Study Guide Econ Statecraft Midterm

Balance of Payments – A double-entry accounting of payments made to other countries and revenue received from other countries. This includes private and government transactions.

**Bop** Surplus - A balance of payments surplus means more money is coming in from trade and investment than going out. It results in an appreciation of currency.

Deficit results in depreciation.

**Debits** – an increase in assets or a decrease in liabilities.

**Credits –** increase in liabilities or a decrease in assets.

Types of transactions

-Goods, Services, and Income

-remittances, unilateral transfers

-financial (stocks and bonds)

Commercials exports are a goods/services transactions. U.S. company ships $50 million in equipment to foreign country in return for future payment in 90 days. The U.S. loses the physical goods and transportation services. U.S. gains a financial asset of $50 million due in the short term.

Debit - $50 million in short term claims

Credit - $49 million in goods

1 million in service (transportation)

**Current Account**:

* Net change in goods/services (balance of trade)
* Income from investments, dividend payments, from investment abroad
* Unilateral transfer from abroad.

**Financial Account:**

* Net change in foreign ownership of investment assets.

A *financial account surplus* means foreign ownership of domestic assets increased more quickly than domestic ownership of foreign assets.

**Strategic Trade**

Steps other countries can take to increasing trading position against other countries.

*Reducing a Current Account deficit:*

Increase exports or decrease imports. Tariffs and quotas are primary mechanisms for reducing imports. However, retaliatory measures by other countries could lead to a reduction in exports as well.

Exports can be increased by subsidizing firms in export oriented markets by making their goods/services cheaper for foreign consumers.

Exchange rate manipulation

Also can be used to reduce current account deficit. Increasing inflation, making more money available will cause foreign currencies to appreciate against the dollar make U.S. exports more affordable.

**Important terms**

Neoclassical Model of Trade – Goods are produced with two factors of production – labor and capital Technical knowledge allows efficiency – some things need more amounts of labor and other things need more amounts of capital.As specialization occurs, countries that have capital intensive industries find too much labor released from other sectors. In turn, capital intensive industries start using more labor intensive processes and will eventually start declining. **Convergence in opportunity costs.**

Hecksher-Olin Model - a country will specialize in, and export, goods that require the intensive use of the factor of production it has in relative abundance.

Stolper-Samuelson - Even though free trade increased society’s welfare on the whole, some groups have rational reasons to oppose it. Owners of the relatively abundant factor will experience a gain in their returns and real incomes. This causes owners of the scarce factor to sustain a drop in returns.

In a capital intensive country, the owners of labor (employees in uncompetitive industries) will oppose trade for rational reasons.

Intra-industry trade – the majority of trade in many countries happens for goods that the country already produced relatively efficiently. Why?

*Differentiation* – products, like cars, are differentiated in the eyes of consumers. Faster, more fuel efficient, etc. Consumer preference creates demand for different types of cars.

**Free Trade vs. Activist Trade**

Free trade:

Consumer/Producer Surplus

Economies of Scale

Comparative advantage

Political Economy

C/P Surplus – tariffs usually create a producer surplus by distorting the incentives to producer. Consumers usually lose. Consumer surplus is the area above the price line, below demand. The difference between what they actually pay and what they are willing/able to pay. Producer surplus is above the supply curve and below the market price.

Meaning, producers would be willing supply some units at a lower price, but don’t have to because the price is artificially high.

* Political Economy – interventions in the economy are conducted by politicians, not economists. Policies usually increase rents, not welfare. Most always, interventions are welfare reducing. Often times, govts shoot themselves in the foot with interventions.

Activist trade:

* Externalities- Technological innovations create spillovers that can be used by the society and other industries. These spillovers are used without any compensation and this can reduce the incentive for knowledge firms to innovate.
* However, how can you identify when these spillover, or wider benefit, effects are happening? What’s the optimal subsidy? Also, companies most likely to use it are abroad instead of domestic so it becomes really complicated how to actually protect.
* Brander-Spencer Analysis – two companies, two countries. What are the profits or losses for both if only one produces, if both produce, or if none produce.
* Subsidies can alter this picture substantially. It can make it impossible for one company to operate at a profit. However, you can’t counteract it sufficiently because of problems of information. What if your subsidy fails to act as a deterrent to the other company because they have a more efficient process. What if you don’t subsidy enough and your company still operates at a loss?
* **Economic Statecraft Examples**
* 4 ways of economic influence:
  + Impoverishment
* Sanctions/embargoes – Sanctions can financial in nature, or something like the denial of visas. Embargoes are explicit trade items (Cuban cigars)
* Tariffs and quotoas intended to cause current account deficit for other country

Reduce Warmaking Potential

-European Coal and Steel Community – proposed to keep Germany from rearming.

- Japan oil embargo – Was it effective? Depends on the perspective. If the point was to keep them from bombing us, the embargo failed. If the point was to make them weaker when they bombed us because they were intent on doing so, it was a success.

3. Cause Financial Turmoil

- Chile in the 1970s. Cia helped crash the economy so Einde would lose power.

* 1956 Egypt claimed Suez Canal, Britain and France threatened military action. U.S. wanted Egyptian control. Worked to deny loans from the IMF
* North Korean counterfeiting/ Nazi Counterfeiting to reduce ally potential to procure.

4. Making Friends (low tariffs, Most Favored Nation status)

Other things : Iran/Libya Sanctions Act. Now just the Iran Sanctions act because Libya complied. Macau Bank –freezing $14 million in North Korean assets for compliance on Yongbyon reactor. Hit the bank with money laundering charges.

Grain embargo against the USSR under Carter.