish ESG ratings used by trillions of dollars of managed assets.

Regulation and reporting requirements around CSR and sustainability are tightening considerably. The EU's Corporate Sustainability Reporting Directive (CSRD) requires large companies to disclose extensive non-financial information under the European Sustainability Reporting Standards (ESRS). The International Sustainability Standards Board (ISSB) has developed global baseline disclosure standards for climate and sustainability risks. The UK's Mandatory Climate-Related Financial Disclosures requirements align with the Taskforce on Climate-related Financial Disclosures (TCFD) framework, compelling listed companies to assess and disclose their exposure to climate risk.

Critics of CSR raise concerns about 'greenwashing' — the practice of making misleading claims about environmental or social performance to attract favourable attention from investors and consumers. The proliferation of competing ESG rating methodologies, inconsistent definitions, and limited standardisation make it difficult for investors to make reliable comparisons between companies. Regulatory authorities in the EU, US, and UK have launched crackdowns on greenwashing in financial products and corporate communications.

The concept of the 'social licence to operate' is increasingly relevant in sectors such as mining, fossil fuels, and financial services. This informal but powerful notion reflects the expectation that businesses can only operate sustainably with the ongoing consent and trust of the communities in which they operate. High-profile corporate controversies — from data breaches and tax avoidance to human rights abuses in supply chains — have demonstrated the severe reputational, financial, and regulatory consequences of failing to meet societal expectations.

Looking ahead, the integration of sustainability into core business strategy — rather than treating it as a compliance exercise — is increasingly recognised as a driver of competitive

advantage, talent attraction, and long-term financial resilience. Companies that proactively manage social and environmental risks, invest in their people and communities, and operate with transparency and integrity are better positioned to navigate an increasingly demanding stakeholder environment.

## COMPREHENSION QUESTIONS

1. What is CSR, and how has its role in corporate strategy evolved over recent decades?
2. Compare and contrast the shareholder primacy view with stakeholder theory. Which do you find more compelling and why?
3. Explain the ESG framework. What do environmental, social, and governance criteria respectively measure?
4. What is greenwashing, and why is it a significant problem for investors and regulators?
5. What is the 'social licence to operate', and why is it particularly relevant for industries such as mining and fossil fuels?
6. Describe the main sustainability reporting requirements currently in force or being introduced, including CSRD, ISSB, and TCFD.

**Exercise 1. Match each CSR/ESG term with its correct definition.**

1. greenwashing	a) the argument that businesses must consider all affected parties, not just shareholders
2. shareholder primacy	b) the informal consent from society for a company to conduct its activities
3. stakeholder theory	c) investing with the aim of generating measurable social or environmental benefits alongside financial returns
4. ESG	d) making misleading claims about environmental or social performance
5. social licence to operate	e) an economic model focused on eliminating waste and reusing resources continuously
6. double materiality	f) a framework evaluating environmental, social, and governance corporate performance
7. TCFD	g) the EU directive requiring large companies to report sustainability information
8. CSRD	h) the principle that companies must report both how sustainability affects them and how they affect society
9. impact investing	i) the view that maximising shareholder returns is the only corporate obligation
10. circular economy	j) a framework requiring disclosure of climate-related financial risks

**Exercise 2. Fill in the blanks with the correct word or phrase.**

**Word box:**

carbon footprint · diversity · remuneration · supply chain · philanthropy · compliance  
· resilience · disclosure · materiality · stakeholder engagement

1. A company's \_\_\_\_\_ refers to the total greenhouse gas emissions it produces directly and indirectly.

- 
2. Board \_\_\_\_\_ policies are scrutinised under the governance pillar of ESG ratings.
  3. Many companies began their CSR journey through corporate \_\_\_\_\_ — donating money to charities.
  4. Ethical \_\_\_\_\_ management requires monitoring labour standards and environmental practices at all tiers.
  5. Mandatory \_\_\_\_\_ requirements compel companies to publish detailed non-financial information.
  6. A \_\_\_\_\_ assessment identifies which ESG issues are most significant to the business and its stakeholders.
  7. Proactive \_\_\_\_\_ helps companies understand societal expectations and manage reputational risk.
  8. Many firms treat CSR purely as a \_\_\_\_\_ exercise, rather than embedding it in their strategy.
  9. Gender \_\_\_\_\_ and inclusion are key social criteria used in ESG evaluation frameworks.
  10. Companies with strong ESG profiles tend to demonstrate greater financial \_\_\_\_\_ in times of economic stress.

***Exercise 3. Decide whether each statement is TRUE or FALSE and correct the false statements.***

1. Milton Friedman argued that companies have obligations to a broad range of stakeholders beyond shareholders. [ T / F ]
2. ESG investing considers only environmental factors when evaluating corporate performance. [ T / F ]
3. The TCFD framework requires companies to disclose their exposure to climate-related financial risks. [ T / F ]
4. Greenwashing involves companies accurately reporting their environmental performance. [ T / F ]
5. The CSRD applies only to small and medium-sized enterprises in the European Union. [ T / F ]
6. Stakeholder theory holds that long-term value creation requires addressing the interests of a wide range of parties. [ T / F ]
7. A company's social licence to operate can be revoked through reputational damage or community opposition. [ T / F ]
8. Double materiality requires companies to report only on how sustainability risks affect their own financials. [ T / F ]
9. MSCI and FTSE Russell publish ESG ratings that are used to guide trillions of dollars in investment decisions. [ T / F ]
10. Integrating sustainability into core strategy is now recognised as a potential source of competitive advantage. [ T / F ]

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**Exercise 4. Complete the sentences using the correct form of the word in brackets.**

1. The company published its first \_\_\_\_\_ (SUSTAIN) report covering environmental, social, and governance performance.
2. Critics accused the bank of \_\_\_\_\_ (GREEN) after it continued to finance new coal projects despite climate pledges.
3. Strong \_\_\_\_\_ (GOVERN) structures help prevent corruption and protect minority shareholder rights.
4. The regulator fined the company for making \_\_\_\_\_ (MISLEAD) claims about the environmental impact of its products.
5. The firm's commitment to \_\_\_\_\_ (DIVERSE) and inclusion was reflected in its board composition.
6. Supply chain \_\_\_\_\_ (AUDIT) revealed labour standard violations at several tier-two suppliers.
7. The investment fund integrated \_\_\_\_\_ (ENVIRONMENT) criteria into its stock selection process.
8. A high level of \_\_\_\_\_ (TRANSPARENT) in reporting builds trust with investors and regulators.
9. Rising stakeholder \_\_\_\_\_ (EXPECT) are compelling businesses to go beyond legal minimum requirements.
10. The task force recommended mandatory \_\_\_\_\_ (DISCLOSE) of climate-related risks for listed companies.

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## UNIT 12. EFFICIENCY AND EMPLOYMENT

Economic efficiency describes the state in which resources are allocated in a way that maximises the total output or welfare generated by a given set of inputs. It is a central concept in economics, underlying debates about market organisation, government intervention, and public policy. Two key forms of efficiency are allocative efficiency — where resources are directed to their highest-valued uses — and productive efficiency — where output is produced at the lowest possible cost given available technology.

Labour markets are central to the study of efficiency and employment. In a perfectly competitive labour market, wages adjust to equate the supply of and demand for labour, ensuring that all workers who wish to work at the prevailing wage can find employment and that all employers who wish to hire at that wage can find workers. Deviations from this ideal — caused by information asymmetries, bargaining power imbalances, institutional rigidities, and frictions — generate persistent unemployment and wage inequality.

Unemployment is classified into several categories. Frictional unemployment arises from the time required to match workers with suitable vacancies, even in a healthy economy. Structural unemployment results from a mismatch between the skills of available workers and the requirements of available jobs — often caused by technological change, automation, or shifts in comparative advantage between industries or regions. Cyclical unemployment is associated with insufficient aggregate demand during economic downturns. Natural unemployment — the irreducible minimum even in a well-functioning economy — consists of frictional and structural components.

The relationship between inflation and unemployment was famously captured by the Phillips curve, which originally suggested a stable negative trade-off: lower unemployment was achievable at the cost of higher inflation. Stagflation in the 1970s revealed the limitations of this simple model, and modern macroeconomics incorporates the concept of the Non-Accelerating Inflation Rate of Unemployment (NAIRU) — the unemployment rate below which inflation begins to accelerate. Monetary authorities aim to keep unemployment close to the NAIRU without generating persistent inflationary pressure.

Technological change — particularly automation, artificial intelligence, and digitalisation — has profound implications for employment. While technology historically has created new jobs even as it has destroyed existing ones, concerns are growing about the pace and distributional consequences of the current wave of technological displacement. Routine cognitive and manual tasks are increasingly susceptible to automation, threatening employment in clerical, transport, and manufacturing occupations. However, technology also creates demand for new skills and generates entirely new industries.

Labour market flexibility is highly valued in standard economic analysis as it enables rapid adjustment to shocks and improves resource allocation. Flexible labour markets feature easy hiring and firing, mobile workers, transparent wages, and active employment services. By contrast, labour market rigidities — including strict employment protection legislation, collective bargaining arrangements, and high minimum wages — may reduce efficiency and increase unemployment, though proponents argue they also provide important worker protection, reduce inequality, and support aggregate demand.

Active labour market policies (ALMPs) — including retraining programmes, employment subsidies, job placement services, and entrepreneurship support — aim to reduce structural and long-term unemployment by improving the skills and employability of the workforce. The effectiveness of ALMPs varies significantly across country contexts, with

Scandinavian economies often cited as models for combining labour market flexibility with strong employment protection, social insurance, and investment in lifelong learning — a framework known as 'flexicurity'.

## COMPREHENSION QUESTIONS

1. Distinguish between allocative efficiency and productive efficiency. Why are both important for economic welfare?
2. Classify and explain the three main types of unemployment. Which type is most amenable to policy intervention, and why?
3. What is the Phillips curve, and why did its original formulation prove inadequate? What is the NAIRU?
4. How does technological change affect employment? Discuss both the risks and the potential benefits.
5. What is labour market flexibility, and what are the arguments for and against flexible labour markets?
6. What are Active Labour Market Policies (ALMPs), and what is 'flexicurity'?

### *Exercise 1. Match each term with its correct definition.*

1. allocative efficiency	a) unemployment caused by insufficient demand during economic downturns
2. frictional unemployment	b) a policy combining flexible labour markets with strong social protection
3. structural unemployment	c) resources directed to their highest-valued uses in the economy
4. cyclical unemployment	d) the ease with which wages and employment adjust to economic conditions
5. NAIRU	e) a graph depicting the trade-off between unemployment and inflation
6. Phillips curve	f) government programmes to improve the skills and employability of workers
7. labour market flexibility	g) unemployment caused by skill mismatches between workers and available jobs
8. flexicurity	h) the unemployment rate at which inflation neither accelerates nor decelerates
9. ALMP	i) a legally mandated lower limit on hourly wages paid to workers
10. minimum wage	j) short-term joblessness due to time needed to match workers and vacancies

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**Exercise 2. Fill in the blanks with the correct word or phrase.**

**Word box:**

*productivity · automation · wage rigidity · underemployment · labour mobility · collective bargaining · skills gap · redundancy · outsourcing · income inequality*

1. \_\_\_\_\_ refers to the ability of workers to move between jobs, sectors, and regions.
2. \_\_\_\_\_ occurs when workers are employed in jobs below their skill level or in insufficient hours.
3. The \_\_\_\_\_ between available workers' skills and employer requirements contributes to structural unemployment.
4. Advances in \_\_\_\_\_ are replacing routine cognitive and manual tasks across multiple sectors.
5. Total factor \_\_\_\_\_ measures how efficiently an economy uses both capital and labour inputs.
6. When a trade union negotiates a pay rise for its members, this is an example of \_\_\_\_\_.
7. High \_\_\_\_\_ — wages that do not fall even when unemployment rises — prevents the labour market from clearing.
8. \_\_\_\_\_ of manufacturing to lower-wage countries has contributed to structural unemployment in advanced economies.
9. A worker who loses their job due to a company restructuring may receive a \_\_\_\_\_ payment.
10. Rising \_\_\_\_\_ is a major social concern in many developed economies following decades of globalisation.

**Exercise 3. Choose the correct option (A, B or C).**

1. A graduate searching for the right first job experiences \_\_\_\_\_ unemployment.  
*A) structural B) cyclical C) frictional*
2. The NAIRU suggests that trying to push unemployment too low will cause \_\_\_\_\_ to rise.  
*A) wages B) inflation C) productivity*
3. 'Flexicurity' combines flexible markets with strong \_\_\_\_\_ for displaced workers.  
*A) penalties B) social protection C) wage controls*
4. Routine cognitive tasks are most at risk from \_\_\_\_\_ driven by AI and automation.  
*A) outsourcing B) displacement C) regulation*
5. A coal miner who loses her job due to the energy transition faces \_\_\_\_\_ unemployment.  
*A) frictional B) structural C) voluntary*
6. Active labour market policies aim to improve workers' \_\_\_\_\_ through training and placement.  
*A) wages B) employability C) contracts*
7. Productive efficiency means producing output at the \_\_\_\_\_ possible cost.

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A) highest B) lowest C) average

8. A rising minimum wage may reduce \_\_\_\_\_ for low-skilled workers if it exceeds the market rate.

A) demand B) supply C) productivity

9. The original Phillips curve trade-off broke down during the \_\_\_\_\_ of the 1970s.

A) recession B) stagflation C) boom

10. Labour market \_\_\_\_\_ allows wages and employment to adjust quickly to economic shocks.

A) rigidity B) protection C) flexibility

**Exercise 4. Complete each sentence with the correct form of the word in brackets.**

1. Technology has \_\_\_\_\_ (TRANSFORM) the nature of work, creating new roles while eliminating others.

\_\_\_\_\_

2. Persistent \_\_\_\_\_ (EMPLOY) among young people is a major challenge in many European economies.

\_\_\_\_\_

3. The government invested heavily in \_\_\_\_\_ (RETRAIN) programmes for workers displaced by automation.

\_\_\_\_\_

4. Strong \_\_\_\_\_ (PRODUCE) growth enables firms to pay higher wages without generating inflation.

\_\_\_\_\_

5. The \_\_\_\_\_ (RIGID) of wages in the public sector contributes to budget pressures during downturns.

\_\_\_\_\_

6. Labour \_\_\_\_\_ (MOBILE) is constrained by housing costs, language barriers, and family ties.

\_\_\_\_\_

7. The union negotiated a \_\_\_\_\_ (COLLECTIVE) agreement covering all workers in the sector.

\_\_\_\_\_

8. \_\_\_\_\_ (FLEXICURE) economies combine market adaptability with comprehensive social safety nets.

\_\_\_\_\_

9. Rising \_\_\_\_\_ (AUTOMATE) threatens jobs in manufacturing, logistics, and back-office functions.

\_\_\_\_\_

10. Economists debate whether \_\_\_\_\_ (MINIMUM) wage increases reduce employment or simply redistribute income.

\_\_\_\_\_

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## UNIT 13. EXCHANGE RATE

An exchange rate is the price at which one currency can be exchanged for another. Exchange rates play a fundamental role in international trade and finance, influencing the competitiveness of exports, the cost of imports, the value of foreign investments, and the burden of foreign-denominated debt. Their determination and management have been central concerns of international monetary policy since the breakdown of the gold standard in the twentieth century.

Exchange rate regimes vary significantly across countries. Under a floating exchange rate system, the rate is determined entirely by the forces of supply and demand in the foreign exchange (forex) market, with no government or central bank intervention to set or maintain a target rate. The US dollar, euro, and British pound operate under managed floats, where authorities may occasionally intervene to smooth excessive volatility but allow underlying market forces to determine the rate over time.

Under a fixed exchange rate system, a country pegs its currency to another currency or to a basket of currencies at an officially established rate. Maintaining the peg requires the central bank to buy or sell foreign reserves to offset market pressure. Hong Kong's currency board arrangement — which links the HKD to the USD at a fixed rate — is a prominent modern example. The advantages of a fixed exchange rate include reduced currency risk for traders and investors, and enhanced monetary credibility. The disadvantages include the loss of an independent monetary policy and vulnerability to speculative attacks when the peg is perceived as unsustainable.

The theory of purchasing power parity (PPP) holds that exchange rates should, in the long run, equalise the prices of identical goods across countries. If a basket of goods costs \$100 in the US and £90 in the UK, the PPP exchange rate would be \$1.11 per pound. Deviations from PPP — caused by trade barriers, non-tradeable goods, and capital flows — may persist for extended periods, but are expected to correct over the long run. The Economist's 'Big Mac Index' is a popular, if simplified, PPP benchmark.

Interest rate differentials between countries are a primary driver of short-term exchange rate movements. According to the theory of uncovered interest parity (UIP), investors will move capital to the currency offering the higher interest rate until the expected depreciation of that currency offsets the interest rate advantage. In practice, the 'carry trade' — borrowing in low-interest currencies and investing in high-interest currencies — generates profits when expected exchange rate movements do not materialise, but can unwind sharply and disruptively.

Currency depreciation makes a country's exports cheaper and imports more expensive, which theory predicts will improve the trade balance — the Marshall-Lerner condition holds that this improvement will occur provided the combined elasticities of demand for exports and imports exceed one. The J-curve effect describes the empirical observation that the trade balance initially worsens following a depreciation, as import prices rise before export volumes respond, before improving over time.

Currency crises — rapid and disorderly depreciations — can have devastating economic consequences, as demonstrated by the Asian financial crisis of 1997-98, the Russian rouble crisis of 1998, and the Turkish lira crisis of 2021-22. Vulnerabilities typically include large current account deficits, high foreign currency debt, inadequate reserves, and fragile banking systems. International Monetary Fund (IMF) emergency lending programmes provide a safety net for countries facing balance of payments crises.

## COMPREHENSION QUESTIONS

1. Explain the difference between a floating and a fixed exchange rate regime. What are the main advantages and disadvantages of each?
2. What is purchasing power parity (PPP) and what factors cause exchange rates to deviate from their PPP level?
3. How do interest rate differentials influence exchange rates? Explain the concept of the carry trade and its risks.
4. Explain the Marshall-Lerner condition and the J-curve effect. Why does the trade balance initially worsen following a currency depreciation?
5. What economic vulnerabilities make a country susceptible to a currency crisis?
6. What role does the IMF play in addressing balance of payments crises?

### *Exercise 1. Match each exchange rate concept with its definition.*

1. floating exchange rate	a) borrowing in a low-interest currency to invest in a higher-yielding currency
2. fixed exchange rate	b) a fixed regime where the domestic currency is fully backed by a foreign currency
3. purchasing power parity	c) foreign currency assets held by a central bank to defend the exchange rate
4. carry trade	d) a rate pegged at an officially determined level by monetary authorities
5. Marshall-Lerner condition	e) a trade-weighted measure of a currency's value adjusted for inflation
6. J-curve effect	f) the theory that exchange rates equalise prices of identical goods across countries
7. currency board	g) the requirement that combined import and export demand elasticities exceed one for depreciation to improve the trade balance
8. speculative attack	h) a rate freely determined by market supply and demand without official intervention
9. foreign exchange reserve	i) a large-scale sell-off of a currency to force an unsustainable peg to break
10. real effective exchange rate	j) the tendency for the trade balance to worsen before improving after depreciation

### *Exercise 2. Fill in the blanks with the correct word or phrase.*

#### **Word box:**

*appreciation · depreciation · current account deficit · capital account · hot money · intervention · revaluation · devaluation · convertibility · managed float*

1. A \_\_\_\_\_ of the domestic currency makes exports more competitive and imports more expensive.
2. An \_\_\_\_\_ of the domestic currency raises the purchasing power of domestic consumers.
3. A large persistent \_\_\_\_\_ is a common vulnerability preceding currency crises.

- 
4. \_\_\_\_\_ flows refer to short-term speculative capital attracted by interest rate differentials.
  5. Under a \_\_\_\_\_ regime, the central bank allows market forces to move the rate within a broad range.
  6. A \_\_\_\_\_ is an official reduction in the value of a fixed exchange rate by the government.
  7. A \_\_\_\_\_ is a deliberate increase in the value of a fixed exchange rate.
  8. Central bank \_\_\_\_\_ in the forex market may involve buying domestic currency to halt depreciation.
  9. Full \_\_\_\_\_ of a currency means it can be freely exchanged for foreign currencies without restriction.
  10. The \_\_\_\_\_ records all financial flows between residents and non-residents, excluding trade.

***Exercise 3. Complete each sentence with the correct form of the word in brackets.***

1. A \_\_\_\_\_ (DEPRECIATE) currency boosts the competitiveness of a country's exported goods.

\_\_\_\_\_

2. The central bank sold foreign reserves to prevent further \_\_\_\_\_ (DEVALUE) of the currency.

\_\_\_\_\_

3. Interest rate \_\_\_\_\_ (DIFFER) are a key driver of capital flows and exchange rate movements.

\_\_\_\_\_

4. The currency underwent rapid \_\_\_\_\_ (APPRECIATE) following the announcement of higher interest rates.

\_\_\_\_\_

5. PPP theory predicts long-run \_\_\_\_\_ (CONVERGE) of prices across countries.

\_\_\_\_\_

6. The carry trade strategy became highly \_\_\_\_\_ (PROFIT) when target currencies remained stable.

\_\_\_\_\_

7. The IMF provided an emergency \_\_\_\_\_ (LEND) package to stabilise the country's currency.

\_\_\_\_\_

8. A \_\_\_\_\_ (SPECULATE) attack forced the government to abandon the exchange rate peg.

\_\_\_\_\_

9. The country's mounting foreign currency \_\_\_\_\_ (OWED / DEBT) increased its vulnerability to a crisis.

\_\_\_\_\_

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10. Exchange rate \_\_\_\_\_ (VOLATILE) creates uncertainty for businesses engaged in international trade.

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*Exercise 4. Decide whether each statement is TRUE or FALSE and correct the false statements.*

1. Under a floating exchange rate regime, the central bank actively sets the rate on a daily basis. [ T / F ]
2. Purchasing power parity predicts that exchange rates should equalise the price of identical goods internationally. [ T / F ]
3. Currency depreciation always immediately improves the trade balance with no delay. [ T / F ]
4. The carry trade involves investing in low-interest currencies using high-interest currency borrowing. [ T / F ]
5. The Marshall-Lerner condition must be satisfied for depreciation to improve the trade balance. [ T / F ]
6. Hong Kong operates a currency board arrangement linking the HKD to the US dollar. [ T / F ]
7. A speculative attack occurs when investors buy large quantities of a currency to force an appreciation. [ T / F ]
8. The J-curve effect suggests that the trade balance worsens initially before improving after depreciation. [ T / F ]
9. High foreign currency debt levels reduce a country's vulnerability to a currency crisis. [ T / F ]
10. The IMF provides balance of payments financing to countries facing serious external payment difficulties. [ T / F ]

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## UNIT 14. INTERNATIONAL TRADE

International trade — the exchange of goods and services across national borders — has been a cornerstone of economic development throughout history. The theoretical foundations for trade were established in the classical period: Adam Smith's principle of absolute advantage demonstrated that countries should specialise in activities they perform better than others, while David Ricardo's principle of comparative advantage showed that mutually beneficial trade is possible even when one country is more efficient in the production of all goods.

Comparative advantage holds that a country should specialise in and export the goods in which its opportunity cost of production is lowest — even if it is less efficient in absolute terms than its trading partners at producing those goods. This insight, though counterintuitive, remains one of the most powerful results in economic theory. Modern extensions, including the Heckscher-Ohlin model, predict that countries export goods that use their relatively abundant factor of production intensively — labour-abundant countries export labour-intensive goods, while capital-abundant countries export capital-intensive goods.

The gains from trade arise through several mechanisms. Specialisation raises productivity and allows countries to consume beyond their production possibilities frontier. Trade enables economies of scale by expanding the market for domestic producers. Competition from foreign producers pressures domestic firms to improve efficiency. And a wider variety of goods becomes available to consumers at lower prices. Empirical evidence broadly supports the view that trade liberalisation is associated with higher GDP per capita over the long run, though the distributional consequences — the winners and losers — are highly uneven.

Despite the theoretical benefits of free trade, all countries maintain some degree of trade protection. Tariffs are taxes imposed on imported goods, raising their price and protecting domestic producers at the expense of consumers. Quotas set quantitative limits on the volume of imports permitted. Non-tariff barriers — including regulatory standards, licensing requirements, and subsidies to domestic producers — are increasingly prominent as tariff levels have fallen in advanced economies. Each of these instruments distorts resource allocation and typically reduces overall welfare, though they may serve legitimate policy goals such as infant industry protection, national security, or environmental standards.

The World Trade Organization (WTO) provides the legal and institutional framework for international trade, setting rules, resolving disputes, and facilitating negotiation of trade liberalisation agreements. The multilateral trading system established under the WTO has been under strain, with the rise of preferential trade agreements (PTAs) — bilateral and regional agreements outside the WTO framework — reflecting frustration with the slow pace of multilateral negotiations.

The global value chain (GVC) revolution has transformed international trade. Rather than exchanging finished goods, countries increasingly trade tasks and components, with production fragmented across multiple countries to exploit comparative advantages at each stage. This has tightly integrated economies and increased the interdependence of supply chains, as vividly illustrated by the disruptions caused by the COVID-19 pandemic and escalating geopolitical tensions.

Trade policy has returned to the forefront of political debate in many countries, driven by concerns about deindustrialisation, inequality, supply chain vulnerability, and strategic competition with China. Industrial policy — including subsidies, tax incentives, and trade restrictions to support domestic sectors — has been revived in the United States, the European

Union, and elsewhere, challenging the post-war consensus in favour of free trade and open markets.

## COMPREHENSION QUESTIONS

1. Explain the principle of comparative advantage. Why is it more significant than absolute advantage for understanding international trade?
2. What are the main gains from international trade? Are these gains equally distributed among all groups in society?
3. What is a tariff, and how does it affect domestic consumers, producers, and the overall economy?
4. What is the WTO and what role does it play in the international trading system?
5. Explain the concept of global value chains (GVCs) and describe the risks associated with deep supply chain integration.
6. Why has industrial policy returned to prominence in many advanced economies, and what tensions does this create with free trade principles?

**Exercise 1. Match each international trade term with its definition.**

1. comparative advantage	a) the ratio of a country's export prices to its import prices
2. absolute advantage	b) a limit on the quantity of a specific imported good allowed into a country
3. terms of trade	c) an international production system where different countries perform different stages
4. tariff	d) the ability to produce more of a good with the same resources as a trading partner
5. quota	e) a situation where a country's imports exceed its exports in value
6. WTO	f) the justification for temporary protection to allow new industries to develop
7. global value chain	g) a tax imposed on imported goods by the importing country
8. trade deficit	h) the international organisation that regulates and facilitates global trade
9. infant industry argument	i) the practice of selling exports below cost to capture market share abroad
10. dumping	j) the ability to produce a good at a lower opportunity cost than a trading partner

**Exercise 2. Fill in the blanks with the correct term.**

**Word box:**

*trade liberalisation · non-tariff barrier · most-favoured-nation · current account · protectionism · bilateral · free trade agreement · factor endowment · reshoring · supply chain*

1. The \_\_\_\_\_ principle requires WTO members to extend the same favourable trade terms to all other members.

- 
2. A \_\_\_\_\_ between two countries eliminates tariffs and reduces trade barriers between them.
  3. The Heckscher-Ohlin model predicts trade patterns based on each country's \_\_\_\_\_ of capital and labour.
  4. Excessive reliance on foreign \_\_\_\_\_ for critical goods created vulnerabilities exposed by the pandemic.
  5. The \_\_\_\_\_ records trade in goods and services, as well as income and current transfers.
  6. Regulatory differences and technical standards are examples of \_\_\_\_\_ that restrict trade.
  7. Rising \_\_\_\_\_ sentiment led many governments to impose new tariffs and quotas on foreign goods.
  8. \_\_\_\_\_ of manufacturing refers to bringing production back from overseas to the domestic market.
  9. Progressive \_\_\_\_\_ since the 1940s has dramatically reduced average tariff levels globally.
  10. A \_\_\_\_\_ trade agreement applies only to two specific countries, unlike multilateral agreements.

**Exercise 3. Choose the correct option (A, B, or C).**

1. Comparative advantage is based on \_\_\_\_\_ cost rather than absolute productivity.  
*A) financial B) opportunity C) marginal*
2. The WTO's \_\_\_\_\_ function allows member states to challenge unfair trade practices.  
*A) dispute settlement B) lending C) monetary*
3. A tariff raises revenue for the government but reduces \_\_\_\_\_ welfare by raising domestic prices.  
*A) producer B) consumer C) global*
4. The COVID-19 pandemic revealed the \_\_\_\_\_ of highly concentrated global supply chains.  
*A) efficiency B) flexibility C) fragility*
5. Under the Heckscher-Ohlin model, a capital-abundant country will export \_\_\_\_\_ goods.  
*A) labour-intensive B) capital-intensive C) agricultural*
6. Dumping involves exporting goods at prices \_\_\_\_\_ their production cost.  
*A) above B) equal to C) below*
7. The re-emergence of industrial policy reflects concerns about \_\_\_\_\_ and strategic competition.  
*A) free trade B) deindustrialisation C) tariff reduction*
8. Trade liberalisation generally raises \_\_\_\_\_ but may create winners and losers within society.  
*A) average welfare B) inequality C) tariffs*
9. A trade \_\_\_\_\_ occurs when a country imports more goods and services than it exports.

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A) surplus B) deficit C) balance

10. Global value chains allow countries to specialise in specific \_\_\_\_\_ of production rather than final products.

A) industries B) stages C) markets

**Exercise 4. Rewrite each sentence using the word in brackets without changing the meaning.**

1. Portugal is better at producing wine than cloth relative to England. (COMPARATIVE ADVANTAGE)

\_\_\_\_\_

2. The government placed a maximum limit of 500,000 units on car imports. (QUOTA)

\_\_\_\_\_

3. The company decided to bring production back from overseas to reduce vulnerability. (RESHORE)

\_\_\_\_\_

4. Countries that have agreed to trade freely with each other impose no tariffs on bilateral trade. (FREE TRADE AGREEMENT)

\_\_\_\_\_

5. Selling exports below the cost of production to gain market share is an illegal practice under WTO rules. (DUMPING)

\_\_\_\_\_

6. The pandemic disrupted the flow of components from suppliers in multiple countries. (SUPPLY CHAIN)

\_\_\_\_\_

7. Rich countries export technologically advanced goods because they have more capital per worker. (FACTOR ENDOWMENT)

\_\_\_\_\_

8. Emerging economies argued that protecting new domestic industries is sometimes justified. (INFANT INDUSTRY)

\_\_\_\_\_

9. The rise of regional trade deals has put pressure on the WTO's multilateral system. (PREFERENTIAL)

\_\_\_\_\_

10. When import prices rise faster than export prices, the terms of trade deteriorate. (TERMS OF TRADE)

\_\_\_\_\_

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## UNIT 15. ECONOMICS AND ECOLOGY

The relationship between economics and ecology has moved from the margins of academic discourse to the centre of global policy debate. For most of the twentieth century, economic growth was pursued without systematic accounting for its environmental costs. The depletion of natural resources, the degradation of ecosystems, and the accumulation of greenhouse gases in the atmosphere were treated as external to economic analysis — what economists call externalities. A growing body of scholarship and mounting empirical evidence have challenged this approach, giving rise to environmental economics and ecological economics as distinct fields.

Environmental economics applies standard economic tools — cost-benefit analysis, pricing mechanisms, and market design — to environmental problems. The fundamental insight is that environmental degradation arises from market failure: the absence of markets for clean air, clean water, and biodiversity means that the social costs of pollution and resource depletion are not reflected in private prices, leading to overuse and underprotection. Policy remedies include Pigouvian taxes (such as carbon taxes), cap-and-trade systems (such as the EU's Emissions Trading System, ETS), payments for ecosystem services, and regulatory standards.

Ecological economics takes a more radical position, arguing that the economy is embedded within, and fundamentally dependent upon, the natural world. It emphasises the concept of natural capital — the stock of natural resources and ecosystem services that underpin all economic activity. Unlike man-made capital, many components of natural capital are irreplaceable or renewable only over very long timescales. Ecological economists challenge the conventional assumption that natural capital can be substituted by man-made capital indefinitely, and argue that sustainable development requires maintaining the total stock of natural capital above a critical threshold.

Climate change represents the most significant market failure in history, according to the Stern Review on the Economics of Climate Change (2006). The accumulation of greenhouse gases in the atmosphere — primarily from the combustion of fossil fuels — creates a global negative externality whose costs will fall disproportionately on the poorest and most vulnerable countries and future generations. Effective climate policy requires international coordination to overcome the free-rider problem inherent in a global commons: no individual country has sufficient incentive to bear the full costs of emissions reduction when the benefits are shared globally.

Carbon pricing is widely regarded by economists as the most efficient policy instrument for reducing greenhouse gas emissions, as it sends a price signal across the entire economy, incentivising emission reductions wherever they are cheapest. The EU's Emissions Trading System operates a cap-and-trade mechanism: a ceiling is set on total emissions, and companies must hold permits for each unit of carbon they emit. The scarcity of permits creates a carbon price that encourages investment in low-carbon technologies and efficiency improvements.

The concept of sustainable development — meeting the needs of the present without compromising the ability of future generations to meet their own needs — was formalised in the Brundtland Report (1987) and underpins the United Nations Sustainable Development Goals (SDGs). A just transition to a low-carbon economy must address not only environmental outcomes but also the social and economic consequences for workers and communities in fossil fuel-dependent regions.

Biodiversity loss, deforestation, ocean acidification, and freshwater scarcity represent ecological crises that interact with and amplify the economic impacts of climate change. The

Dasgupta Review (2021) on the Economics of Biodiversity argued that humanity's impact on nature is unsustainable, requiring a transformation in how we measure economic success — moving beyond GDP to incorporate measures of natural capital and genuine societal wellbeing. Green finance, ESG investing, and nature-based solutions are increasingly recognised as essential components of the transition to a sustainable global economy.

## COMPREHENSION QUESTIONS

1. Why is environmental degradation described as a market failure? What does this mean in economic terms?
2. Distinguish between environmental economics and ecological economics. What are the key differences in their approaches?
3. Why does climate change represent a global public goods problem, and why is international cooperation necessary to address it?
4. Explain how a cap-and-trade system such as the EU ETS works. What are its advantages over direct regulation?
5. What is the concept of natural capital, and why do ecological economists argue it cannot always be substituted by man-made capital?
6. What is the Brundtland definition of sustainable development, and how does the concept of a 'just transition' extend it?

*Exercise 1. Match each environmental economics term with its definition.*

1. natural capital	a) the benefits provided to humans by natural systems such as clean water and pollination
2. Pigouvian tax	b) a market-based mechanism setting a total emissions limit and allowing permit trading
3. cap-and-trade	c) the total greenhouse gas emissions caused by an individual or organisation
4. externality	d) a shift to a low-carbon economy that addresses the social impact on affected workers
5. ecosystem services	e) a tax set equal to the marginal social cost of a negative externality to internalise it
6. carbon footprint	f) investment and lending specifically directed at environmentally sustainable activities
7. sustainable development	g) the incentive to benefit from a public good without contributing to its provision
8. free-rider problem	h) development that meets present needs without compromising future generations' ability to meet theirs
9. green finance	i) the stock of renewable and non-renewable natural resources that generate ecosystem services
10. just transition	j) a cost or benefit of an economic activity not reflected in the market price

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**Exercise 2. Fill in the blanks with the correct word or phrase.**

**Word box:**

<i>carbon tax · biodiversity · deforestation · net zero · Paris Agreement · emissions permit · Stern Review · circular economy · greenwashing · environmental externality</i>
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1. The \_\_\_\_\_ (2006) described climate change as the greatest market failure in history.
2. Under the EU ETS, each company must surrender one \_\_\_\_\_ for each tonne of CO<sub>2</sub> it emits.
3. The loss of \_\_\_\_\_ — the variety of life on Earth — undermines the resilience of ecosystems.
4. A \_\_\_\_\_ is a direct charge on carbon emissions intended to make the social cost of pollution visible.
5. The \_\_\_\_\_ commits signatory countries to limiting global warming to well below 2°C above pre-industrial levels.
6. \_\_\_\_\_ — the clearing of forests for agriculture — releases large quantities of carbon and destroys habitat.
7. The company faced criticism for \_\_\_\_\_ after claiming to be carbon-neutral without credible evidence.
8. A \_\_\_\_\_ model aims to eliminate waste by keeping products and materials in use for as long as possible.
9. Many countries have set \_\_\_\_\_ targets, aiming to balance greenhouse gas emissions and removals by 2050.
10. Industrial pollution is a classic example of a negative \_\_\_\_\_ not captured in market prices.

**Exercise 3. Decide whether each statement is TRUE or FALSE and correct the false ones.**

1. Environmental economics treats nature as embedded within and inseparable from the economic system. [ T / F ]
2. A Pigouvian tax is designed to internalise a negative externality by increasing its private cost. [ T / F ]
3. The EU Emissions Trading System allows total emissions to be determined by the market without any cap. [ T / F ]
4. Climate change is described as a global public goods problem because the benefits of mitigation are shared. [ T / F ]
5. Ecological economics accepts the assumption that man-made capital can always substitute for natural capital. [ T / F ]
6. The Brundtland Report defined sustainable development as meeting current needs without harming future generations. [ T / F ]
7. The Dasgupta Review argued that GDP alone is a sufficient measure of genuine economic progress. [ T / F ]

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8. A cap-and-trade system creates a price incentive to reduce emissions at the lowest possible cost across the economy. [ T / F ]
  9. A just transition refers exclusively to the environmental dimension of moving to a low-carbon economy. [ T / F ]
  10. Green finance channels investment specifically towards environmentally sustainable economic activities. [ T / F ]

***Exercise 4. Complete the sentences with the correct form of the word in brackets.***

1. The government introduced a \_\_\_\_\_ (CARBON) tax to internalise the social cost of fossil fuel combustion.

\_\_\_\_\_

2. Climate change is primarily caused by the \_\_\_\_\_ (ACCUMULATE) of greenhouse gases in the atmosphere.

\_\_\_\_\_

3. Effective climate policy requires \_\_\_\_\_ (INTERNATIONAL) cooperation to overcome the free-rider problem.

\_\_\_\_\_

4. The ETS has been \_\_\_\_\_ (REFORM) several times to strengthen the carbon price signal.

\_\_\_\_\_

5. Protecting biodiversity requires \_\_\_\_\_ (SUSTAIN) management of forests, oceans, and freshwater systems.

\_\_\_\_\_

6. The \_\_\_\_\_ (DECARBONISE) of the energy sector requires massive investment in renewables and storage.

\_\_\_\_\_

7. Companies that cannot \_\_\_\_\_ (REDUCE) emissions sufficiently can purchase permits from those that do.

\_\_\_\_\_

8. Natural capital \_\_\_\_\_ (DEplete) reduces the productive capacity available to future generations.

\_\_\_\_\_

9. The concept of \_\_\_\_\_ (EMBED) the economy within nature challenges conventional GDP-focused growth models.

\_\_\_\_\_

10. Nature-based \_\_\_\_\_ (SOLVE) such as rewilding offer cost-effective ways to sequester carbon.

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