

International Economics

Dr. Hannes Egli / Dr. Karen Pittel

Lecture 351-0550-00L

SS 2006

Wed 3-5 pm, MLJ 34.1

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Time schedule:

	date	lecturer
	April 5, 2006	Karen Pittel
	April 12, 2006	Karen Pittel
	April 19, 2006	Karen Pittel
	April 26, 2006	Karen Pittel
	May 03, 2006	Karen Pittel
	May 10, 2006	Karen Pittel
	May 17, 2006	Hannes Egli
	May 24, 2006	Hannes Egli
	May 31, 2006	Hannes Egli
	June 07, 2006	no lecture
	June 14, 2006	Hannes Egli
	June 21, 2006	Hannes Egli
	June 28, 2006	Hannes Egli
	July 05, 2006	no lecture

Syllabus:

1. Introduction
2. Supply and Production Possibilities
3. Preferences, Demand and Welfare
4. General Equilibrium in Open and Closed Economies
5. Gains from trade
6. Differences in Technology
7. Heckscher-Ohlin Model
8. Government Policies
9. Imperfect Competition
10. Increasing Returns to Scale
11. Tastes, Per Capita Income, and Technological Change
12. Empirical Studies of Causes and Consequences of Trade

Basic readings:

- Markusen, J.R., J.R. Melvin, W.H. Kaempfer and K.E. Maskus, International Trade: Theory and Evidence, McGraw-Hill, New York, 1995.
- Krugman, P. R., Rethinking International Trade, MIT Press, Cambridge (Massachusetts), 1994.

further readings: at the beginning of each chapter

lecture notes: will be made available online before the respective lecture at

<http://www.wif.ethz.ch/resec/teaching>

Basic recommendations:

- attend classes regularly as course notes are no perfect substitute to visiting the lecture
- take notes during classes
- study literature

"International Economics" → 2 parts:

1. Monetary analysis (international finance)

- determination of exchange rates, international transmission of inflation
- foundation in macroeconomic analysis

2. Real analysis

- reasons for and consequences of international trade
- implications of changes in real variables such as capital stocks and labor supply
- effects of trade restrictions
- foundation in microeconomic analysis

This lecture: focus on real analysis.

Motivation

Economic integration

... is an important aspect of "globalization"

... comprises (an intensification of):

- exchange of goods and services
- exchange of ideas (blueprints)
- foreign direct investments
- mobility of input factors
(financial/physical capital, labor)
- special role of multinational cooperations

Specifics of international trade vs domestic trade:

- degree of factor mobility:
 - higher within countries than in between countries
 - reasons: language, religions, social customs,...
- governmental regulatory power:
 - hardly regulation of inner-country trade
 - tariffs, taxes and non-tariff barriers in international trade

Examples of formal economic integration:

- regional:
 - EU (including its recent enlargement)
 - NAFTA (North American Free Trade Agreement)
 - AFTA (ASEAN Free Trade Agreement)
- global:
 - WTO (GATT = General Agreement on Tariffs and Trade
GATS = General Agreement on Trade in Services
TRIPS = Agreem. on Trade-Related Aspects of Intellectual Property Rights)

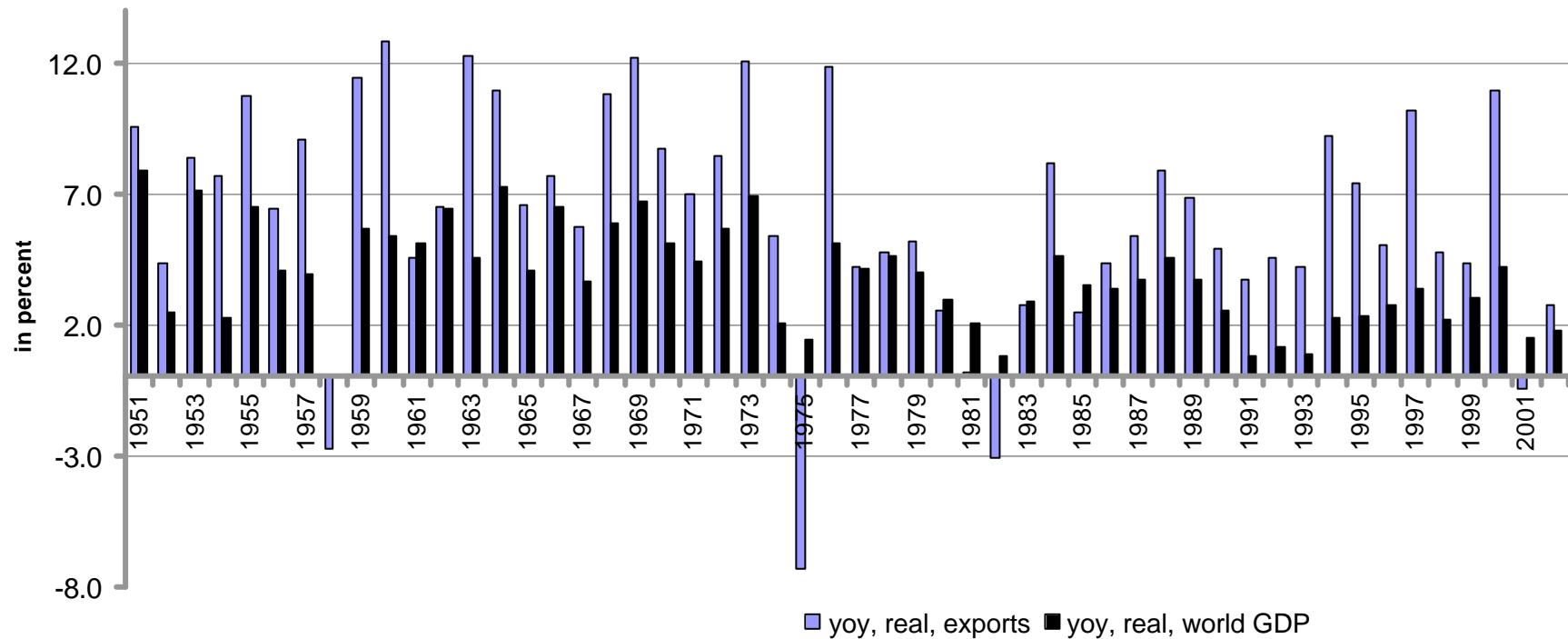
Additionally: substantial informal integration due to technological progress in transportation and communication sectors

Some Empirics

- **Development of global international trade:**
 - **1979-1991:** average growth of
 - worldwide real exports: 4.4%pa
 - real output: 2.9%pa

- 1950-2002:

World: Growth of GDP and Exports

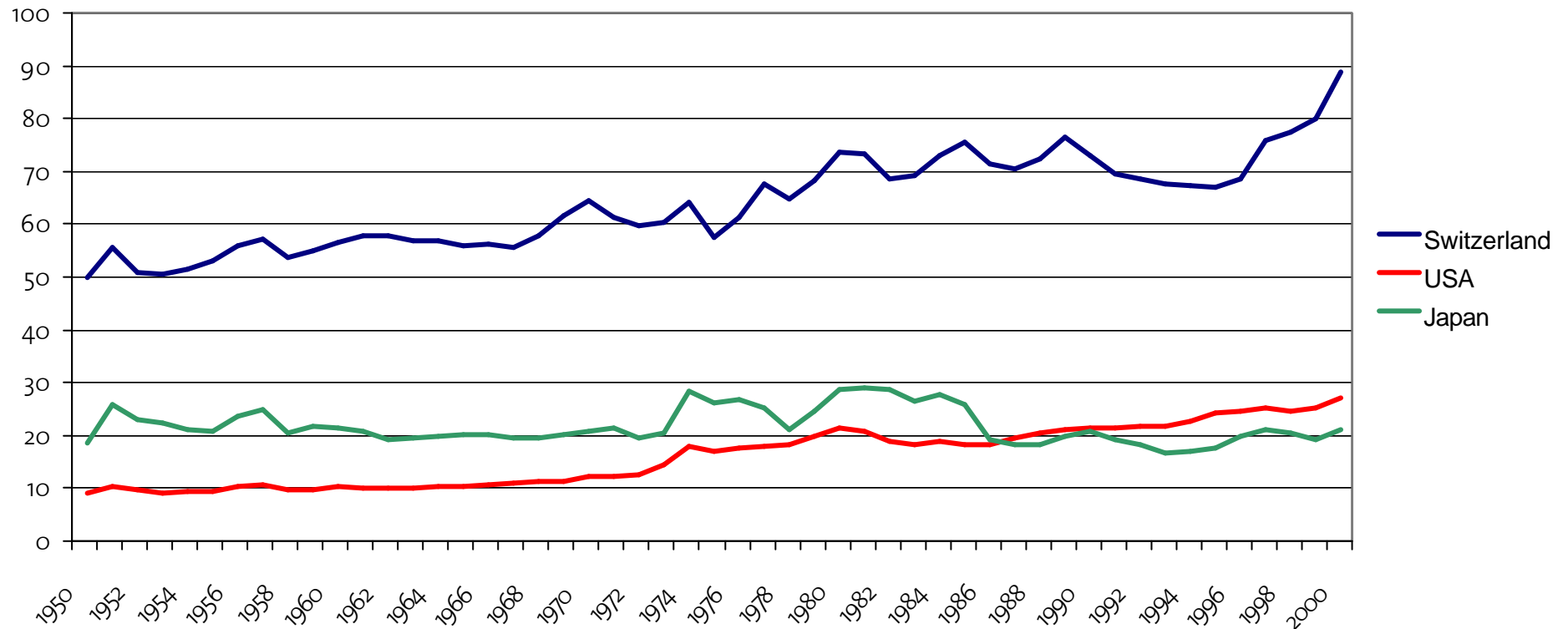


Source: WTO (http://www.wto.org/english/res_e/statis_e/its2003_e/its03_longterm_e.htm)

→ increasing share of production is exchanged for foreign goods

- Development of "Openness" of Selected Countries (1950-2000)

openness indicator: $(\text{exports} + \text{imports}) / \text{GDP}$

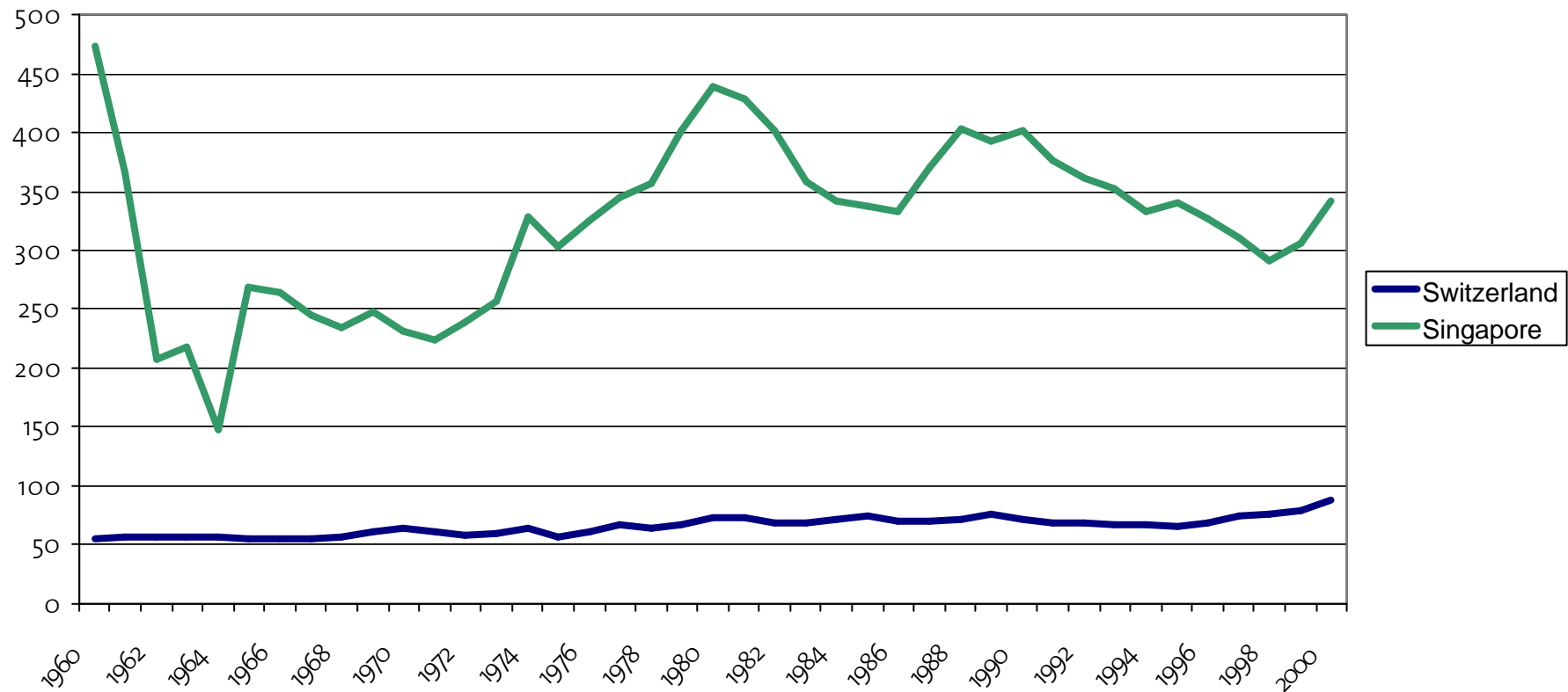


Source: Penn World Tables 6.1

→ "openness" depending (aside from trade policy) on factors like country size, geographical isolation,...

- Development of "Openness" of Singapore (1960-2000)

openness indicator: $(\text{exports} + \text{imports}) / \text{GDP}$



Source: Penn World Tables 6.1

→ indicator can exceed 100% (Singapore classical *entrepot trade*)

- **Structural composition of trade**

Example: Export to import ratio (2004), Switzerland and Brasil, selected commodities

food and live animal*

	exports**	imports**	exports/imports
Brasil	18.465.919.299	2.804.118.757	6.59
Switzerland	2.516.669.693	4.873.852.661	0.52

chemicals and related products*

	exports**	imports**	exports/imports
Brasil	5.747.562.346	14.445.778.405	0.40
Switzerland	40.98.546.467	24.738.220.122	1.66

Source: UN Statistics Division 2006
 * according to SITC Rev.3 Classification
 ** in US \$

→ different comparative advantages with respect to availability of e.g. capital and agricultural land

Two basic questions

From the perspective of economic theory, two main questions arise:

1. **Causes of international trade?**
2. **Consequences of international trade?**

Some very quick answers:

- ad (1):**
- one ostensible (but not ultimate) cause: international differences in market prices
 - economic reasons: differences in
 - demand conditions (e.g. differences in preferences)
 - supply conditions (e.g. differences in technology and factor endowments differences in production costs)
- ad (2):**
- international division of labour
 - increased specialization rising labour productivity
 - increases welfare (in general! exceptions to this rule due to market imperfections)

Some misconceptions about international trade

list from: Krugman, P. (1993), What do undergrads need to know about trade? AER 83, p. 23-27.

1. "We need a new paradigm"

- claim: everything is different in open economies
- reality: trade is just another economic activity, subject to the same principles as anything else
- imagine,
 - entrepreneur uses new secret technology to convert wheat into cheap high-quality cons. goods
 - entrepreneur hailed as hero, that some domestic competitors are hurt is taken as the price of a free-market economy
 - then discovered that wheat shipped to Asia and proceeds used to buy manufactured goods
 - entrepreneur denounced as a fraud who is destroying American jobs
- trade should be thought of as a kind of production process that transforms exports into imports

2. "Competition in the world marketplace"

- claim: countries are in competition with each other in the same way that companies in the same business are in competition
- reality: trade is a mutually beneficial exchange whose gains allow a country to import things it wants

3. "Productivity"

- claim: high productivity beneficial, because it helps a country to compete with other countries
- reality: high productivity beneficial, because it lets a country produce and therefore consume more (holds for closed as for open economies)
- thought experiment: image...
 1. productivity rises by 1% annually in all countries
trend in the Swiss standard of living? → rises by 1% per year
 2. Swiss productivity rises by 1 percent annually while it increases by 3% in the rest of the world
trend in the Swiss standard of living? → rises by 1% per year (except for minor tot effects)

4. "High-value sectors"

- claim: international competition as struggle over who gets the "high-value" sectors
- reality: international trade beneficial for participating economies whenever international specialization follows comparative advantages
(whether or not specialization in "high-value sector" not relevant)

5. "Jobs"

- claim: central issue of free trade is employment
- reality: employment is a macroeconomic issue, depending on aggregate demand (short run) and on the natural rate of unemployment (long run); little net effect of e.g. tariff policies

6. "A new partnership"

- claim: government should support domestic firms against foreign rivals
- reality: government support of an industry may help that industry compete against foreigners,
but: draws resources away from other domestic industries;
if specific reasons for selective policy, than others than trade (external economies...)