

**Economics 3500**

**International Economics**

**Summer 2014**

**MW 9:00-12:00 Noon; OSH 104**

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**3500 International Economics** (3 credit hours)

- Prerequisites: ECON 2010 and 2020 (or ECON 1010 and instructor's consent)
- Fulfills "Quantitative Intensive" Bachelor of Science Graduation Requirement because of mathematical (geometric and algebraic) modeling throughout the course.
- Fulfills "International Requirement" Graduation Requirement
- We will ***not*** address everything in the reading in class (we will do the hard part in class) and we will supplement the reading material in lecture. The reading is critical, too.
- The course objectives are to give you an understanding of the cross border economic phenomena (international payments and exchange rates and international movements of goods, labor and capital) from multiple perspectives (theoretical, empirical and historical) and of macroeconomic and microeconomic relationships among national economies, e.g., the U.S. economy, other national economies, and the global economy.
- This course is offered every semester. **If you expect to miss even one class or do not have the prerequisites** you are advised ***NOT*** to register for this class during this very intensive short session during summer semester! Four sections of this course are offered in Fall Semester.

**General Description:** History, institutions, and theory of international economic relations. Alternative theories relating to the pattern of international trade, commercial policy, relationships between national income and international trade and payments, balance-of-payments adjustment, international monetary arrangements, and foreign investment.

**Text: Paul R. Krugman, Maurice Obstfeld and Marc Melitz, International Economics: Theory and Policy, 9<sup>th</sup> Edition, Pearson/Addison-Wesley. There may be some short additional readings. Read all assignments before class!**

**No make-up exams** will be given, regardless of reason, except when required under University regulations. University regulations permit "incomplete" grades only when no more than 20% of the required work remains to be completed. There is no comprehensive final exam. **The Parts I and II are weighted equally in determining the FINAL COURSE GRADE.** The midterm for Part I is one-half of the final course grade. The other half of the final course grade is determined from the exam given in Part II.

The University of Utah seeks to provide equal access to its programs, services and activities for people with disabilities. If you will need accommodations in the class, reasonable prior notice needs to be given to the Center for Disability Services, 162 Olpin Union Building, 581-5020 (V/TDD). CDS will work with you and the instructor to make arrangements for accommodations.

All written information in this course can be made available in alternative format with prior notification to the Center for Disability Services.

Please note that the course syllabus is subject to change due to time constraint and/or any other reasons, which in the lecturer's professional judgment will be of benefit to students. At the discretion of the instructor, there may be adjustments to the syllabus and/or course material, lecture and/or exam, including additional assignments, etc.

### **Classroom Etiquette**

This classroom etiquette has been established to encourage a deeper appreciation of and respect of the classroom environment so as to enhance the learning experience for all students.

Exercising personal freedom is one of the most appealing things about being an undergraduate student. Some students do not know where to draw the line on individual expression and social interchange. There are some behaviours which are clearly rude and unacceptable.

Although many students do not need me to remind them about basic classroom civility, but some do. Therefore, I have decided to list guidelines of classroom etiquette; students are therefore expected to understand and adhere to basic standards of classroom etiquette based on the following principles:

***Attendance:*** Students are expected to attend every class throughout the semester.

***Punctuality:*** Students are expected to arrive for class on time so that the class could start and end according to the schedule. If despite your best effort you arrive late, please quietly take a seat at the back of the classroom, and not make a big scene.

***Personal Conversation:*** It is rude and disruptive to engage in personal conversation during class. If you have big news to share with your friends, please do so before or after class.

#### **Turn off Electronic Devices and put them away**

Cell phones, PDAs, and pagers should be turned off or in a "silent mode" (not a "vibrate mode") while class is in session. Certainly **never answer you cell phone in class.** **No text messaging or emailing.** If your phone does ring; make a quick apology to class as you deny the call.

**No listening to iPods or other electronic recording devices during class**

No watching movie or clips on laptop or other electronic recording devices during class.

No taping, filming, recording, or photography in class by any means without my prior permission.

Take your lecture notes by hand and put your laptop away. Recent researches show that typing lecture note while listening to a lecture does not help with student's learning process.

*Exiting and Entering the Classroom:* Students are expected to remain in the classroom for the duration of the class. If a student have to leave because of physiological needs; the student may leave and return with as little disruption as possible. If a student must depart early due to unavoidable circumstances; the student should inform the lecturer prior to the start of a class.

*Be Attentive, Enthusiastic, and Fully Present in Class:*

Do not put your make up on; trim your nails; comb your hair; rearrange/clean your wallet, purse and/or backpack; read newspaper during class. Such behaviours can **disrupt** – or **disgust** – others.

Food and drink are not allowed in classroom buildings. There may be times that students need water; please do not spill the water. If it does spill, wipe it off thoroughly.

It is completely unacceptable and unprofessional to sleep in class. Your bed is likely to be more comfortable than the chair in the lecture room.

Do not work on an assignment for another class, or engage in other irrelevant activities in this class.

*Any behaviour determined to be disruptive/disrespectful to peers or the lecturer will not be tolerated. Students who persist in disruptive/disrespectful behaviour may be asked to leave the classroom. Once you are asked to leave; please do so and leave quietly*

PART I: INTERNATIONAL TRADE THEORY AND POLICY, (9th edition):

*Week 1. (May 12) Determinants of the Pattern of Trade: Classical Theory*

*Krugman and Obstfeld Ch. 1, 2 & 3*

*Important key words:*

*Absolute advantage, comparative advantage, reciprocal demand, terms of trade, gain from trade, international trade with constant costs and increasing costs, offer curves, opportunity cost, production possibility curve, community indifference curves, equilibrium in a closed economy, equilibrium before and after trade, pre-trade equilibrium, post-trade equilibrium. Balance of Trade and Balance of Payments; A basis for trade : International trade theories*

*(May 14) Determinants of the Pattern of Trade: Factor Proportions Theory  
Krugman and Obstfeld Ch. 4, 5 & 6*

*Important key words :*

*Factor proportions, Heckscher-Ohlin theorem, factor endowment, equalization of factor prices, welfare economics of trade, factor movements, production function, factor intensity, factor reversal, box-diagram and production possibility curve, product cycle, economy of scale, intra-industry trade, border trade, effect of economic growth on trade, immiserizing growth, transport costs, gravity model.*

*Week 2. (May 19) Trade policy  
Krugman and Obstfeld Ch. 8, 9 & 11*

*Important key words:*

*Tariff protection, non-tariff protection, effective tariff, value added, dumping, cartels, international aspects of environmental economics, quota, voluntary export restraint, retaliation, export subsidies, terms-of-trade argument, infant-industry argument, protection to correct distortion.*

*(May 21) Trade and Economic Development  
Krugman and Obstfeld Ch. 7, 10, & 12*

*Important key words:*

*Trade blocs, primary product exporters, import substitution, export-led growth, migration, capital flows and multinational firms.*

*Week 3. (May 26) Memorial Day Holiday – No Classes*

*(May 28) Catch-up and Review  
No new assignment. 1 and 1/2 hour midterm exam!*

***PART II: OPEN ECONOMY MACROECONOMICS & INTERNATIONAL FINANCE***

*Week 4. (June 2) Introduction, Overview, and National Income Accounting and the Balance of Payments*

*Krugman et. al. Ch. 1, 2, and 13*

*(June 4) Currency Exchange Rates and the Foreign Exchange Market, and Money, Interest Rates, and Exchange Rates  
Krugman et.al. Ch. 14, and 15*

*Week 5. (June 9) Price Levels and the Exchange Rate in the Long Run, and Output and the Exchange Rate in the Short Run*

*Krugman et.al. Ch. 16, and 17*

*(June 11) Fixed Exchange Rates and Foreign Exchange Intervention, International Monetary Systems, and Optimum Currency Areas, European Monetary Union & the Euro*

*Krugman et.al. Ch. 18, 19, and 20*

**Week 6. (June 16) Financial Globalization: Opportunity and Crisis**  
**Krugman et.al. Ch. 21 and 22**

**(June 18) Catch-up, Review and 1 1/2 hour midterm exam!**

**Selected Key Words:**

**Part I.** (from Dominick Salvatore, International Economics, 6<sup>th</sup> edition, Prentice Hall International, Inc. 1998.)

Absolute Advantage. The argument, associated with Adam Smith, that trade is based on absolute differences in cost. Each country will export those products for which its costs, in terms of labor and other inputs, are lower than costs in other countries.

Comparative Advantage. The argument, associated with David Ricardo in the early nineteenth century, that mutually beneficial balanced trade is possible even if one country has an absolute advantage in both goods. All that is required is that there be a difference in the relative costs of the two goods in the two countries and that each country export the product for which it has relatively or comparatively lower costs.

Heckscher-Ohlin theorem. The argument, developed by two Swedish economists in the 1920s, that international trade patterns are determined by the fact that countries have different relative factor inputs. Each country will export those products that require a great deal of its relatively abundant factor of production.

Factor Price Equalization. The argument that international trade that is based on differences in relative factor endowments, as predicted by the Heckscher-Ohlin, will tend to reduce or eliminate international differences in factor prices.

Stolper-Samuelson theorem. The argument that in a world of Heckscher-Ohlin trade, free trade will reduce the income of the scarce factor of production and increase the income of the abundant factor of production in each country. Under rather demanding assumptions, wage rates will be equalized across countries, as will returns to capital.

Relative factor endowments. The relative amounts of different factors of production which two countries have. India has a relative abundance of labor, while the United States has a greater relative abundance of capital.

Relative factor intensities. The relative amounts of different factors of production that are used in the production of two goods. Textiles and garments are relatively labor intensive, whereas oil refining is relatively capital intensive.

Factor intensity reversal. A situation in which it is impossible to rank clearly or identify the relative factor intensities of two products, because one is more labor intensive at one set of relative factor prices, but the other becomes more labor intensive at another set of relative factor prices. Factor intensity reversal can occur when it is far easier to substitute one factor for the other in one industry than it is in the other industry.

Terms of trade. The ratio of a country's export prices to its import prices. High terms of trade imply large welfare benefits from trade.

Offer curve. A curve that illustrates the volume of exports and imports that a country will choose to undertake at various terms of trade. Also known as a reciprocal demand curve.

Leontief paradox. The 1953 research findings by Wassily Leontief that U.S. exports were more labor intensive than U.S. imports, which contradicts the predictions of the Heckscher-Ohlin theorem.

Immiserizing growth. Economic growth that is so strongly biased toward the production of exports, and where the world demand for these exports is so price inelastic, that the world price falls sufficiently to leave

the country worse off than it was before the growth occurred.

Rybczynski theorem. The argument, associated with Thomas Rybczynski, that if the supply of one factor of production increases, when both relative factor and goods prices are unchanged, the output of the product using that factor intensively will increase and the output of the product using the other factor of production intensively must decline.

Vernon product cycle. The observation that a country such as the United States will frequently export a product that it has invented only for as long as it can maintain a technical monopoly. When the technology becomes available abroad, perhaps because a patent has expired, production grows rapidly in foreign countries where costs are lower, and the inventing country experiences a decline in its production of the product because of a rapid growth of imports.

Mercantilism. The view that a government should actively discourage imports and encourage exports, as well as regulate other aspects of the economy.

Commercial policy. Government policies that are intended to change international trade flows, particularly to restrict imports.

Cartel. A collusive arrangement among sellers of a product in different countries, which is intended to raise the price of that product in order to extract monopoly rents.

Nontariff barrier. Any government policy other than a tariff which is designed to discourage imports in favor of domestic products. Quotas and government procurement rules are among the most important nontariff trade barriers.

Quota. A government policy that limits the physical volume of a product which may be imported per period of time.

Effective tariff. A measurement of the amount of protection provided to an industry by a tariff schedule which allows for tariffs on inputs that industry buys from others, as well as for the tariffs on the output of the industry. The effective tariff can be negative, which means that the government policy is discriminating against local firms and in favor of imports, if tariff levels on inputs are sufficiently higher than the tariff on the final good.

Ad valorem tariff. A tariff that is measured as a percentage of the value of the traded product.

Specific tariff. A tariff that is measured as a fixed amount of money per physical unit imported--\$500 per car or \$10 per ton, for example.

Dumping. Selling a product in an export market for less than it sold for in the home market or for less than the importing country views as a fair value, which is usually based on estimates of average cost.

Predatory dumping. Temporary dumping designed to drive competing firms out of business in order to create a monopoly and raise prices.

Countervailing duty. A tariff imposed by an importing country which is intended to increase the price of the goods to a legally defined fair level. Often used in export subsidy and dumping cases.

Voluntary Export Restraint (VER). A way of maintaining a quota by evading the GATT prohibition on such quantitative limits. The exporting country agrees to maintain limits on its sales, frequently in order to avoid a more damaging protectionist policy by the importing country. Sometimes known as an Orderly Marketing Agreement (OMA). VERs are to be removed under the recently completed Uruguay Round agreement.

Optimum tariff. A tariff that is designed to maximize a large country's benefits from trade by improving its terms of trade. Optimum only for the country imposing the tariff, not for the world.

Import substitution strategy. A development policy in which economic growth is to be encouraged by repressing imports and by encouraging the domestic production of substitutes for those imports.

Infant-industry protection. The argument that an industry's costs will be high when it is beginning, and it will therefore need protection from imports to survive. If provided with a period of protection, the

industry's cost will decline and it will be able to prosper without protection.

Export-led growth. Policies in developing countries that are designed to encourage economic growth which is based on rapid growth of exports sales. Widely used in East Asian countries.

Free-trade zone. An area within a nation where manufacturing can be carried out with imported parts and components on which no tariffs have been paid. The output of such manufacturing efforts must then be exported if it is to remain duty free. Many developing countries have free-trade zones, which are also known as duty-free zones, as a way of encouraging export activities, which require import inputs, without eliminating protection for domestic industries that produce such inputs for the rest of the economy.

Intraindustry trade. Trade that occurs when a country both exports and imports the output of the same industry. Italy exporting Fiat automobiles to Germany and importing VWs from Germany would be an example of intraindustry trade.

Singer-Prebisch hypothesis. The argument developed by Hans Singer and Raul Prebisch that developing countries face a secular decline in their terms of trade owing to a trend toward lower prices for primary commodities relative to prices of manufactured goods.

Brain drain. The movement of scientists, engineers, and other highly educated people from developing to industrialized countries, which imposes a loss of public investment in education on the developing countries.

Transfer pricing. The practice of using false or misleading prices on trade documents in order to evade ad valorem tariffs or exchange controls, or to shift profits within a multinational firm from a high tax rate jurisdiction to a low tax rate jurisdiction. Also known as false invoicing.

Free-trade area. A group of countries that maintain free trade among the membership, but where each country maintains its own tariff schedule for trade with nonmembers.

Customs union. A group of countries that maintain free trade in goods among the membership and a common external tariff schedule.

Economic union. An agreement among a group of countries to maintain free trade among themselves, a common external tariff, mobility of capital and labor among the members, and some degree of unification in their budgetary and monetary systems.

Trade creation. An efficiency gain that results from the operation of a free-trade area because more efficient firms from a member country displace less efficient local producers in the domestic market.

Trade diversion. An efficiency loss that results from the operation of a free-trade area because less efficient firms from a member country displace more efficient producers from a nonmember country. It occurs because of the discriminatory nature of the tariff regime. The member country faces no tariff in the import market, whereas the nonmember still faces a tariff.

Generalized System of Preferences. A preferential trading arrangement in which industrialized countries allow tariff-free imports from developing countries while maintaining tariffs on the same products from other industrialized countries.

Deadweight loss. The loss from a tariff or other restrictive policy that is a gain to nobody. A pure efficiency loss.

Arbitrage. Purchase of a good or an asset in a low-price market and its riskless sale in a higher price market. If arbitrage is possible, prices should be forced together, differing by no more than transport or transactions costs.

Embargo. A complete prohibition of trade with a country. U.S. trade with Libya and Cuba, for example, is under an embargo.

Escape clause. A provision of U.S. law which allows temporary protection for U.S. industries that are under particular pressure from imports.

Law of the second best. The argument associated with Richard Lipsey and Kelvin Lancaster, that when an economic distortion exists which cannot be removed, government intervention may be necessary to

minimize the losses resulting that distortion. Many arguments for protection are example of this law.

Multi-Fibre Arrangement (MFA). A system of bilateral quotas in the markets for textiles and garments in which each exporting country is allowed to send a specified quantity of various textiles or garment products to an importing country per year.

## **Part II.**

( from Dominick Salvatore, International Economics, 6<sup>th</sup> edition, Prentice Hall International, Inc. 1998.)

Balance of Payments. -A summary statement of all international transactions of the residents of a nation with the rest of the world during a particular period of time, usually a year.

Credit transactions. -Transactions that involve the receipt of payments from foreigners. These include the export of goods and services, unilateral transfers from foreigners, and capital inflows.

Debit transactions. -Transactions that involve payments to foreigners. These include the import of goods and services, unilateral transfers to foreigners, and capital transfers.

Current account. -The account that includes all sales and purchases of currently produced goods and services, income on foreign investments, and unilateral transfers.

Autonomous transactions. -International transactions that take place for business or profit motives (except for unilateral transfers) and independently of balance-of-payments consideration; also called above-the-line items.

Accommodating transactions. -Transactions in official reserve assets required to balance international transactions; also called below-the-line items.

Capital account. -The change in U.S. assets abroad and foreign assets in the United States, other than official reserve assets.

Open-economy macroeconomics. -The study of foreign exchange markets, the balance of payments and adjustment to balance-of-payments disequilibria

Hedging. -The avoidance of a foreign exchange risk (or covering of an open position)

Speculation. -The acceptance of foreign exchange risk, or open position, in the hope of making a profit.

Exchange rate. -The domestic currency price of the foreign currency.

Cross exchange rate. -The exchange rate between currency A and currency B, given the exchange rate of

Forward rate. -The exchange rate in foreign exchange transactions involving delivery of the foreign exchange one, three, or six months after the contract is agreed upon.

Foreign exchange futures. -A forward contract for standardized currency amounts and selected calendar dates traded on an organized market (exchange).

Gold standard. A monetary system in which governments or central banks maintain a fixed price of gold in terms of their currencies by offering to purchase or sell gold at fixed local currency prices. Exchange rates are then determined by relative national prices of gold.

Bretton Woods system. --The gold-exchange standard that operated from the end of World War II until 1971.

Devaluation. -A deliberate (policy) increase in the exchange rate by a nation's monetary authorities from one fixed or pegged level to another.

Depreciation. -An increase in the domestic currency price of the foreign currency.

Appreciation. -A decrease in the domestic currency price of the foreign currency.

Foreign exchange reserves. Foreign financial assets held by a government or central bank which are



available to support the country's balance of payments or exchange rate. Includes holding of gold, the country's reserve position in the International Monetary Fund, and claims on foreign government and central banks.

Marshall-Lerner condition. -Indicates that the foreign exchange market is stable when the sum of the price elasticities of the demands for imports and exports is larger than 1.

J-curve effect. -The deterioration before a net improvement in a country's trade balance resulting from a depreciation or devaluation.

Monetary approach to the balance of payments. -The approach that views the balance of payments as an essentially monetary phenomenon with money playing the key role in the long run as both the cause and the cure of balance-of-payments disequilibria or in determining exchange rates.

Freely floating exchange rate system. -The flexible exchange rate system under which the exchange rate is always determined by the forces of demand and supply without any government intervention in foreign exchange markets.

Exchange market intervention. Purchase or sales of foreign exchange by a central bank which are intended to maintain a fixed exchange rate or to affect the behavior of a floating rate.

Crawling peg system. -The system under which par values or exchange rates are changed by very small pre-announced amounts at frequent and clearly specified intervals until the equilibrium exchange rate is reached.

Managed or dirty floating exchange rate. A policy in which a government or central bank does not maintain a parity and instead allows the exchange rate to change to some degree with market forces. The behavior of the market. Such intervention is intended to produce exchange market behavior which the government prefers.

Par value. A fixed exchange rate, denominated in terms of a foreign currency or gold.

Purchasing power parity. The argument that the exchange for two currencies should reflect relative price levels in the two countries. If yen prices in Japan are on the average 200 times as high as dollar prices in the United States, the exchange rate should be 200 yen = \$1. Associated with Gustav Cassel.