

# ECO 352 – INTERNATIONAL TRADE – SPRING 2010

No. 1 – Feb. 2

## LOGISTICS AND ADMINISTRATION

Syllabus and reading list on Blackboard. Slides posted by 1 p.m. for each class.

Check “ECO 352” e-mails regularly, don't ignore. Keep account under quota.

Krugman-Obstfeld textbook. Two other books (Krugman, Irwin) worth buying

Other readings mostly on e-reserve. Advance reading highly recommended

Occasional supplementary handouts / notes from time to time

Most important: Lectures, precepts, problem sets, readings

are all mutual complements, or parts of a package, not substitutes

Cooperative discussion of problem sets encouraged

But submit own individual work; exams under Honor Code will expose ignorance

Midterm Thursday March 11 in class; no replacement

Final exam in exam period; time chosen by registrar's office

These take priority over all other commitments

Just to clarify: This course is about micro international economics

Not about macro, business, or politics per se, although these will get some mention

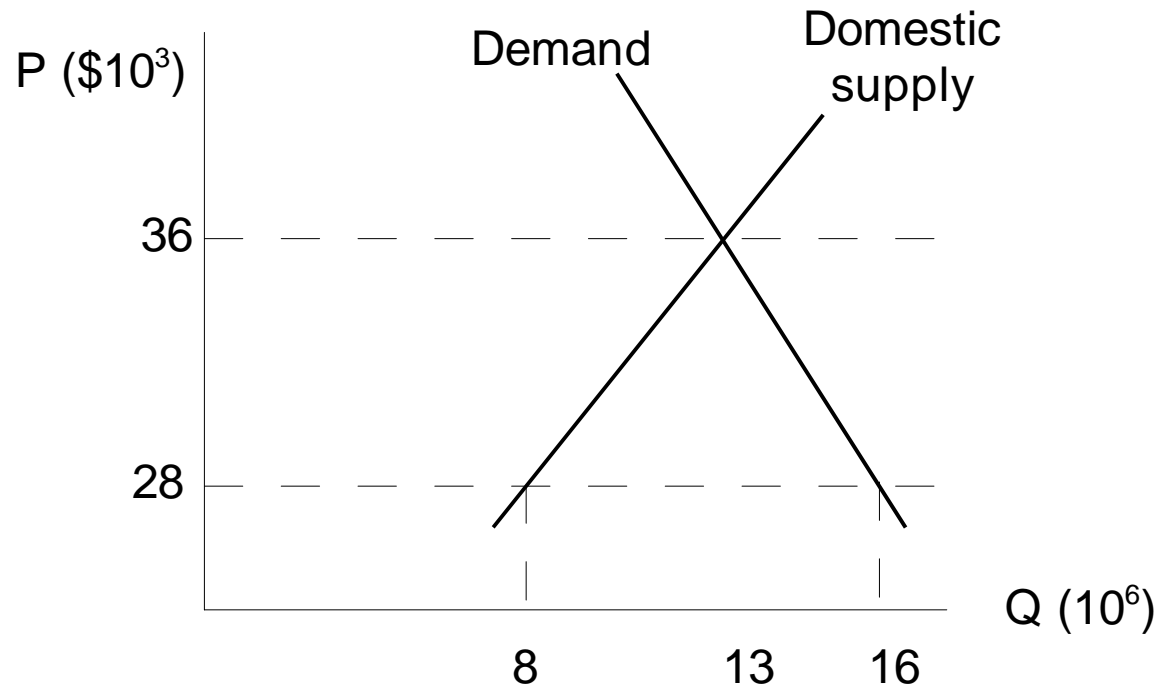
**Important:** Review your intermediate microeconomics (ECO 300 or 310)

## WHY STUDY INTERNATIONAL TRADE?

- [1] Big part of economic activity in the US
    - exports 11.5% , imports 17% of GDP in 2007; up from 4.5% each in 1960
    - Even bigger in other countries: World average about 30%
    - Some have exports, imports > 100% of GDP. How can this be?
    - $Y = C + I + G + X - M$  , so  $X$  and  $M$  can each be >  $Y$
    - Small countries, those specialized in one resource, have high ratios.
  - [2] Big item in news and public policy discussions
    - Many problems of US economy get blamed on
      - trade, immigration (legal and illegal), outsourcing, investment abroad ...
    - Lou Dobbs only the latest of many “trade warriors”
    - Policy debate will continue and even heat up during economic crisis
  - [3] Others blame globalization, multinationals, international organizations
    - for problems of LDCs, former socialist countries
  - [4] Major focus of international institutions: WTO, World Bank, IMF, ...
    - Recent failure of the Doha round of trade negotiations
- This course can only provide a start on some of these topics;  
others in development, labor, international relations courses

## KEY ISSUE 1 : GAINS FROM TRADE, BUT CONFLICT

Example: US Auto market. Data approximate for 2007.



Underlying assumptions: (arc) elasticity of demand  $\approx 1$ , of domestic supply  $\approx 2.5$

If the US bans imports: Consumer surplus loss = \$116 billion

Producer surplus gain = \$84 billion

Net loss to US economy = \$32 billion

Must understand the source and implications of this conflict.

This is useful to get across the basic issue: conflict underlying net gain.  
But it is only the simplest picture; needs elaboration in many ways.

[1] Estimation of the demand and supply curves:

Usual econometric problems of specification, identification, ...  
Not covered much in this course (302 is not a prerequisite),  
but good research topics for your JIW or Senior Theses.

[2] This is just one industry / market or partial equilibrium;  
need to consider interaction with other markets: substitutes and complements,  
markets for labor and capital that determine marginal costs and so the supply curve, ...

[3] This is static; need to consider dynamic effects  
as resources reallocate, capital is accumulated, ...

[4] The comparison in practice is rarely zero trade versus totally free trade:  
Usually we calculate the effect of partial liberalization or increase in trade barriers.

[5] Supply-demand curve analysis applies to perfectly competitive industries.  
But with large economies of scale, can have oligopoly, monopolistic competition  
Can there be strategic national incentive to seize industries with excess profit?

All these issues will be taken up during the term.

Also basic questions of interpretation of the gains and losses:

- [a] Who are these producers who gain from import restriction / lose from trade?  
Who are the consumers who gain from trade / lose from import restriction?  
In US as a whole, everyone is a consumer of many things,  
most are producers of one thing  
But lot of heterogeneity: few are auto producers, so their losses concentrated  
This affects politics of trade policy: producers are usually more vocal
- [b] Where does the producer surplus go?  
Wages? Union premium or other “economic rent” component of wages?  
Profits? Who gets them: idle rich, or deserving pensioners?  
Our normative judgment may depend on this.
- [c] In the statistics, auto “imports” include US transplants of foreign firms  
Shouldn't we be concerned about jobs, wages of workers in transplants?
- [d] Portfolios are increasingly internationally diversified:  
US financial investors own shares in foreign auto firms and vice versa.  
This further complicates normative judgments about trade policy.

Many questions raised here; will be taken up one by one later in the course.

## KEY ISSUE 2 : MISCONCEPTIONS

### COUNTRY'S COMPETITIVENESS

US complaint: "we can't compete with low wages"

LDCs complaint: "we can't compete with productive US"

But the two are logically and factually incompatible with each other:

If labor productivity is high, labor demand will rise and wages will go up

Implication: a country can't outcompete others in everything:

Only **comparative** advantage matters for trade; productivity for income per capita

### HIGH VALUE ADDED PER WORKER

Claim: Government policy should support industries that have this

Value added = Sales – Cost of material inputs, is a function of labor, capital, ?land, ...

High value added per worker if lot of capital per worker

Typical examples: petroleum refining, cigarette manufacture

### STRATEGIC INDUSTRIES

Claim: Government policy should support industries of national importance

Some truth: imports of items critical for national defense may be cut off in wartime etc.

But other policies may be better than protectionism: e.g. stockpiling

More often this argument is "hijacked" for political purposes: e.g. Danone in France

## TRADE POLICY TO REMEDY MARKET FAILURES

Export promotion to create jobs, import barriers to preserve jobs

Import bans for environmental or biodiversity objectives ...

Sometimes such policies can improve upon pure laissez faire

But trade measures are typically not the best policies against these market failures

Better: macro policies for employment, taxes or “carbon markets” for pollution etc.

Tariff for revenue was historically important when other activities were hard to monitor

But now negligible compared to income taxes, sales taxes etc.

General principle: Look for policy instrument that most directly addresses the problem

## JOB LOSSES / WAGE REDUCTIONS DUE TO TRADE VS. TECHNOLOGY

“Logic of market” or “downside of progress” arguments are relatively more acceptable when the cause is an improvement in production technology, e.g. labor-saving

But less acceptable when cause is trade liberalization, or foreign subsidies etc,

Should view trade as just another technology for obtaining goods and services

Social insurance (safety net or adjustment assistance) should be equally available regardless of the source of the disruption.

## GLOBALIZATION

Just another name for trade expansion / liberalization?

Usual idea of trade in theory and in popular perception: final goods. But much broader:

- [1] Trade in intermediate goods, including intra-firm trade of goods in process.  
Made possible by reduction in transportation costs: containerization, airfreight.
- [2] Foreign direct investment; multinational firms.
- [3] Trade in services made possible by fast and cheap telecommunication.  
International borrowing and lending, portfolio capital flows.
- [4] Migration: skilled and unskilled, permanent and temporary, legal and illegal.
- [5] Policy coordination via international organizations, worldwide and regional.

Definitions: [1] Deardorff and Stern: Increase in international transactions of goods, services, and factors; expanded scope of international firms and institutions. [2] Niall Ferguson: rapid integration of international markets for commodities, manufactures, labor and capital. [3] Also non-economic aspects : rapid worldwide dissemination of ideas, trends, ..

However, national borders, and restrictive policies, remain important  
Differential international mobility of different goods, services, factors  
is why international trade is a special branch of economics;  
otherwise it would be just "world microeconomics".

Interaction among these markets, e.g. how cross-border trade in goods affects  
within-border rewards to factors (wages), is a basic question for trade theory.