


International Economics  
Fall 2010  
**Introduction and Overview**

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## Contact Information

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- For office hours, I adopt open-door policy, i.e., come in for a chat when my office door opens. You can also make an appointment by emailing me first.

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## Course Materials

- Textbook - Krugman & Obstfeld, “International Economics”, 8<sup>th</sup> ed. all previous editions published after 2000 are also fine.
- Lecture notes, additional reading materials, and homework will be posted on course website at: <http://www.pauldeng.com/teaching/intecon/index.html>

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## Structure of the Course

- International Economics includes two parts:
  - International Trade
  - International Finance
    - or the so-called open-economy macroeconomics
- We will devote roughly equal time on the two parts
- The schedule is quite tight for such a heavy textbook, so the key is to get the core concepts and ideas (and this will be reflected in my teaching and design of final exam)
- But of course, having some fun in this oldest field of economics is also important

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## Course Requirement

- You are expected to:
  - Read assigned materials (textbook and other readings) before the class
  - Come to the class fully prepared for asking or answering questions, i.e., active attendance is required
  - Quickly review lecture notes after class, which will become available online after lecture
  - Practice on homework questions. These questions will be similar to final exam questions.

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## Course Requirement

- You're also advised to:
  - Get used to reading *Wall Street Journal (WSJ)* or *Financial Times (FT)* on a daily basis. Pick one and stick to it.
  - *Economist Magazine* is also good, but its economics section sometimes can be quite difficult.
  - At the beginning, try spend at least 30 minutes each day; then gradually cut down your time. The final goal is to be able to read the whole paper in 10-15 mins (involves a lot of techniques, of course).
  - Having this habit will benefit you tremendously in your later career, especially if you want to become an economist, a banker, a policy maker, a financial analyst, or even a country-song singer...😊(how could this be???)

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## Sampler of Merle Hazard

-- a country-song singer who sings about economics...

Double Dipping  
Recession



Watch at: <http://www.youtube.com/watch?v=3geBEc2cJGs>

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## So what are International Economics dealing with?

### ■ Part 1, International Trade

- What do countries gain by trading with each other?
- What to trade? In what patterns? And why?
- How could trade change income distribution of a country?
- What are the major trade barriers? What are their impact on a country's welfare?
- What is the relationship between trade and development?

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## What are International Economics dealing with?

### ■ Part 1, International Trade

- What do countries gain by trading with each other?
  - e.g., what gains does Denmark get by shipping its pork to UK and Germany?
- What to trade? In what patterns? And why?
  - Why do Germans sell autos to America, and Japanese ship their electronics, while Chinese ship almost everything else?
  - Both Germany and the US produce cars, but why do they still sell cars to each other?
- How could trade change income distribution of a country?
  - Is international trade to blame for America's rising inequality over the past few decades?

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## What are International Economics dealing with?

### ■ Part 1, International Trade

- What are the major trade barriers? What are their impact on country's welfare?
  - aka - What ammunitions do policy makers have, when they consider trade as "enough is enough", so they want to engage in some "folly" activities in protecting domestic industries, for example? What are the costs and benefits of these policies?
- What is the relationship between trade and development?
  - Essentially, this is the same question on "trade and wealth of nations".
  - e.g., why Latin America couldn't sustain its growth while most East Asian countries did?
  - e.g., why did India suddenly take off in early 1990s?

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## What are International Economics dealing with?

### ■ Part 2, International Finance

- What is balance of payments (or BOP), and how is it related to national income accounting?
- How do foreign exchange or currency market operate?
- How do our macro-economy work with introduction of currency and exchange rate?
- How is exchange rate determined in the long run and in the short run?
- What are world's major exchange rate regimes? Their history, and what are their strengths and weaknesses?

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## What are International Economics dealing with?

### ■ Part 2, International Finance

- What is balance of payments (or BOP), and how is it related to national income accounting?
  - Why does the US tend to run current account deficits, while with capital account surplus?
- How do foreign exchange or currency market operate?
  - The main actors and features of FX market
  - Why is FX market so volatile?
- How do our macro economy work through currency and exchange rate?
  - e.g., How lowering interest rate by the Federal Reserve could affect US dollar in the currency market?

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## What are International Economics dealing with?

### ■ Part 2, International Finance

- How is exchange rate determined in the long run and in the short run?
  - Why do consumers from developed countries feel instantly rich when they travel to developing countries? or vice versa...
- What are world's major exchange rate regimes? Their history, and what are their strengths and weaknesses?
  - Why do Chinese want to peg their currency to the US dollar, while Danes want to peg their currency to the Euro?
  - Why do someone argue the Euro is a flawed currency by design?

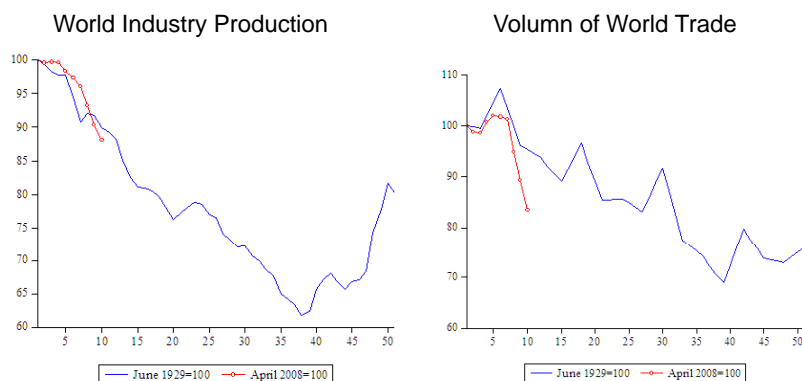
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## An Introduction to World Trade

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# First, the shocker...

## A Tale of Two Depressions (as of March 2009)

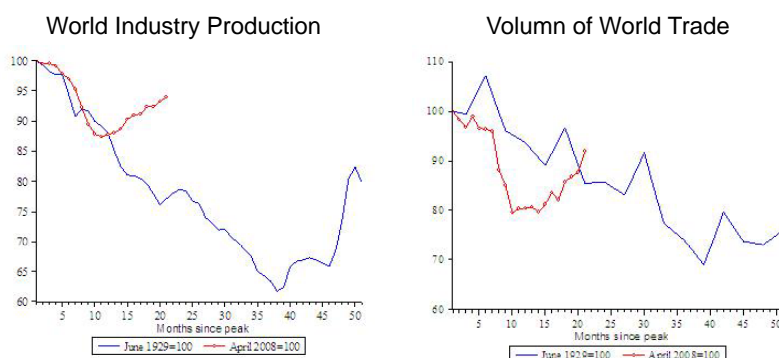


Source: Barry Eichengreen, "A Tale of Two Depressions"

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# First, the shocker...

## A Tale of Two Depressions (as of Feb. 2010)



Source: Barry Eichengreen, "A Tale of Two Depressions"

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## Trade and Recessions

- International trade is strongly correlated with global business cycles.
- When recession originated from the US, the recession tends to be global, such as the most recent one and the Great Depression. And the world trade tends to suffer a great deal.
- In recent years, with the fast rise of Chinese economy, China starts to have more influence on the global business cycle and world trade, and this trend will continue. For example, the recent strong recovery of German economy was, to a larger extent, due to the surge of exports to China.

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## World's Largest Trading Nations

The Top 10 Trading Nations by Total Trade  
(Imports + Exports), 2009 est.

1	 United States	\$2,439,700,000,000
2	 People's Republic of China	\$2,208,000,000,000
3	 Germany	\$2,052,000,000,000
4	 Japan	\$1,006,900,000,000
5	 France	\$989,000,000,000
6	 United Kingdom	\$824,900,000,000
7	 Netherlands	\$756,500,000,000
8	 Italy	\$727,700,000,000
-	 Hong Kong	\$672,600,000,000
9	 South Korea	\$668,500,000,000
10	 Belgium	\$611,100,000,000

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## World's Largest Trading Nations

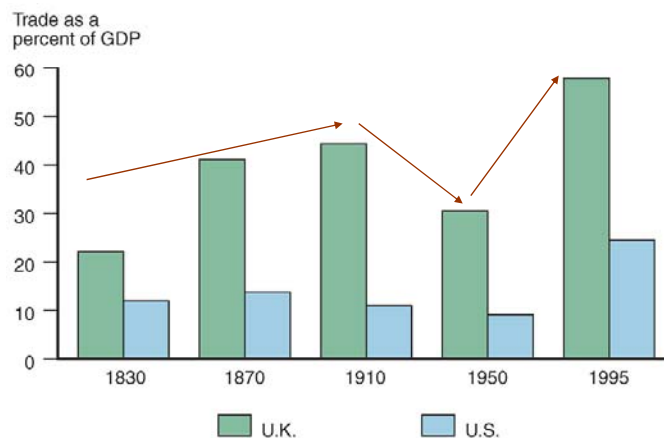
World's Top 10 Exporters, 2009 est.

1	 People's Republic of China	\$1,204,000,000,000
2	 Germany	\$1,159,000,000,000
3	 United States	\$1,046,000,000,000
4	 Japan	\$542,300,000,000
5	 France	\$472,700,000,000
6	 Netherlands	\$417,600,000,000
7	 Italy	\$412,900,000,000
8	 South Korea	\$373,600,000,000
9	 United Kingdom	\$357,300,000,000
10	 Canada	\$323,400,000,000

World's Top 10 Importers, 2009 est.

1	 United States	\$ 1,604,000,000,000
2	 People's Republic of China	\$ 1,006,000,000,000
3	 Germany	\$ 931,000,000,000
4	 France	\$ 551,000,000,000
5	 Japan	\$ 551,000,000,000
6	 United Kingdom	\$ 480,000,000,000
7	 Netherlands	\$ 446,000,000,000
8	 Italy	\$ 410,000,000,000
-	 Hong Kong	\$ 353,000,000,000
9	 Belgium	\$ 351,000,000,000
10	 South Korea	\$ 313,400,000,000

## The Rise, Fall, and Rise of International Trade Since 1830



Source: Richard E. Baldwin and Phillippe Martin, "Two Waves of Globalization: Superficial Similarities, Fundamental Differences," in Horst Siebert, ed., *Globalization and Labor* (Tubingen: Mohr, 1999).

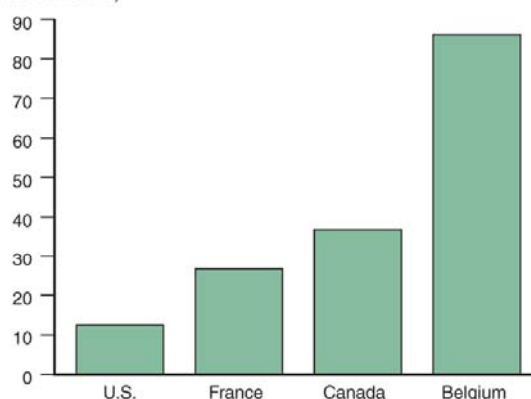
## Two/Three Waves of Globalization

- 1840–1914: economies relied on steam power, railroads, telegraph, telephones. Globalization was interrupted and reversed by wars and depression.
- 1945– present: economies rely on telephones, airplanes, computers, the Internet, fiber optics, GPS satellites...and iPhones ☺
- I would argue,
  - We are now in the third wave of globalization, which started in early 1990s. This wave of globalization is characterized by the integration of the two most populous countries, China and India, into the world economy, with a lot of new phenomena and issues...

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## U.S. is one of the largest trading countries in the world, but trade/GDP ratio is relatively low, 2005

Exports, imports  
(percent of  
national income)



### Question:

Trade/GDP ratio is also called trade dependency ratio, and it measures how a country is dependent on its international trade.

Can trade dependency ratio be equal or greater than 1?

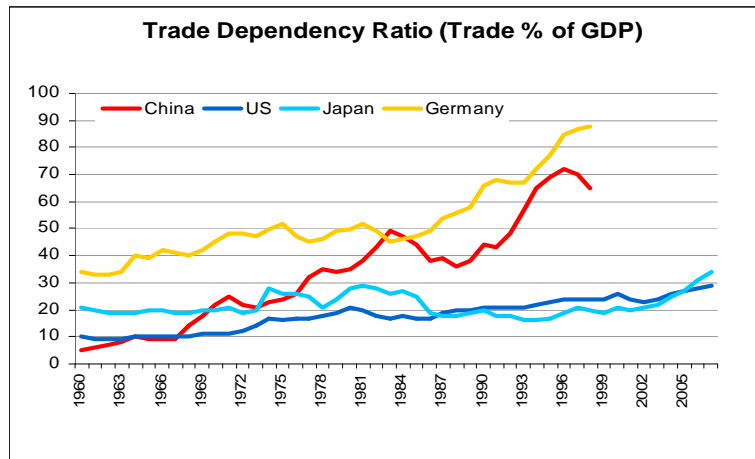
The answer is yes. In 2008, among countries with the highest trade dependency ratio, Singapore was at 450%, Luxemburg, 330%; Belgium 185%; Netherlands, 146%.

And FYI, Denmark was at 101%; China, 65%, and the US only 29%.

Source: Organization for Economic Cooperation and Development

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## Trade Dependency Ratio, cont.



→ China and Germany are markedly different from the US and Japan, i.e., more dependent on trade.

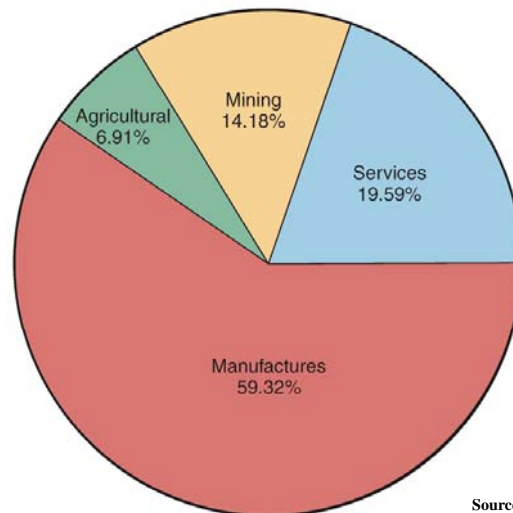
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## Changing Composition of Trade

- What kinds of products do nations currently trade, and how does this composition compare to trade in the past?
- Today, most of the volume of trade is in *manufactured products* such as automobiles, computers, clothing and machinery.
  - *Services* such as shipping, insurance, legal fees, and spending by tourists account for 20% of the volume of trade.
  - *Mineral products* (ex., petroleum, coal, copper) and *agricultural products* are a relatively small part of trade.

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## The Composition of World Trade, 2005



Source: World Trade Organization

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## Changing Composition of Trade

- In the past, a large fraction of the volume of trade came from agricultural and mineral products.
  - In 1910, Britain mainly imported agricultural and mineral products, although manufactured products still represented most of the volume of exports.
  - In 1910, the U.S. mainly imported and exported agricultural products and mineral products.
  - In 2002, manufactured products made up most of the volume of imports and exports for both countries.

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## Manufactured Goods as a Percent of Merchandise Trade

	United Kingdom		United States	
	Exports	Imports	Exports	Imports
1910	75.4	24.5	47.5	40.7
2002	82.6	80.4	82.1	77.8

Source: 1910 data from Simon Kuznets, *Modern Economic Growth: Rate, Structure and Speed*. New Haven: Yale Univ. Press, 1966. 2002 data from World Trade Organization.

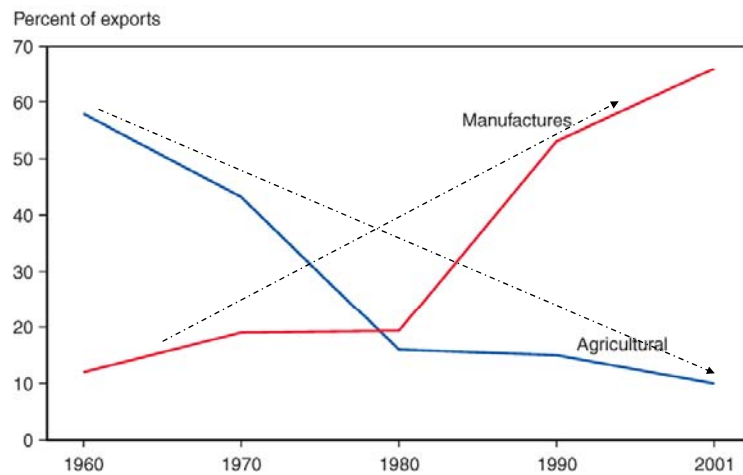
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## Changing Composition of Trade

- Low and middle-income countries have also changed the composition of their trade.
  - In 2001, **about 65% of exports** from low and middle-income countries were manufactured products, and only 10% of exports were agricultural products.
  - In 1960, about 58% of exports from low and middle-income countries were agricultural products and only 12% of exports were manufactured products.

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## The Changing Composition of Developing-Country Exports



Source: United Nations Council on Trade and Development

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## For the next class

- Read Chapter 3
- Read “What is an ‘American’ Car?” by Matt Slaughter, posted on course website at <http://www.pauldeng.com/teaching/intecon/>

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