

Economics 0500
INTRODUCTION TO INTERNATIONAL TRADE

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TEXT: Steven Husted and Michael Melvin, International Economics, 8th ed. Addison-Wesley Publishers, 2010 (cited below as "HM").¹

COURSE REQUIREMENTS AND GRADING SCHEME: Your grade will be daily quizzes (25%), mid term, and a final.² The mid-term is optional. If not taken, the final will count for 75% of your grade. However, **taking the mid-term cannot lower your grade.** If your final exam grade exceeds your mid-term grade, then the mid-term results will not count. Otherwise, the mid-term will count 30%.

OUTLINE AND READING LIST:

- I. Introduction - HM: chapter 1 (skim)
- II. The Pure Theory of International Trade
 - a. Tools of Analysis - General Equilibrium for a Closed Economy - HM: chapter 2 (omit Appendix).
 - b. Classical Model - HM: chapter 3 (omit Appendices)
 - c. The Heckscher-Ohlin Model -- HM: chapter 4 (omit pp. 100-106 and the Appendices)
 - d. The Leontief Paradox and Alternative Theories - HM: chapter 5 (read pp 120-129 to "Recent Tests" then skim the rest)
 - e. Review Questions - HM: pp. 49-50: 7,8, 11; pp. 76-78: all; pp. 107-109: 1, 3, 5, 7, 9, 10, 11; pg. 142-143: 1,5,7
- III. Tariffs and Other Barriers to Trade
 - a. Gains from Free Trade - HM: pp. 147-150

¹ Note that an online version of this text is available at <http://www.coursesmart.com/>. A cheaper international edition may also be available for sale on the web. Used copies of earlier editions of this book are available for sale online and in the library. Feel free to use any of these, although some of the material in the older editions will be out of date.

² Grade based on the best 20 (out of 26) scores. Bonus grade awarded to students with 24 or more scores.

- b. Introduction to Tariffs - HM: pp 149-154, pp. 174-176 ("How High Are Tariffs?")
 - c. Effects of a Tariff - HM: pp. 154-163
 - d. Export Tariffs - HM: pp. 163-168
 - e. Non-Tariff Barriers - HM: pp. 180-194
 - f. Arguments for Protection - HM: pp. 194-212, 168-174 ("The Optimal Tariff")
 - g. Review Questions - HM: pp. 176-178: all; pg. 217-219: all
- IV. U.S. Commercial Policy
- a. U.S. Trade Policy-History and Current Practice - HM: Chapter 8
- V. Customs Unions and Free Trade Areas
- a. HM: pp. 249-260
 - b. Review Questions - HM: pp. 246-247: all; pp. 268-269: all

Midterm

- VI. Basics of International Finance
- a. Balance of Payments Accounting - HM: pp. 313-325 (stop at "Balance-of- Payments Equilibrium and Adjustment")
 - b. The Foreign Exchange Markets - HM: pp. 303-309 (line 8) & Chapter 13
 - c. Review Questions - HM: pp. 327-328: 2-3, 5, 7-8, 9; pp. 346-348: 1-4, 6-9.
- VII. International Monetary Standards
- a. The Gold Standard and Its Collapse - HM pp. 460-464; "Gold Standard" in Course Documents Section of CourseWeb.
 - b. Bretton Woods - HM pp. 464-467 (to Floating Exchange Rates: Since 1973); "The Bretton Woods System" in Course Documents Section of CourseWeb.
 - c. Today's System - HM pp. 467-471 and 476-478; "Today's International Monetary System" in Course Documents Section of CourseWeb.
 - d. Choice of Exchange Rate Regimes - HM pp. 472-474
 - e. Review Questions - HM: pp. 487-488: 3, 4, 5, 9, 12; "Questions" in Course Documents Section of CourseWeb.

VIII. Floating Exchange Rates

- a. Exchange Rates in the Long Run - HM: Chapter 14
- b. Exchange Rates in the Short Run - HM: Chapter 15; pp. 382-392; pp. 453-456
- c. Review Questions - HM: pg. 365: all; pp. 377-378: 1-3, 5, 7

IX. Balance of Payments Adjustment

- a. Balance of Payments Equilibrium and Adjustment - HM: pp. 325-326
- b. Growth and the Balance of Payments - HM: pp. 529-531; “Growth and the Balance of Payments” in Course Documents Section of CourseWeb.
- c. Devaluation - HM: pp. 409- 421
- d. Review Questions - HM: pg. 533: 10, pp. 428-429: 1, 7;

Sample Midterm Questions

1. Compare and contrast the classical and HO theories of comparative advantage. Discuss differences in assumptions, in sources of comparative advantage, post trade output points, role of tastes, and effects of trade on factor prices.
2. What is the Leontief Paradox? Discuss several reconciliations of the paradox with the HO model. Pick one of the alternative theories described in class. What determines comparative advantage in that model? How does it explain the paradox?
3. Robotland is capital abundant. Serftown is labor abundant. Cars are capital intensive. Butter is labor intensive. Pick one of the two countries. Graphically demonstrate the pre and post trade equilibrium production and consumption points for that country, including the pre and post trade price of cars in terms of butter. Find and label the trade triangle. Indicate desired levels of exports and imports. Label carefully. Prove that free trade is better than no trade. In a short essay, identify which factor gains from trade and which loses. How do factors gain or lose?
4. Given the following input-output table, answer the questions below:

	A	B
X	20	10
Y	4	1

- a. Which country has absolute advantage in which good(s)? Why?
 - b. Which country has comparative advantage in which good(s)? Why?
 - c. What will be the pretrade relative price of X in each country? Why?
 - d. What will be the international terms of trade after trade begins?
 - e. Let W_A = A's wage rate in A's currency
 W_B = B's wage rate in B's currency
 E = the exchange rate that converts A's currency into B's.
 In order for balanced trade to occur, EW_A/W_B must lie in some range, i.e.
 $m < EW_A/W_B < n$.
 Determine the values of m and n.
 - f. Which country would prefer a t.o.t. of 9? 6? Why?
5. Prove each of the following statements is true:
 - a. Free trade is better than no trade.
 - b. Some trade (i.e. restricted) trade is better than no trade.
 - c. The optimal tariff for a small country is zero.
 - d. The higher the per unit tariff the greater the deadweight costs.

6. Discuss the terms of trade and the infant industry arguments for protection. In what sense are these valid arguments for protection? Are they the best available policies to meet their stated goals? Explain.
7. In what sense are tariffs and quotas equivalent? How do they differ? Discuss at least 4 ways. Which is generally thought to be worse?
8. Define trade creation and trade diversion. Give a graphical example of each.
9. How is trade policy implemented in the United States today? Discuss such topics as escape clause protection, antidumping policy, countervailing duties, and WTO negotiations.
10. Explain why each of the following is not a valid argument for protection.
 - a. patriotism
 - b. fair play (e.g. level playing fields)
 - c. preservation of jobs

Sample Final Exam Essay Questions

1. Given the following data, answer parts a-d below: (**note: the data below pertain to the country of Freedonia**)

Merchandise Exports	\$50 million
Merchandise Imports	\$65 million
Foreign Tourist Expenditures	\$5 million
Interest Payments to Foreigners	\$12 million
Foreign Aid from the U.S.	\$10 million
Direct Investment in Freedonia	\$8 million
Direct Investment in U.S.	\$14 million
Increase in Official Short Term Assets	\$3 million
Gold Outflow	\$7 million
Errors and Omissions	\$???

- a. Indicate whether each of the above is a debit or credit in Freedonia's BOP statement and calculate Freedonia's errors and omissions entry.
- b. Calculate Freedonia's balance of trade, current account balance, net long term capital flows, and official settlements balance.
- c. Explain how Freedonia financed its current account balance.
- d. Explain how Freedonia financed its official settlements balance.
2. Suppose a country's $mpm = .05$ and its $mps = .15$. Calculate its foreign trade multiplier. Suppose the country begins with a zero current account balance. Discuss the effects of each of the following alternative scenarios on the country's GNP and current account balance:
- a. $+\Delta X = \$10$ billion b. $+\Delta I = \$10$ billion
c. $+\Delta X = \$10$ billion & (simultaneously) $-\Delta I = \$10$ billion
3. What is meant by covered interest parity? Derive and explain.
4. What determines long run movements in exchange rates?
5. What determines short run movements in exchange rates?
6. Discuss the major similarities and differences between the gold standard and the Bretton Woods systems.
7. Define the following concepts: SDR's, reserve and credit tranches, exchange control, managed floating.
8. Explain how a speculator could make money under the gold standard and under the Bretton Woods System.