

# Economics @ Lady Margaret Hall

## International Economics

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Please find attached reading lists for this term's tutorials on International Economics. You are encouraged to read widely for this paper and to venture off the reading list! Readings that are especially recommended are marked with an asterisk, all other references appear in alphabetical order.

We will alternate between tutorials and classes. For the tutorial I expect you to write an essay (to be handed in at the tutorial itself) and for the classes I expect you to prepare answers to the questions given and to be prepared to defend these in class.

Tutorials and classes will take place in my LMH office: flat 2, 1 Fyfield Road. If you walk along Norham Gardens towards LMH, 1 Fyfield Road is just on the corner about 40 yards before the LMH porters' lodge. It is a large house with two front doors. Come to the left hand front door and ring the top left bell.

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### Recommended textbooks:

Krugman, P. and Obstfeld, M. (2003) *International Economics: Theory and Policy* (Addison Wesley, 6<sup>th</sup> edition).  
Caves, Frankel and Jones (1999) *World Trade and Payments : an Introduction* (Harper Collins, 8<sup>th</sup> edition).

In addition, Williamson, J. and Milner, C. (1991) *The World Economy* (Harvester Wheatsheaf) is useful but at a lower level than the other two books. Sodersten, B. and Reed, G. (1994) *International Economics* (Macmillan, 3<sup>rd</sup> edition) may also be of use.

Good sets of readings are provided by:

Krugman, P. (1990) *Strategic Trade Policy and New International Economics* (MIT Press).

Krugman, P. (1990) *Rethinking International Trade* (MIT Press).

Krugman, P. (1992) *Currencies and Crises* (MIT Press).

Jones, R. and Kenen, P. (1984) *Handbook of International Economics* (North Holland).

Van der Ploeg, F. (1994) *Handbook of International Macroeconomics* (Blackwells).

Greenaway, D. (1985) *Current Issues in International Trade* (Macmillan).

Also of use are Corden, W. (1997) *Trade Policy and Economic Welfare* (Oxford, 2<sup>nd</sup> edition) and Corden, W. (1994) *Economic Policy, Exchange Rates and the International System* (Oxford).

You may also find the following books of general interest:

Krugman, P. (1994) *Peddling Prosperity* (Norton).

Bhagwati, J. (2000) *The Wind of the Hundred Days: How Washington Mismanaged Globalization* (MIT Press).

## **Week One: Tutorial**

### **The Positive Theory of International Trade**

#### **Readings:**

The first topic is simply an introduction to the workhorse models of international trade, especially the Heckscher-Ohlin and Ricardian models. Krugman and Obstfeld (2003) give a clear introduction to the issues. You should certainly try to understand the three main predictions of the Heckscher-Ohlin model: factor price equalization, Stolper-Samuelson, and the Rybczynski Theorem. These are well explained in Sodersten and Reed (1994), as well as Kierzkowski (1987). It will also be worth reading up on the Leontief paradox.

#### **Essay:**

Outline the Heckscher-Ohlin, Specific Factors, and Ricardian models of Comparative Advantage. How do they differ? Which do you think is more empirically attractive?

#### **References:**

- \* Krugman, P. and Obstfeld, M. (2003) *International Economics: Theory and Policy* (Addison Wesley, 6<sup>th</sup> edition). chapters 2-5.
  - \* Caves, Frankel and Jones (1999) *World Trade and Payments : an Introduction* (Harper Collins, 8<sup>th</sup> edition), chapters 5-7.
  - \* Kierzkowski, H. (1987) 'Recent Advances in International Trade Theory: A Selective Survey', *Oxford Review of Economic Policy*, vol. 3, no. 1, reprinted in Jenkinson, T. (2000) *Readings in Microeconomics*, 2<sup>nd</sup> ed (OUP).
- Jones, R. and Kenen, P. (1984) *Handbook of International Economics* (North Holland), chapter 1.
- Sodersten, B. and Reed, G. (1994) *International Economics* (Macmillan, 3<sup>rd</sup> edition), chapters 1-5.
- Williamson, J. and Milner, C. (1991) *The World Economy* (Harvester Wheatsheaf), chapters 1-3, 7.4.

## Week Two: Class

### The Normative Theory of International Trade

#### Readings:

It is quite rare to observe fully free trade in practice. Instead, countries often resort to protectionism. This tutorial attempts to explain the theory of protectionism. Krugman and Obstfeld (2003) is a good place to start. Oxfam (2002) is a nice polemic about fair trade – careful thought is needed to relate this to free trade? Bhagwati (2000) is a powerful proponent of increased efforts to ensure free trade. The World Bank website is a good place to look for information on trade rules and globalisation.

#### Questions for Discussion:

1. What are the domestic effects of a tariff on consumer surplus, producer surplus and government revenue. What is the overall effect of a tariff for a small country?
2. What are the effects of a tariff for a large country?
3. What are the effects of export subsidies, import quotas, and voluntary export restraints?
4. What is the effect of a tariff on domestic income distribution? Is this a good argument for a tariff?
5. What are the other standard arguments for tariffs? Why are they second-best policies?
6. Is free trade different from fair trade? What is the effect of a fair trade policy on domestic and foreign welfare?

#### References:

- \* Krugman, P. and Obstfeld, M. (2003) *International Economics: Theory and Policy* (Addison Wesley, 6<sup>th</sup> edition), chapters 8-10.
  - \* Caves, Frankel and Jones (1999) *World Trade and Payments : an Introduction* (Harper Collins, 8<sup>th</sup> edition), chapters 10,13.
  - \* Jones, R. and Kenen, P. (1984) *Handbook of International Economics* (North Holland), chapter 2.
- Bhagwati, J. (2000) *The Wind of the Hundred Days: How Washington Mismanaged Globalization* (MIT Press), chapters 7-10.
- Dollar, D. and Kraay, A. (2002) 'Growth is Good for the Poor', *Journal of Economic Growth*, [http://econ.worldbank.org/files/22015\\_Growth\\_is\\_Good\\_for\\_Poor.pdf](http://econ.worldbank.org/files/22015_Growth_is_Good_for_Poor.pdf)
- Krugman, P. (1990) *Strategic Trade Policy and New International Economics* (MIT Press), chapter 1.
- Oxfam (2002) *Rigged Rules and Double Standards: trade, globalisation and the fight against poverty* <http://www.maketrade-fair.com/stylesheet.asp?file=26032002105549&cat=2&subcat=6&select=13>
- Sodersten, B. and Reed, G. (1994) *International Economics* (Macmillan, 3<sup>rd</sup> edition), chapters 10-12.

## Week Three: Class

### Strategic Trade

#### Readings:

In the 1980s, trade theory made significant advances when it started to consider the role of increasing returns and monopolistic industries. Krugman's work was very important in this process, so Krugman (1990) is an important reading. Greenhalgh (1990) and Harrigan (1997) both suggest an important role for technology in explaining trade flows. Thurow (1992) is interesting nonsense.

#### Essay:

'In a world of monopolistic competition, traditional trade theory is useless'. Discuss.

#### References:

- \* Krugman, P. and Obstfeld, M. (2003) *International Economics: Theory and Policy* (Addison Wesley, 6<sup>th</sup> edition), chapters 6,7,11.
- \* Harrigan, J. (1997) 'Technology, Factor Supplies, and International Specialization: Estimating the Neoclassical Model', *American Economic Review*, 4, 475-494.
- \* Krugman, P. (1990) *Rethinking International Trade* (MIT Press).
- Bliss, C. (1987) 'The New Trade Theory and Economic Policy', *Oxford Review of Economic Policy*, vol. 3, no. 1, reprinted in Jenkinson, T. (2000) *Readings in Microeconomics*, 2<sup>nd</sup> ed (OUP).
- Caves, Frankel and Jones (1999) *World Trade and Payments : an Introduction* (Harper Collins, 8<sup>th</sup> edition), chapter 8,12.
- Greenaway, D. and Milner, C. (1985) *The Economics of Intra Industry Trade* (Blackwells).
- Greenhalgh, C. (1990) 'Innovation and Trade Performance in the UK', *Economic Journal*, vol. 100, no. 400.
- Krugman, P. (1994) *Peddling Prosperity* (Norton).
- Sodersten, B. and Reed, G. (1994) *International Economics* (Macmillan, 3<sup>rd</sup> edition), chapters 8,9, 13.
- Thurow, L. (1992) *Head to Head: the coming economic battle among Japan, Europe and America* (Morrow).
- Van der Ploeg, F. (1994) *Handbook of International Macroeconomics* (Blackwells), chapter 2.
- Williamson, J. and Milner, C. (1991) *The World Economy* (Harvester Wheatsheaf), chapter 5,6,10.4.

## Week Four: Class

### Customs Unions and Regionalism

#### Readings:

For much of the postwar period, the GATT and WTO focussed on multilateral trade arrangements. Recently, there has been more emphasis on bilateral trade arrangements. Wonnacot and Wonnacot (1981) is the classic reference on why unilateral tariff reduction is such a great policy. It is worth reading about the effects of EU integration and NAFTA to understand the economic processes as work.

#### Questions for discussion:

1. How does a customs union differ from a free trade area?
2. What is trade creation?
3. What is trade diversion and trade deflection?
4. Under what conditions will trade creation outweigh trade diversion?
5. Are the arguments for free trade in capital the same as those for free trade in goods?
6. Is regionalism a threat to world trade efficiency?

#### References:

- \* Krugman, P. and Obstfeld, M. (2003) *International Economics: Theory and Policy* (Addison Wesley, 6<sup>th</sup> edition), chapter 9.
- \* Krugman, P. (1993) 'Regionalism versus multilateralism: analytical notes' chapter 3 in De Melo, J. and Panagariya, A. eds. *New Dimensions in Regional Integration* (Cambridge University Press).
- \* Wonnacot, P. and Wonnacot, R. (1981) 'Is Unilateral Tariff Reduction Preferable to a Customs Union? The Curious Case of the Missing Foreign Tariffs', *American Economic Review* vol. 71.

Badinger, H. (2001) 'Growth Effects of Economic Integration – the case of the EU member states (1950-2000)', IEF Working Paper No. 40, <http://fgr.wu-wien.ac.at/institut/ef/wp/WP40.pdf>

Bhagwati, J. (2000) *The Wind of the Hundred Days: How Washington Mismanaged Globalization* (MIT Press), chapters 25-30.

Burfisher, M., Robinson, S., and Thierfelder, K. (2001) 'The Impact of NAFTA on the United States', *Journal of Economic Perspectives*.

El-Agraa, A. (2001) *The European Union: Economics and Policies* (Prentice-Hall: Harlow) 6<sup>th</sup> edition, chapters 5, 7 and 8.

Sapir, A. (1993) 'Regionalism and the New Theory of International Trade', *World Economy*.

Sodersten, B. and Reed, G. (1994) *International Economics* (Macmillan, 3<sup>rd</sup> edition), chapter 16.

## Week Five: Tutorial

### Internal and External Balance with floating and fixed exchange rates

#### Readings:

The Mundell-Fleming model and the Salter-Swan model are the workhorse models for thinking about internal and external balance, and are well described in many of the references. Krugman (1992) is a great reference for the reminder that it is important to always remember the national income accounting identity and also links the issue to the great debate between Ohlin and Keynes on the effect on transfers between countries on trade balances. It is well worth refreshing your memory on such important, but basic, topics as the definition of the current and capital accounts, and the relationship between national saving and the external balance.

#### Essay:

Starting from a position of current account deficit is a devaluation necessary or sufficient in order to achieve balance on the current account? Is current account balance desirable?

#### References:

- \* Krugman, P. and Obstfeld, M. (2003) *International Economics: Theory and Policy* (Addison Wesley, 6<sup>th</sup> edition), chapters 12-13.
- \* Caves, Frankel and Jones (1999) *World Trade and Payments : an Introduction* (Harper Collins, 8<sup>th</sup> edition), chapters 15-20.
- \* Krugman, P. (1992) *Currencies and Crises* (MIT) chapters 1 and 2.
- Bliss, C. (1990) 'Unbalanced Payments: Adjustment and Policy', *Oxford Review of Economic Policy*, Autumn.
- Cuthbertson, K. and Taylor, M. (1987) 'Macroeconomic Systems' (Blackwell) chapter 5.
- Krueger, A. (1983) *Exchange Rate Determination* (Cambridge).
- Sodersten, B. and Reed, G. (1994) *International Economics* (Macmillan, 3<sup>rd</sup> edition), chapters 23-26.
- Williamson, J. and Milner, C. (1991) *The World Economy* (Harvester Wheatsheaf), chapter 12.

## Week Six: Class

### Floating Exchange Rates: theory and evidence

#### Readings:

Policymakers often claim to dislike the volatility of floating exchange rates. But why are they so volatile? The standard model is due to Dornbusch and can be found in most of the readings. The model draws upon both the theory of Purchasing Power Parity and the theory of Interest Parity.

#### Questions for discussion:

1. Describe and assess the theory of Purchasing Power Parity.
2. Why are price levels lower in poor countries?
3. Describe and assess the theory of Interest Parity and the Fisher effect.
4. Describe and assess the Dornbusch overshooting model. Does volatility matter?
5. Will the exchange rate overshoot following a fiscal expansion?
6. Can sterilized foreign exchange intervention work?

#### References:

- \* Krugman, P. and Obstfeld, M. (2003) *International Economics: Theory and Policy* (Addison Wesley, 6<sup>th</sup> edition), chapters 13-16.
- \* Taylor, M. P. (1995) 'The Economics of Exchange Rates' *Journal of Economic Literature* Vol.33(1) March, pp.13-47.
- \* Krugman, P. (1992) *Currencies and Crises* (MIT) chapter 3.
- Caves, Frankel and Jones (1999) *World Trade and Payments: an Introduction* (Harper Collins, 8<sup>th</sup> edition), chapters 20,23,24, 26,27.
- Cote, A. (1994) 'Exchange Rate Volatility and Trade: A Survey', Bank of Canada working paper 94-5:  
<http://www.bankofcanada.ca/publications/working.papers/1994/wp94-5.pdf>
- Froot, K.A. and Rogoff, K. (1995) 'Perspectives on PPP and long-run real exchange rates', chapter 32 in G.M. Grossman and K. Rogoff (eds.) *Handbook of International Economics*, Volume 3, North Holland.
- Frankel, J.A., and Rose A.K. (1995) 'Empirical Research on Nominal Exchange Rates', chapter 33 in G.M. Grossman and K. Rogoff (eds.) *Handbook of International Economics*, Volume 3, North Holland.
- \* Sodersten, B. and Reed, G. (1994) *International Economics* (Macmillan, 3<sup>rd</sup> edition), chapters 27-28.
- Williamson, J. and Milner, C. (1991) *The World Economy* (Harvester Wheatsheaf), chapter 14.

## Week Seven: Tutorial

### Exchange Rate Management

#### Readings:

European political leaders have been obsessed by exchange rate stability since the breakup of the Bretton Woods system. With the EMU project having finally led to a single currency, there is now great pressure on the UK to join. De Grauwe (2000) is a great introduction to the issues, while HMT (1997) gives a clear account of the five tests. Forder and Huhne (2001) is a chatty introduction. See also my OECD lecture on this topic:

<http://www.nuff.ox.ac.uk/Users/Cameron/lmh/lectures/oecd.html>

#### Essay:

Is Europe an optimum currency area?

#### References:

- \* Krugman, P. and Obstfeld, M. (2003) *International Economics: Theory and Policy* (Addison Wesley, 6<sup>th</sup> edition), chapter 20.
- \* de Grauwe, P. (2000) *Economics of Monetary Union* (OUP: Oxford), 4<sup>th</sup> ed.
- \* H.M. Treasury (1997) *UK Membership of the Single Currency: An Assessment of the Five Economic Tests* (H.M. Treasury: London): <http://www.hm-treasury.gov.uk/mediastore/otherfiles/single.pdf>
- Artis, M. and Nixon, F. (2001) *The Economics of the European Union* (OUP: Oxford) 3<sup>rd</sup> ed, chapters 12 (Artis and Bladen-Hovell) and 13 (Ongena and Winkler).
- Bernanke, B., Laubach, T., Mishkin, F. and Posen, A. (1999) *Inflation Targeting* (Princeton University Press: Princeton), chapter 12.
- Blanchard, O. and Giavazzi, F. (2002) 'Current Account Deficits in the Euro Area: The End of the Feldstein-Horioka Puzzle?', *NBER Macroeconomics Annual*.  
<http://econ-www.mit.edu/faculty/blanchar/files/draft1f3.pdf>
- Caves, Frankel and Jones (1999) *World Trade and Payments : an Introduction* (Harper Collins, 8<sup>th</sup> edition), pp. 522-7.
- Economic Policy* (1998) Issue No 26 especially papers by Dornbusch et al, Eichengreen & Wyplosz and Obstfeld & Peri.
- Forder, J. and Huhne, C. (2001) *Both Sides of the Coin* (London: Profile Books), 2<sup>nd</sup> edition.
- Nitsch, V. (2002) 'Honey, I Shrunk the Currency Union Effect on Trade', *World Economy*, 25, 4, 457-474.
- Oxford Review of Economic Policy*, 1998, Vol 14, No 3, issue on EMU (particularly Assessment by Allsopp & Vines, papers by Eichengreen, Artis and MacLennan, Muellbauer & Stephens).



## Week Eight: Class

### International Financial Crises

#### Readings:

Many countries have adopted free trade in capital over the past two decades only to find that they have subsequently suffered major financial crises. Is it the case that countries only suffer crises when they are pursuing bad policies, or do 'bad things happen to good countries'. Krugman (1992) and Bhagwati (2000) give excellent discussions. Recent accounts of financial crises describe them as coordination games (see Agenor et al., 1999). One significant problem countries face is that it is often difficult to borrow in their own currency so that if they devalue, the value of their foreign debt massively increases leading to widespread foreign bankruptcies. This leads to two questions: why can't they borrow in domestic currency (Calvo and Reinhart, 2000) and should debt ever be forgiven (Krugman, 1992 and Jubilee 2000)?

#### Questions for discussion:

1. Why do developing countries find it so hard to borrow in their own currencies?
2. Give an account of any recent financial crisis, such as Mexico, Argentina, or Asia.
3. Are currency crises self-fulfilling events?
4. To what extent are crises actually contagious?
5. What can be done, a) within a country and b) globally, to prevent and mitigate financial crises?
6. Should international debts be forgiven?

#### References:

- \* Krugman, P. and Obstfeld, M. (2003) *International Economics: Theory and Policy* (Addison Wesley, 6<sup>th</sup> edition), chapter 17, 21, 22.
- \* Krugman, P. (1992) *Currencies and Crises* (MIT Press), chapters 4-6 and 7-9.
- Portes, R. and Vines, D. (1997) *Coping with International Capital Flows* London: Commonwealth Secretariat
- \* Agenor, R., Miller, M., Vines, D, and Weber, A. (1999) *The Asian Financial Crises: Causes, Contagion, and Consequences*. Cambridge: Cambridge University Press, especially chapter by Shin and Morris.
- Bhagwati, J. (2000) *The Wind of the Hundred Days: How Washington Mismanaged Globalization* (MIT Press), chapters 4-6.
- Bird, G. and Milne, A.. (2003) 'Debt Relief for Low Income Countries: Is it Effective and Efficient?', *World Economy*, 26, 1, 43-59
- Calvo, G. and Reinhart, C. (2000) 'Fear of Floating', NBER working paper 7993:  
<http://papers.nber.org/papers/W7993>
- Fischer, S (1999) 'On the need for an International Lender of Last Resort'. Paper presented to the annual meetings of the American Economic Association and available at <http://www.imf.org/external/np/speeches/1999/010399.htm>
- Jubilee 2000 (2000) *A beginner's guide to the debt crisis*,  
[http://www.jubilee2000uk.org/analysis/reports/beginners\\_guide/debt.htm](http://www.jubilee2000uk.org/analysis/reports/beginners_guide/debt.htm).
- Obstfeld, M. and Rogoff, K. (1995) 'The Mirage of Fixed Exchange Rates', *Journal of Economic Perspectives*, Vol 9, no 4 pp 73 - 96.