

International Political Economy: Basic Concepts

I. What is IPE?

II. National Income

III. Trade

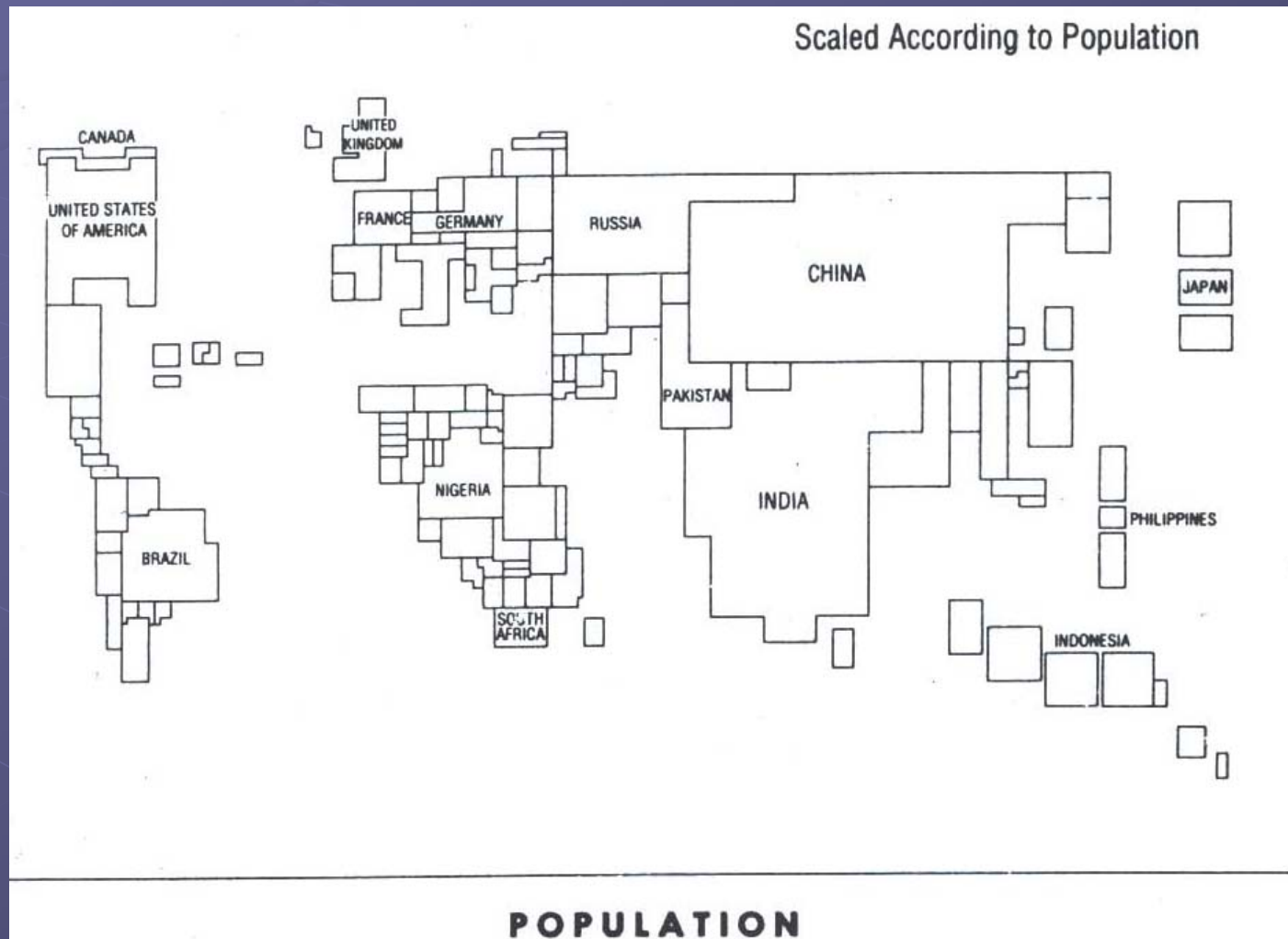
IV. Monetary



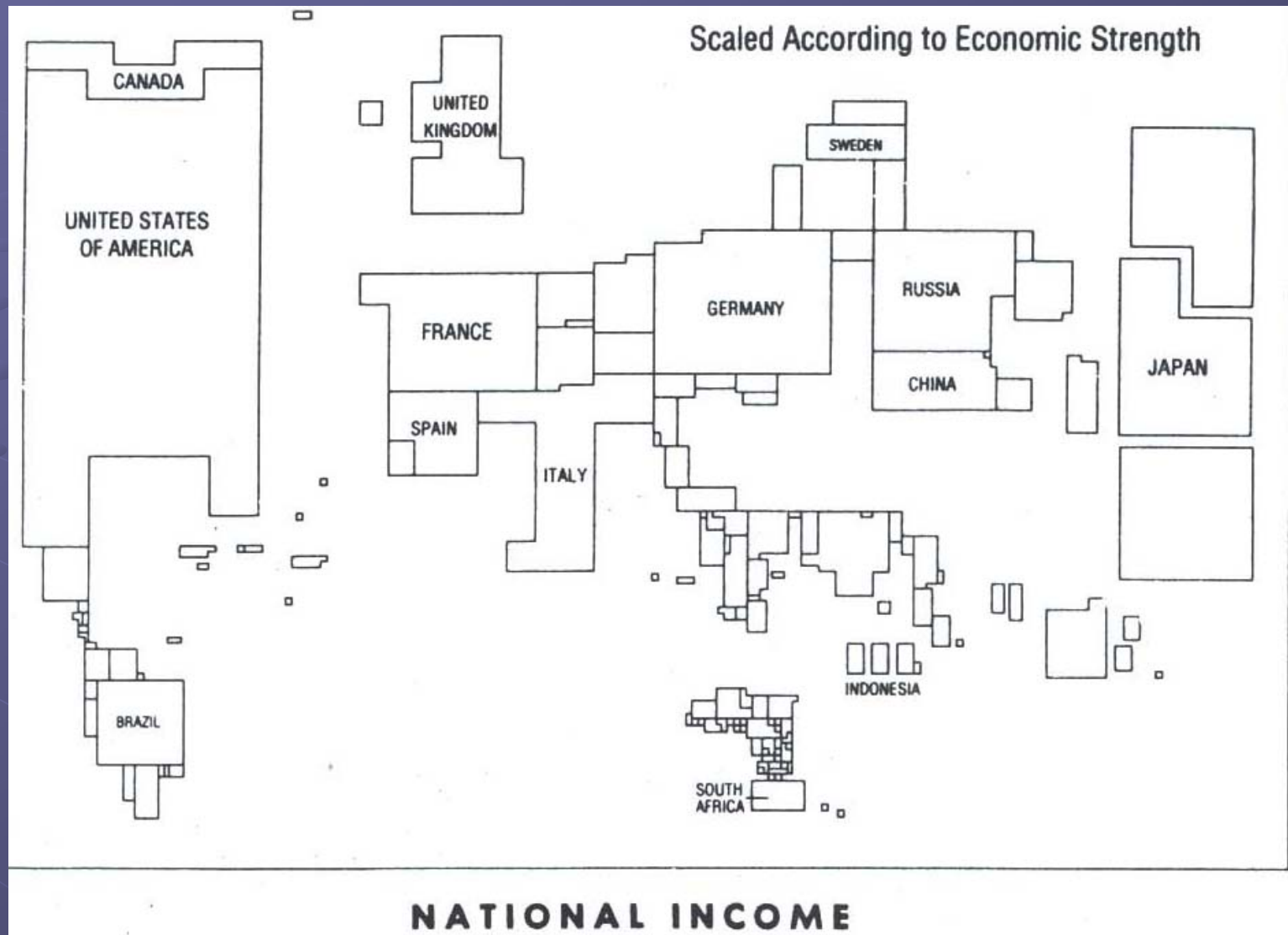
I. What is IPE?

- IPE (from K&R): “The study of the intersection of politics and economics (states and markets) that illuminates the reasons why changes occur in the distribution of states wealth and power “ (p. 278)
- Market: economic structure where outcomes are determined by prices
- Opportunity Cost: trade-off (loss) of ANY economic decision
- BIG Q: Which combination of state and market works best?

World Scaled by Population



World Scaled by Income



II. National Income

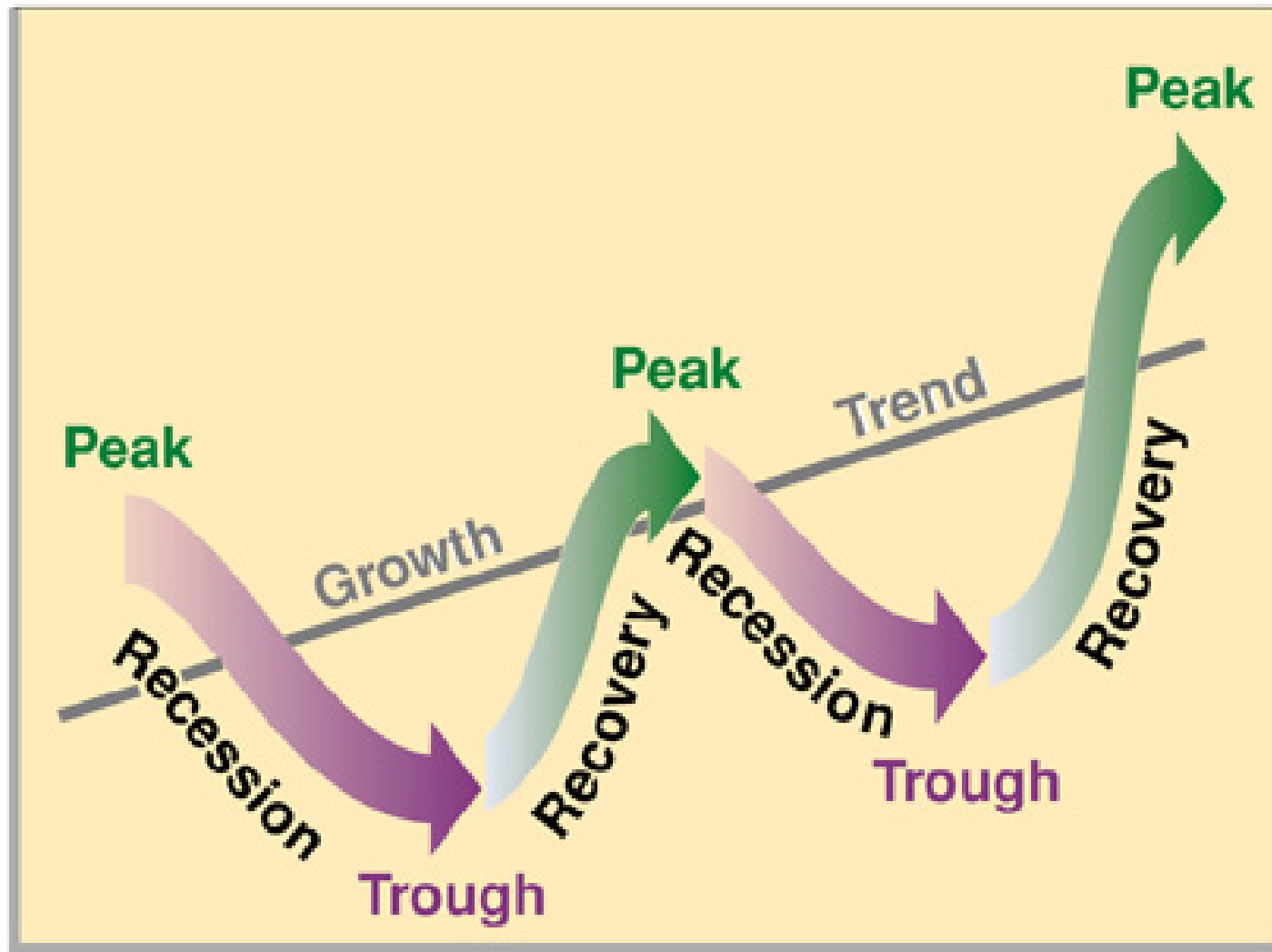
- **Gross Domestic Product:** an estimate of the total monetary value of all goods and services produced in a country in a given year.
- **Gross National Product:** Same as above, but takes into account foreign exchange (trade; foreign companies in the US; US companies producing abroad)
- **Per capita GDP:** Overall GDP divided by the population
- **Purchasing Power Parity:** makes adjustments for costs of living.
 - *The Economist's 'Big Mac Index'*

II. National Income

- Business Cycle: Regular up and down fluctuations of capitalist economies.
- Inflation: a sustained *rise* in the general price level over time.
- Deflation: a sustained *fall* in the general price level over time.
- Productivity: value of output (production) per units of input (materials; capital equipment; labor, etc.).

The Business Cycle

Level of real output



Time

III. Trade – Balance of Payments

● Current Account (goods/services)

- Merchandise Trade ('Trade balance')
- Service Trade (insurance, financial services, etc.)
- Investment Income (Interest)
- Government Transfers and Sales
 - (Exports = Credit; Imports = Debit)

● Capital Account (investment)

- Investment Export (\$'s invested abroad)
- Investment Imports (investments into the US)
- Foreign Currency Reserves
- Statistical Discrepancy
 - (Exports = Debit; Imports = Credit)

US Balance of Payments 2005

(\$ millions)

Merchandise Trade	-\$781,642
Service Trade	+\$58,026
Investment Income	+\$1567
Government Transfers and Sales	-\$82,896
CURRENT ACCOUNT BALANCE	-\$804,945
Capital Exports	-\$491,729
Capital Imports	+\$1,292,395
Statistical Discrepancy	-\$9626
CAPITAL ACCOUNT BALANCE	+\$791,010

Source: US Bureau of Economic Analysis (www.bea.gov)

IV. Monetary Policy -- Domestic

- Fiscal Policy: Taxation and spending
- Monetary policy: money supply and interest rates
- Interest Rate: the cost of borrowing money
- Federal Reserve controls money supply via:
 - Discount Rate (Interest rate charged to banks)
 - Reserve Requirements
 - Open Market Operations (buy/sell Treasury bonds)
- IF want to EXPAND economy → Lower Interest Rates
- IF want to CONTRACT economy (to fight inflation) → Raise Interest Rates

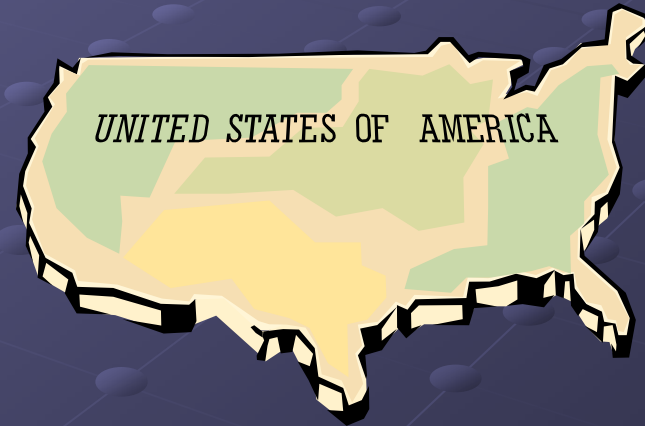
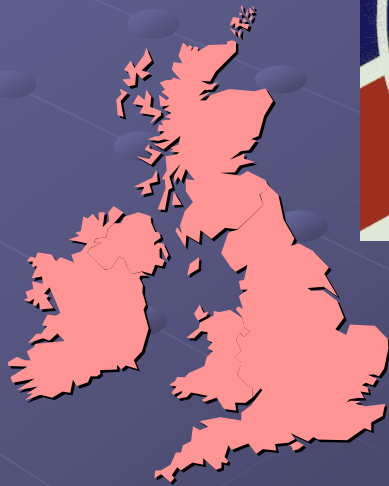
IV. Monetary Policy – International

- Exchange Rates: Price of a currency valued in another currency
- Change in exchange rates change the price of imported/exported goods
- Exchange rates and investment
- Portfolio Investment v. Foreign Direct Investment (FDI)
- No ‘Giant Sucking Sound’!

Changes in Exchange Rates and Trade

DAY 1: £ 1 (UK) = \$1 (US)

- Bass Ale in UK costs £ 1
- Budweiser in US Costs \$1
- Budweiser in UK Costs £ 1
- Bass Ale in US costs \$1



DAY 2: £ 1 (UK) = \$2 (US)

FALL in \$; RISE in £

- Bass Ale in UK costs £ 1
- Budweiser in US Costs \$1
- Budweiser in UK Costs 50p
- Bass Ale in US costs \$2

