



International Economics
Fall 2011
Introduction and Overview

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Contact Information

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Course Materials

- Textbook - Krugman & Obstfeld, “International Economics”, 8th ed.. All other editions published after 2000 are also fine
- Lecture notes, additional reading materials, and homework and answers will be posted on **course website** at:
<http://www.pauldeng.com/teaching/intecon/>
(LEARN system is too new to be trusted)



Structure of the Course

- International Economics includes two parts:
 - International Trade
 - International Finance, also known as “open-economy macroeconomics”
- We will devote roughly equal time on each part
- The schedule is very tight for such a heavy textbook, so try to get the core concepts and ideas (and this will be reflected in my teaching and design of the final exam)



Course Requirements

- You are expected to:
 - Read assigned materials (textbook and other readings) before the class – quick browse-through is enough
 - Come to the class fully prepared for discussions, asking questions, i.e., active attendance is preferred.
 - After class, have a quick review of lecture notes, which will become available online right after each lecture
 - Practice on every homework question. The exam questions will be similar in format.



Course Requirements

- 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 can be quite difficult.
 - At the beginning, try spend at least 30 minutes each day on reading; then gradually cut down your time. The goal is to be able to read the Journal in 10-15 mins.



An Early Note on Final Exam

- I won't test issues not covered in lecture notes
- It's important that you come to lectures – for your own good
- Textbook should be used as complementary material to lecture notes. Don't read all the pages, especially those not related to lectures – again this is a heavy book, so we need to stay focused
- The exam will be designed to test how well you apply theories to explain what's happening in the reality, i.e., I won't test how well you memorize the texts.



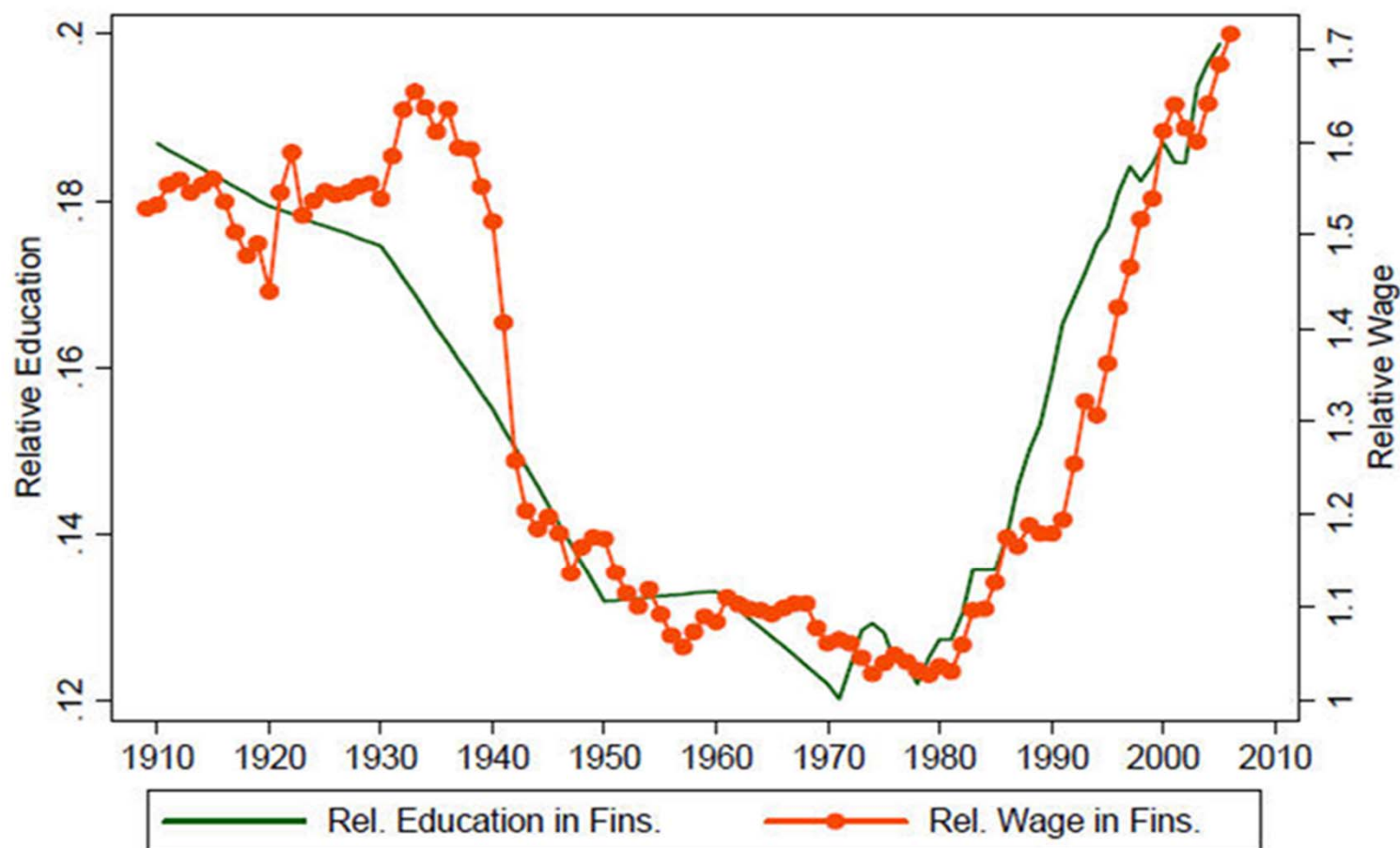
Now, some motivations...

- This is the best time to be an economist – why?
 - An extraordinary crisis brings about many challenges, and unsolved issues – high demand for knowledge in economics
 - already been reflected by the surge of research in global financial crisis

- Ever better to be an economist with concentration in international economics – why?
 - The hottest economic issues today are almost all related to international economics: globalization, currency wars, sovereign debt crisis, hot money and housing bubbles, global imbalances, rising of emerging markets, and so on.
 - We're living in an extraordinary period of time in history – it's good to have some global perspectives

Why are we in an extraordinary time of history? - the Big Pictures (#1)

Figure 1: Relative Wage and Education in the Financial Industry



Why are we in an extraordinary time of history? - the Big Pictures (#2)



Why are we in an extraordinary time of history? - the Big Pictures (#3)

The Global Distribution of Gross Domestic Product (GDP) in 2040, by Grouping of Nations



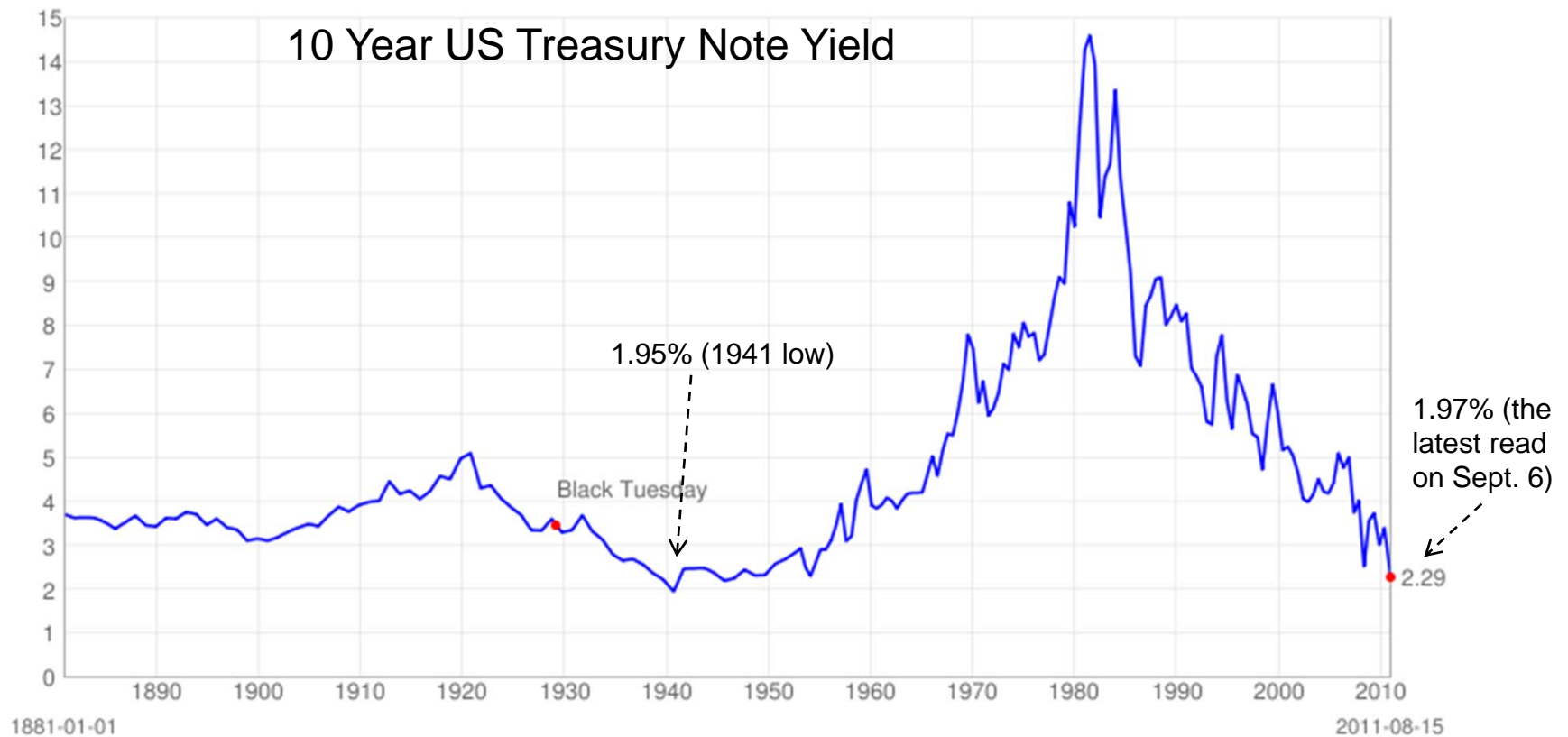
Robert Fogel

Grouping	Population (in millions)	Percent of total	GDP in billions of \$ (PPP)	Percent of total
United States	392	5	41,944	14
European Union (EU 15)	376	4	15,040	5
India	1,522	17	36,528	12
China	1,455	17	123,675	40
Japan	108	1	5,292	2
6 South East Asian Countries (SE6)	516	6	35,604	12
Subtotals	4,369	50	258,083	85
Rest of the World	4,332	50	49,774	16
World	8,701	100	307,857	101*

Note: GDP in U.S. dollars of 2000.

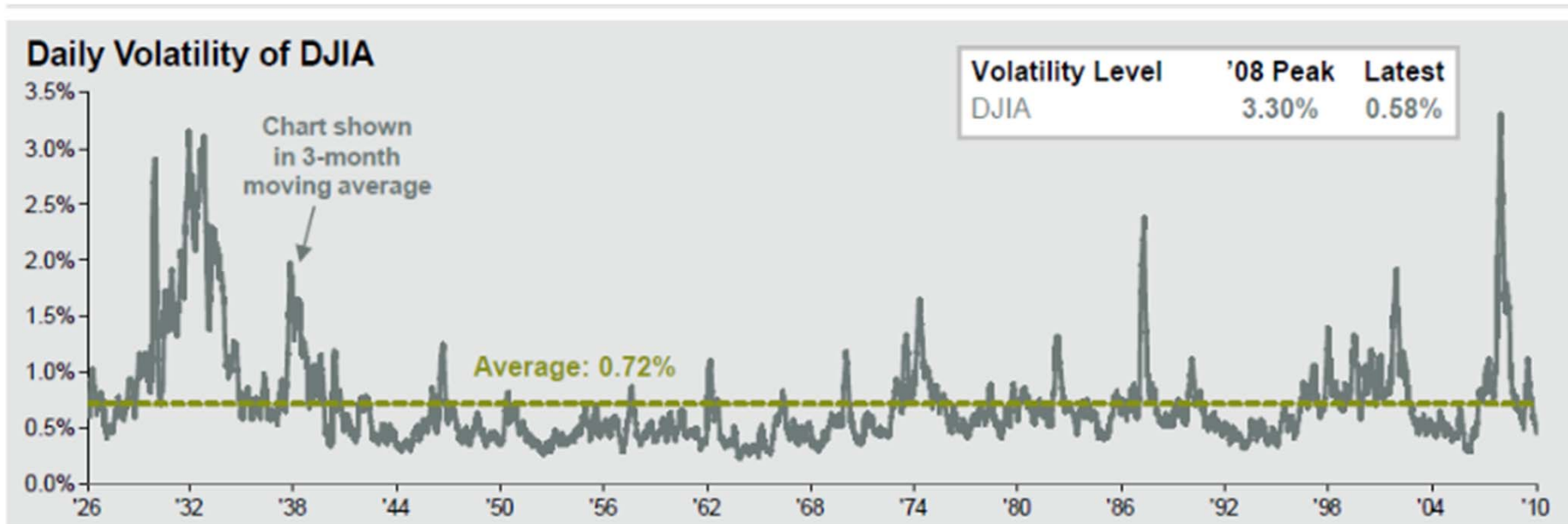
*Total equals more than 100 percent due to rounding.

Why are we in an extraordinary time of history? - the Big Pictures (#4)



Why are we in an extraordinary time of history? - the Big Pictures (#5)

The market is telling us there are going to be more volatilities (risks) ahead... Expect a very different and tumultuous world for the next 50 years.





So what does *International Economics* deal 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 economic development and growth?



So what does *International Economics* deal with? – sampling of issues

■ 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?



So what does *International Economics* deal with? – sampling of issues

■ 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?



So what does *International Economics* deal with?

■ Part 2, International Finance

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



So what does *International Economics* deal with? –sampling of issues

■ Part 2, International Finance

- What is balance of payments (or BOPs), and how is it related to national income accounting?
 - Why does the US tend to run a current account deficit, but a capital account surplus?
- How do foreign exchange (FX) 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 will lowering interest rate by the US Federal Reserve affect the US dollar?



So what does *International Economics* deal with? – sampling of issues

■ 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 (7.45 DKK = 1 USD)?
 - Why do people argue the Euro is a flawed currency *by design*?



An Introduction to World Trade

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

World's Largest Trading Nations

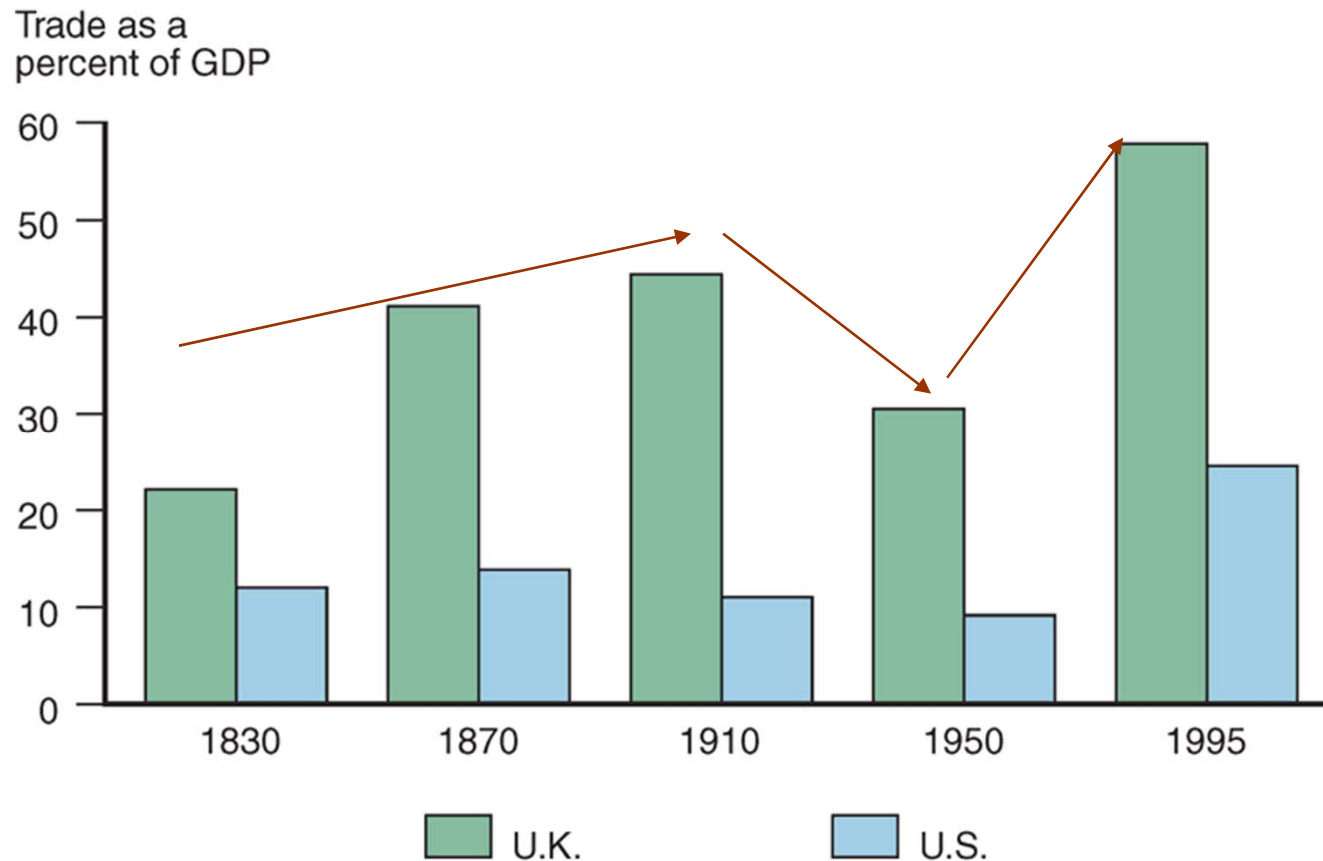
World's Top 10 Exporters, 2009 est.

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).

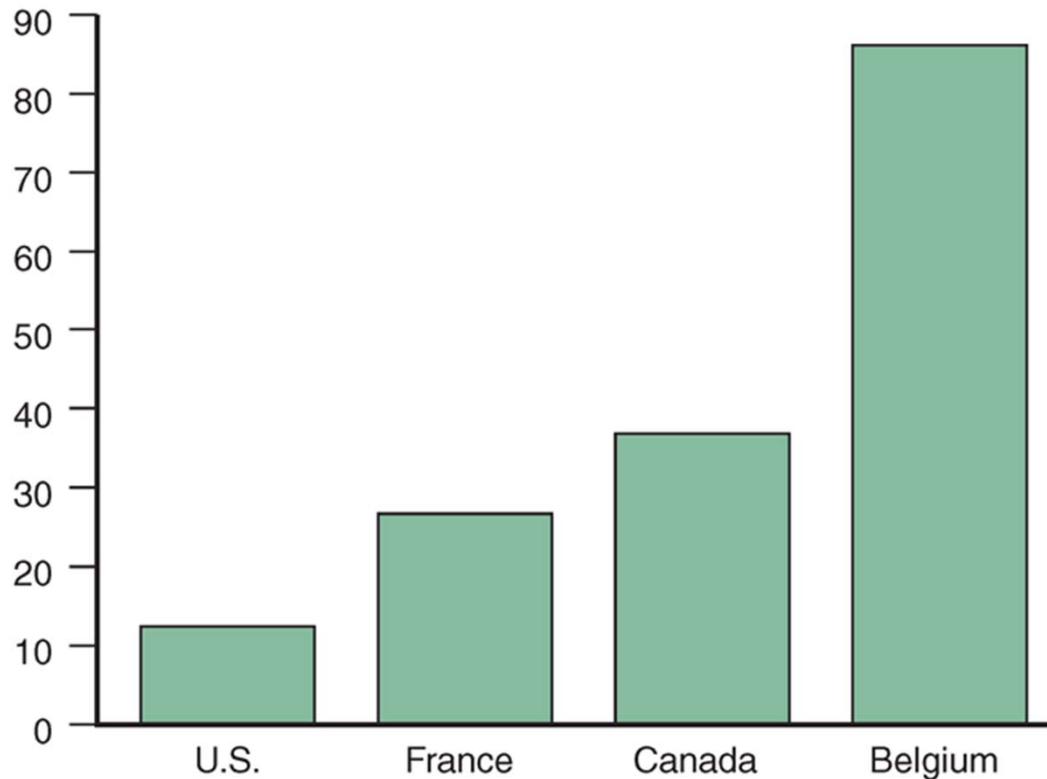


Waves of Globalization

- 1st wave (1840–1914): economies relied on steam power, railroads, telegraph, telephones. Globalization was interrupted and reversed by wars and depression.
- 2nd wave (1945– present): economies rely on telephones, airplanes, computers, the Internet, fiber optics, GPS satellites...and iPhones, and iPads... 😊
- I would argue,
 - we are now in the third wave of globalization, which started in early 1990s. This wave of globalization has been characterized by the integration of the two most populous countries, China and India, into the world economy --- a lot of new issues and challenges

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.

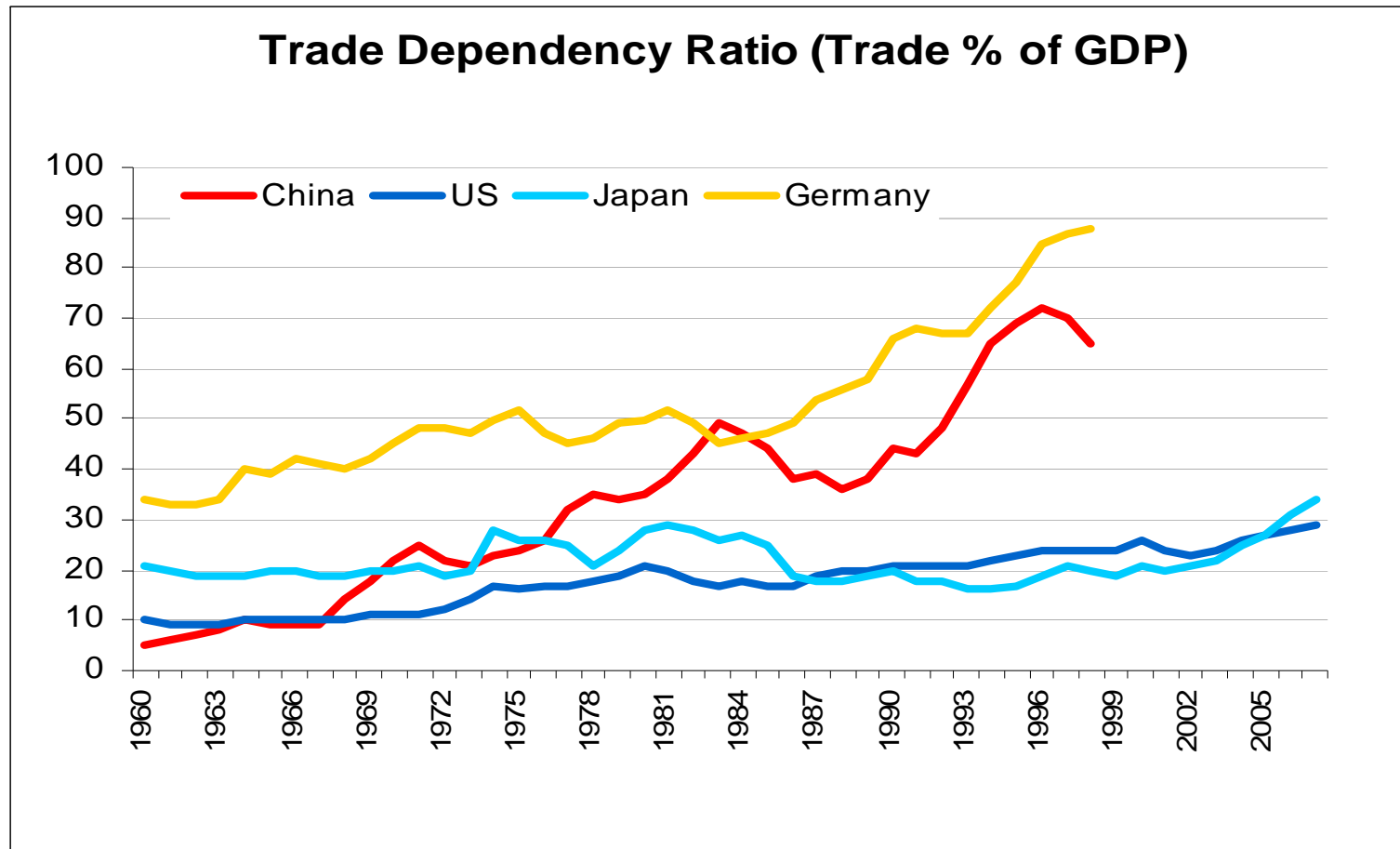
Can trade dependency ratio be equal or greater than 1?

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

Trade Dependency Ratio, cont.

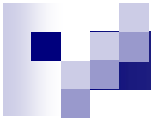


→ China and Germany are markedly different from the US and Japan, i.e., both countries are more dependent on trade.

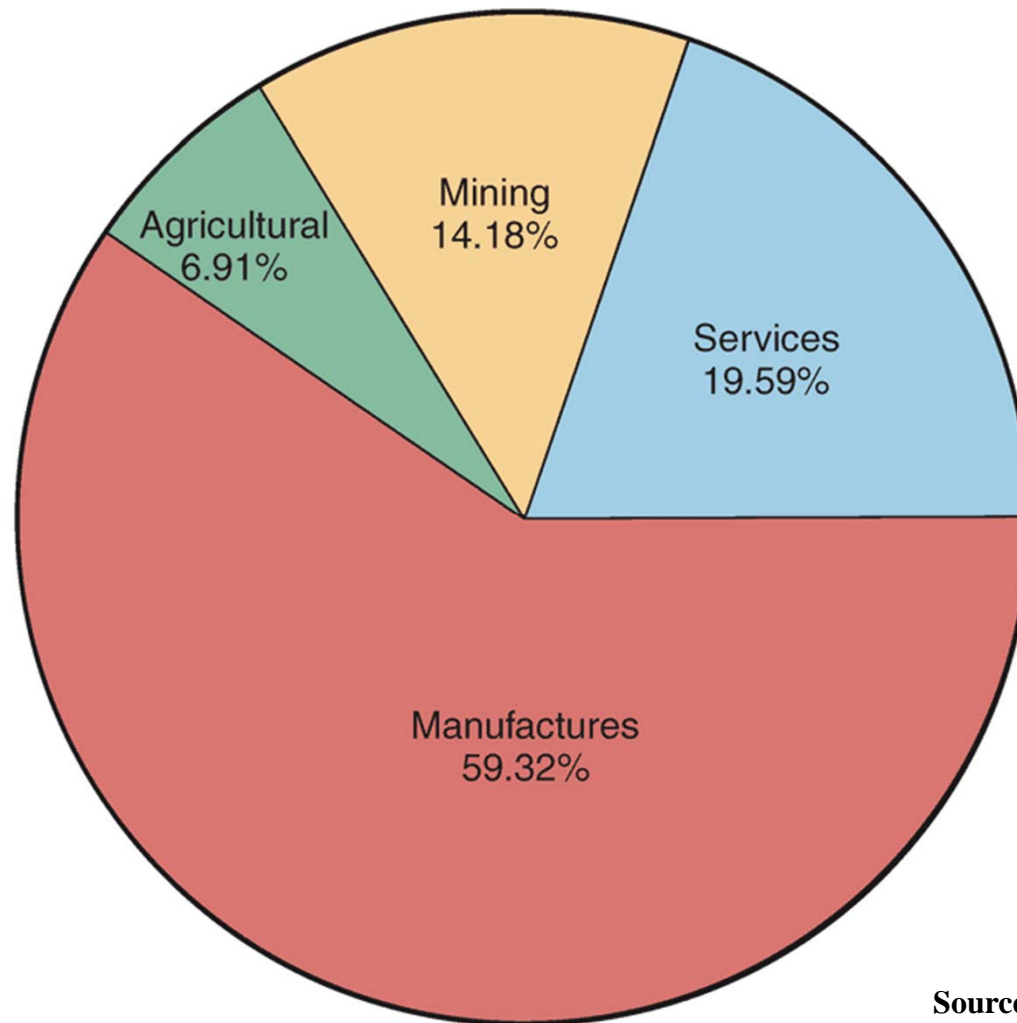


Changing Composition of Trade

- 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.



The Composition of World Trade, 2005



Source: World Trade Organization



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.

	<u>United Kingdom</u>		<u>United States</u>	
	Exports	Imports	Exports	Imports
1910	75.4	24.5	47.5	40.7
2002	82.6	80.4	82.1	77.8

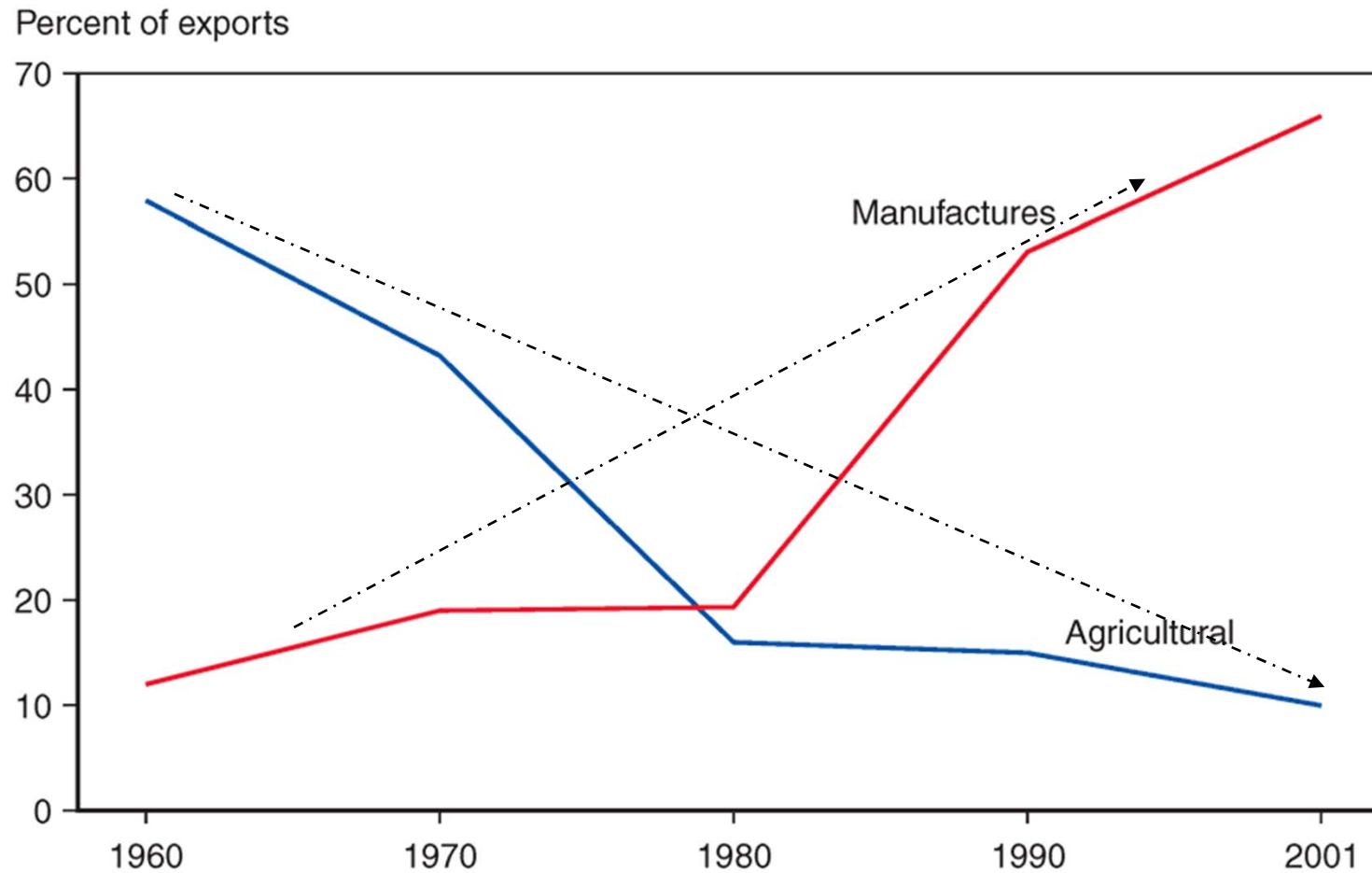
Source: 1910 data from Simon Kuznets, *Modern Economic Growth: Rate, Structure and Speed*. New Haven: Yale Univ. Press, 1966. 2002 data from World Trade Organization.



Changing Composition of Trade

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

The Changing Composition of Developing-Country Exports



Source: United Nations Council on Trade and Development



The Increasing Role of Multinational Firms

- Foreign-owned multinationals (or MNEs) employ **one worker in every five (or 20%)** in European manufacturing, and **one in every seven (or 14.3%)** in US manufacturing.
- MNEs sell **one Euro in every four (or 25%)** of manufactured goods in Europe; and **one dollar in every five (or 20%)** in the US.
- The gross product (value added) of all MNEs was **roughly 25%** of the world's GDP in 1997.
- The **Intrafirm Trade** (or trade within MNE and between affiliates) accounts for **1/3** of world's total trade volume.
- Further, **another 1/3 of world trade** is accounted for by transactions in which MNEs are in one of the two sides of the exchange.
- **The 700 largest MNEs** account for roughly **50%** of world R&D spending, or **70%** of world business R&D spending (excluding government R&D).



For the Next Class

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