POL 231 World Politics

IV International Political Economy
   B. Money and Finance

International currency exchange
• Value of a currency (11/3/04)
  • $1 = ¥106 (Japanese yen)
  • $1 = €0.78 (Euro)
  • $1 = 2.82 (Brazilian real)
  • $1 = 8.27 (Chinese Yuan)
• Demand > Supply
  – Currency price up
• Demand < Supply
  – Currency price down
• Floating exchange rate (¥, €, etc.)
• Fixed (pegged) exchange rate (Chinese Yuan)

Impact of currency fluctuation
• Currency appreciation
  – ¥360 Pokemon Card in Japan
  – If $1 = ¥360 (-1971), ¥360 = $1
    • (¥3,600,000 Camry = $10,000 in US)
  – If $1 = ¥120 (1990s), ¥360 = $3
    • (¥3,600,000 Camry = $30,000 in US)
  – Appreciation export price increase, export down
• Currency depreciation
  – Depreciation export price decrease, export up

Currency stability
• Predictability
• Stable flow of goods and services
• Investment (access to international fund)
• Central bank intervention for currency stability
  – Appreciation pressure => selling its currency
  – Depreciation pressure => buying its currency by US$ (foreign currency reserves)
Development of currency markets

- Currency Speculation
  - Buy $1 million for ¥105 million ($1=¥105)
  - Sell $1 million for ¥106 million (¥1=$106)
  - ¥1 million profit (about $9,433)

- European Currency Crisis of 1992
  - 1 British pound =2.95 German marks
  - Germany’s tight monetary policy
  - Appreciation pressure (higher interest rate)
  - Britain’s reluctance
  - Pound’s fall and governments buying pound
  - Pound’s exit from the pegged currency system

The International Monetary Fund (IMF)

- The Bretton Woods system, 1944-
  - $1= 1/35 ounce of gold (exchanged by the U.S. government)
  - Fixed exchange rate
  - Fixed exchange rate system collapsed in 1971

- Currency exchange coordination
  - Members countries’ deposit
  - IMF provided short-term funding

- Currency Stability
  - Helped the recovery of West European Countries and Japan

The World Bank

- International Bank for Reconstruction and Development (IBRD)
- Long-term lending for economic development
- Supplemented private capital for international investment

International Business

- Multinational Corporations (MNCs)
  - Business operations in other countries
- Foreign direct investment (FDI)
  - Direct investment (vs. portfolio investment)
    - Facilities
    - Cost reduction
    - Market access
MNCs and FDI

Liberals’ view

- MNCs have global interests
  - Shareholders’ interests
- FDI
  - Cost reduction
  - Productivity improvement
  - The economy of scale
- MNCs and FDI promote interdependence

Mercantilists’ (realist) view

- MNCs closely connected to the home state
  - National identities
  - Act as members of society
- FDI
  - Market access, avoiding tariff and non-tariff barriers
  - Productivity improvement
  - FDI threatening to host country
- MNCs and FDI intertwined with the political process

Politics and Markets

- Normative argument (what should be done)
  - Liberals: free flow
  - Mercantilists: limited flow
- Empirical analysis (what is happening)
  - Liberals: individual actors
  - Mercantilists (realist): political process
    - IMF and GATT: political concern