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

Scaled According to Economic Strength

NATIONAL 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
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)

<table>
<thead>
<tr>
<th>Component</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Merchandise Trade</td>
<td>-$781,642</td>
</tr>
<tr>
<td>Service Trade</td>
<td>+$58,026</td>
</tr>
<tr>
<td>Investment Income</td>
<td>+$1567</td>
</tr>
<tr>
<td>Government Transfers and Sales</td>
<td>-$82,896</td>
</tr>
<tr>
<td><strong>CURRENT ACCOUNT BALANCE</strong></td>
<td>-$804,945</td>
</tr>
<tr>
<td>Capital Exports</td>
<td>-$491,729</td>
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<tr>
<td>Capital Imports</td>
<td>+$1,292,395</td>
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<tr>
<td>Statistical Discrepancy</td>
<td>-$9626</td>
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<tr>
<td><strong>CAPITAL ACCOUNT BALANCE</strong></td>
<td>+$791,010</td>
</tr>
</tbody>
</table>

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