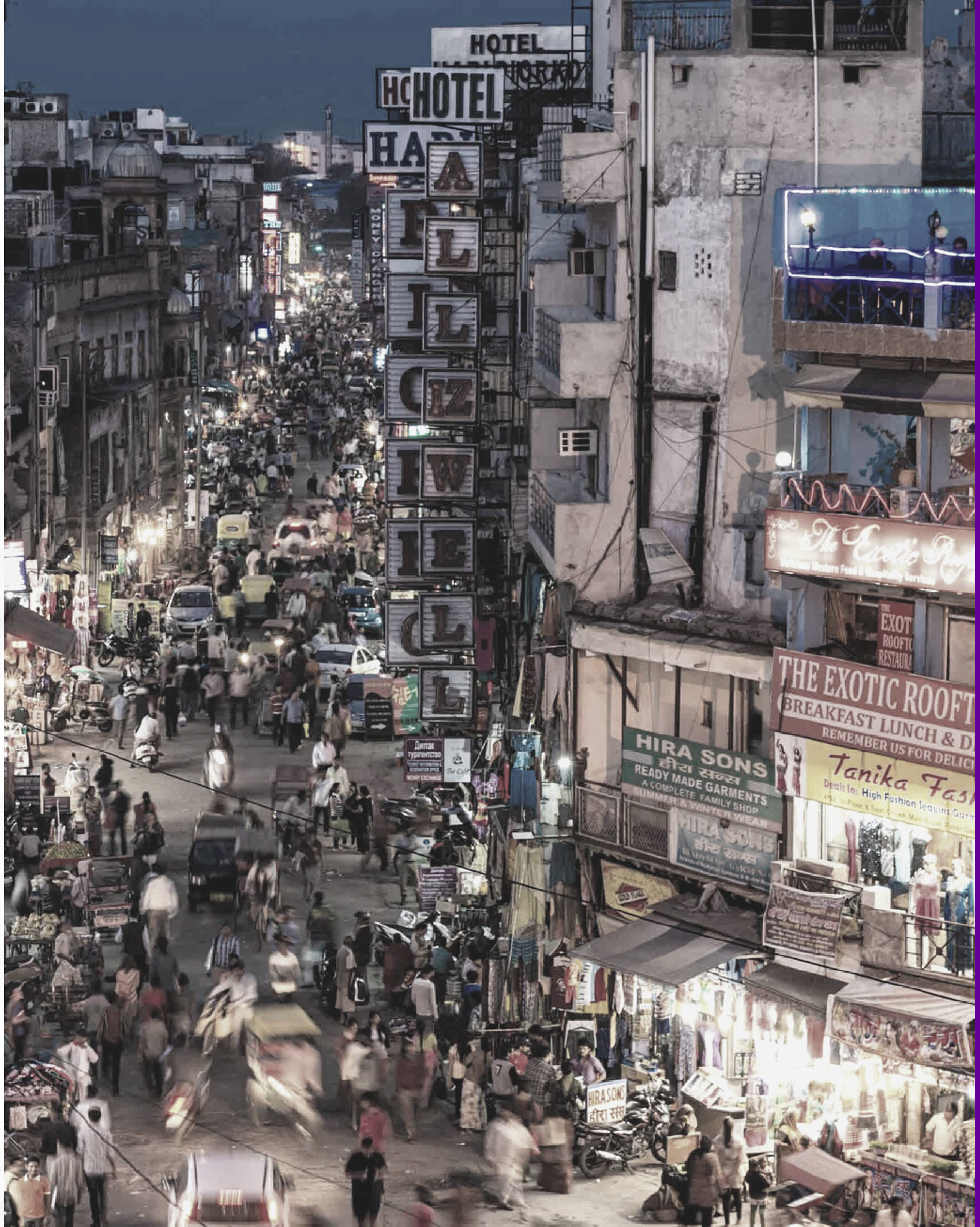
understanding economics iii

development & international economics

mdu advanced training sessions // week 8



currency

- what are exchange rates?
- the trilemma (independent monetary policy X free flows of capital X fixed exchange rates)
    - usually states choose the independent monetary policy and free flows of capital, and allow for exchange rates to float
    - this means you can influence how much you want your currency valued in respect to other currencies
- why might you want a weak / strong currency

- strong currency makes things from other countries cheaper
- weak currency makes exports easier

- manipulating your currency
    - weaker - buy a lot of foreign currency
    - stronger - buy own currency back

centralised currencies

- what are they?
    - a set of countries that agree to use the same currency
    - examples include the Eurozone, Central African Franc and Eastern African Franc (proposed to integrate within African Union), proposals for altyn in Eurasian Economic Union
- why would you want them
    - easier financial trading - companies can set across borders with less risks and less exchange costs
    - more stability - if pool of money is larger, then less volatile - draws in more FDI
    - incentivises big states to care about the wellbeing of smaller states (e.g. West and Eastern Europe)
- why would you not want them
    - hard to implement protectionist measures - need to make concessions in order to join into the common currency area
        - brain drain
        - hard to compete
    - cannot adapt the strength of your currency to suit your market (e.g. Germany wants a strong currency, more export-based economies in the EU do not - now they cannot devalue)

international economic institutions i - the imf

- what are the IMF's incentives?
  - countries have power based on money they put in - e.g. U.S has 15% power in the IMF (effective veto)
  - not a development aid institution - expect their money to be paid back
- main criticisms of the IMF
  - conditionality
    - austerity measures
    - forcing on trade liberalisation
      - prevent from protectionism
      - limits currency control
      - forcing economic focus on resource extraction
  - why is this likely to stay the main tool of the IMF?
    - voting countries have the incentive to get their money back
    - pool of money would decrease - lot of countries would not be willing to give extra money
    - IMF can point to short term successes in terms of preventing catastrophes
- why do countries take money from the IMF then?
  - usually as a last resort – unable to maintain an existing industry, require a loan to fix this → governments often willing to do it as a short term fix
  - need for foreign currency
  - lack of alternatives

international economic institutions ii - alternatives

- why is China not the automatic alternative?
  - far **less money** than the IMF
  - choosing China might compromise your ability to get loans from anyone else - problematic **dependency**
  - China is **volatile -** slowing down, pressure from other countries
  - Chinese **conditions might be worse** – more incentive to let you fail because it can then take securities in the form of land or assets from you
  - the structure of Chinese economy means **bad incentives**
    - some countries compete with China in e.g. tech
    - China also wants resource extraction - but will do it worse than the IMF because it wants preferential rates

international economic institutions iii - BRI

- advantages
  - creates infrastructure - this is useful because many of the countries are export-heavy (e.g. Khorgos dry port)
  - hiring of local workers
  - economic interest of China in the stability of your region
  - will not let you fail because it wants access to your market
- disadvantages
  - sending Chinese workers
  - Chinese access to the market
    - dumping because of overproduction
    - can outcompete with economies of scale & technology
  - conditionality (seizing of the assets - e.g. Sri Lankan port)

development strategies

- what is a poverty trap?
  - low economic growth → low incomes → low investment / saving → lack of access to healthcare, food → low productivity → low economic growth
- why would you choose protectionism
  - tax revenue from **tariffs**
  - protecting domestic industries
    - start developing economies of scale, brand recognition etc. - at some point might compete on international stage - e.g. Samsung
  - better for **workers** (state subsidies, local reinvestment, incentive to create domestic markets)
- why would you not choose protectionism
  - governments **pick bad industries** (lobbying, national pride, lack of knowledge)
  - lack of incentive to compete
  - **less FDI** which allows better job creation
  - more expensive goods
- why would you not want free trade
  - FDI is **volatile** - first to pull out in case of problems (hard to restructure)
  - **unequal** growth - money doesn't trickle down (exporting for rich consumers)
  - companies lobby not to pay taxes