

Department of Economics
University of North Carolina at Chapel Hill

Economics 460
International Economics

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MWF 2:00-2:50pm
Gardner 308

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Outline

This course is divided into two parts: international trade and international finance. International trade mainly focuses on the real transactions in the economy that involve the exchange of physical goods and services. International finance focuses on the financial transactions involved in those physical transactions.

The course will start with international finance. We will first look at the foreign exchange market and balance of payments accounts. Next, we will examine how exchange rates interact with the main macro indicators, such as interest rates and prices. We will then develop a framework for analyzing international monetary problems and macro policies in an open economy. Finally, we will discuss the functioning of monetary and fiscal policies under different exchange rate regimes, and apply our theories to current issues, for example, the fluctuation of dollar against Euro and Yen, the recent economic recovery, and the economic impact of the coming presidential election.

In international trade, we will begin with an overview of the fundamental concepts and theories that explain the aggregate gains and distributive conflicts resulting from trade. Next, we will analyze the welfare effects of tariffs and quotas as the major policy instruments for trade protection. We will also look at the pros and cons for trade protection from different respects. As we proceed, we will gradually gain an insight into the long-lasting debates on free trade and the main issues in the recent WTO negotiations.

Prerequisites and Requirements

Since many issues in international trade are ideal applications of microeconomic theory in action while international finance primarily concerns macroeconomic policies in an open economy, familiarity with the basic tools of micro- and macro-economic analysis is presumed. Specifically, you should already have taken **Economics 100 or 101**; if not or not recently, you must obtain permission to take this course. Economics 132 will be a plus, but is not required. However, you do not need any previous knowledge of international economics in order to enroll in this course.

There will be six problem sets, among which, the best 3 out of the first 4 and the last 2 will count 3% each in your final grade. We will have one **75 minutes** midterm (35%) and the time will be determined in class. There will be no make-up exams for the midterm. The weight of the final examination will be 85% instead of 50% if one misses the midterm. The problem sets are compulsory and you will lose 3% of your final grade if you fail to turn in **one problem set on time**. Since we will discuss answers right after collecting your problem sets, no make-ups are possible and your problem sets will not be graded after the due time. You may still fail the course for a disastrous final examination even if you have a passing average grade.

The problem sets will require a substantial amount of effort. Hence, group discussion is allowed. However, each student should write his/her own answers. Students with very similar answers will all be given a zero grade for their problem sets. Since most students are unable to understand the material well by only reading the text and reviewing class notes, the problem sets will be a great help in terms of grasping the course materials. The problem sets will also be a good indication of exam questions.

This syllabus and other related course materials are posted on the web at <http://www.unc.edu/~wux/index161.html>.

The final exam schedule is posted at <http://regweb.unc.edu/calendars/finals072.php>. Please contact the Dean's Office for any conflicts/changes of your final date/time.

Texts and Other Readings

The textbook for this course is *International Economics*, third edition, by Dennis R. Appleyard and Alfred J. Field (later referred to as A&F). Other materials for supplemental readings are *International Economics: Theory and Policy*, fourth edition, by Paul Krugman and Maurice Obstfeld (later referred to as K&O), and *Lecture Notes on International Trade*, by Avinash Dixit (later referred to as D). These readings will be on reserve in the undergraduate library. Readings from the textbook are required. You should browse through the required readings for the week before the class meetings and then read them thoroughly after the class. If you have extra time, supplemental readings are also highly recommended. In addition, I will cite some journal and press articles to entertain your broader interests on the current international trade and finance issues. Finally, I may replace some of the case studies listed in the reading list with some more up-to-date press articles in the *Economist*, *Financial Times*, *Business Weekly*, etc.

Class Schedule and Reading List

I. Introduction:

Readings: A&F chs 1 and 20, K&O ch 1, D ch 1.

Contents:

- 1) Economics vs. international economics (interdependence and aggregation).
- 2) International trade vs. international finance (real vs. nominal interdependence).

- 3) Main issues: gains from trade, pattern of trade, free trade areas and common markets, fiscal and monetary policies in an open economy.
- 4) Current issues: Anti-Dumping, EMU, Asian Crisis, etc.

II. Balance of Payments:

Readings: A&F chs 20 and 26, K&O ch 12.

Contents:

- 1) Concepts:
 - Current accounts (X, M, BOT/MTB, BTGS, BTGSI).
 - Capital accounts (capital inflow/outflow, official reserve transactions).
 - Statistical discrepancy.
- 2) Balance of Payments summary statement.
- 3) National Income accounts:
 - Linkage to Balance of Payments.
 - The income-expenditure diagram (the good market).

III. Foreign Exchange Market:

Readings: A&F chs 21-22, K&O ch 13.

Contents:

- 1) Concepts:
 - Demand and supply for a foreign currency.
 - Equilibrium exchange rate (e).
- 2) Determinants of e :
 - Private sector: consumers, producers, banks, and other financial institutions.
 - Public sector: reserve/central banks (open market operation).
- 3) Spot and forward markets: arbitrage and hedging.

IV. Exchange Rates and Macro Indicators --- Interest Rates and Prices:

Readings: A&F chs 23, 24, 26, K&O chs 14-15.

Contents:

- 1) Interest rate and exchange rate:
 - Relationship
 - Equilibrium interest rate (the money market).
- 2) Price and exchange rate:
 - Relationship
 - The Law of One Price.
 - Purchasing Power Parity (absolute vs. relative PPP, nominal vs. real e).
- 3) Empirical issues:
 - Exchange rate overshooting.
 - Exchange rate passthrough.
 - J-curve.

V. Macroeconomic Models of the Open Economy:

Readings: A&F chs 25, 26, 28, K&O ch 16.

Contents:

- 1) The IS/LM/BP model:
 - Review the equilibrium in the good market (IS) and the money market (LM).
 - Introducing the BP curve.
- 2) The AD/AS model in a closed vs. in an open economy (if time permits).
- 3) The Swan model: external and internal balance.

VI. International Macroeconomic Policy:

Readings: A&F chs 26 (pp.599-608), 27, 28, 29-30, K&O chs 17-20.

Contents:

- 1) Exchange rate regimes: Fixed vs. Flexible/Floating.
- 2) Fiscal and monetary policies under different e - regimes and capital mobility:
 - The Mundell-Fleming model.
 - The IS/LM/BP approach.
- 3) Institutions (domestic and international) & theories on policy interdependence.
- 4) Applications to current issues:
 - The Asian Crisis.
 - The EMU.

VII. Introduction to International Trade:

Readings: A&F chs 2, 5-7, 13, D Chs 2-7.

Contents:

- 1) Main issues:
 - Free trade or not (aggregate gains vs. distributive conflicts).
 - Instruments of trade policies (tariffs, quotas, and VERs).
- 2) Institutions (domestic and international).
- 3) Concepts and tools:
 - Patterns of Trade (goods & services vs. investments).
 - Terms of Trade (TOT).
 - Consumer equilibrium (indifference curves and budget constraints).
 - Producer equilibrium (isoquants and isocost lines).
 - Autarky equilibrium (production possibility frontier).
 - Edgeworth Box (Pareto improvements).
- 4) Trading equilibria and potential gains from trade:
 - Partial equilibrium (equilibrium TOT and the impact of a tariff).
 - General equilibrium (introducing the offer curve if time permits).

VIII. The Gains from Trade:

Readings: A&F chs 3-4, 8-9, K&O chs 2-5, D chs 8-12.

Contents:

- 1) Ricardian model (gains based on technology differences):
 - Comparative vs. competitive advantage (some misconceptions).
 - Specialization and gains from trade.
 - Extensions to multiple commodities and multiple countries.
 - Real world examples:
 - Export concentration in selected countries.

- Labor productivity and import competitiveness.
- 2) Neoclassical models (gains based on factor endowment differences):
 - All Factors Sector-Specific model (short-run).
 - Ricardo-Viner model (medium-run).
 - Heckscher-Ohlin model (long-run).
- 3) The Heckscher-Ohlin model and its policy implications:
 - Assumptions.
 - Theorems: Stolper-Samuelson, Rybczynski, Heckscher-Ohlin, and FPE.
 - Policy issues:
 - North-South trade and income distribution.
 - The Transfer problem.
 - Empirical tests (if time permits):
 - Leontiff paradox.
 - Heckscher-Ohlin and income inequality.

IX. Additional Considerations on Gains from Trade:

Readings: A&F chs 10-12, K&O chs 6-7, 10, D chs 13-17.

Contents:

- 1) Trade in intermediate goods (e.g. memory chips and LCD screens).
- 2) Imperfect competition:
 - International cartels (e.g. the OPEC).
 - Inter- vs. intra-industry trade (e.g. cars and electronics).
 - Dumping and anti-dumping (e.g. the US steel and memory-chip industries).
 - Interdependence in anti-trust regulations (e.g. the Roche & BASF case).
- 3) Growth:
 - Technology:
 - Theories of product cycle, learning by doing, and leap frogging.
 - Re-examine North-South trade and income distribution.
 - Factor investment in land, labor, and capital.
- 4) International factor movements:
 - Capital: multinationals and FDI (pros & cons for home and host countries).
 - Labor: immigration and the US economy.

X. Tariffs and Quotas:

Readings: A&F ch 14, K&O ch 8, D 18-20.

Contents:

- 1) Welfare effects:
 - Partial equilibrium framework.
 - General equilibrium framework (if time permits).
 - An empirical study on the US textile industry.
- 2) Equivalence under perfect competition and certainty.
- 3) Differences under imperfect competition or uncertainty.
- 4) VERS and other non-tariff barriers:
 - A numerical estimate of the welfare costs for the US.
 - Examples:

- Protections in the US wheat and sugar industries.
 - VER on Japanese autos.
- 5) Nominal vs. effective protection.

XI. Arguments for Trade Protection:

Readings: A&F chs 15-17, K&O chs 9, 11, D chs 21-22.

Contents:

- 1) Traditional arguments and some historical cases.
- 2) Strategic trade policy argument. Examples:
 - “Targeting” of industries in Japan and South Korea.
 - Airbus vs. Boeing.
- 3) Political economy argument. Examples:
 - US restrictions on tomato imports from Mexico.
 - EC’s agricultural policy.

XII. Unilateralism vs. Multilateralism --- Trading Blocks:

Readings: A&F chs 18-19, K&O pp.242-45, D chs 23-24.

Contents:

- 1) Trade creation vs. trade diversion.
- 2) Import substitution vs. export promotion.
- 3) Examples (NAFTA, EU, APEC).