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Class meets: **Thurs. 6:20-9:00 in Whitehead 518**
Office hours: **before class or by appointment**
Undergrad: Econ 76.3 Section: ER6 Code: 3203
Graduate: Econ 727 Section: ER6 Code: 3202

International Trade

Brooklyn College – Fall 2006

After an introduction to key elements of trade theory, we will examine the reasons why free trade affects the distribution of income within a country and why some groups of people oppose free trade. We will also see how trade can increase competition and increases the varieties of a product available to consumers.

A prediction of all multi-factor trade models is that countries effectively trade factors of production (like capital or labor) when they trade in goods. If that were the case and if there is free trade in goods, then there should be no reason for people to migrate and firms to set up factories overseas. In reality however, people do migrate and firms do set up operations overseas, so we'll also examine immigration and foreign direct investment.

We'll also examine the policy tools that governments use to restrict trade and the reasons why they restrict trade. Finally, we'll examine the reasons why protecting domestic industries from competition has failed to raise per capita income in developing countries and the reasons why developing countries with an outward orientation succeeded in providing their citizens with a higher standard of living.

Objectives of this Course

This course has two sets of objectives: practical and academic. The practical objectives aim to teach you how to apply mathematics and economics in daily life. The academic objectives (which are listed with the class schedule) aim to teach you the economic theory about how countries gain from trade and what determines the pattern of trade.

The practical objectives consist of:

- enabling you to interpret graphs and equations, both mathematically and intuitively,
- developing your logical thinking skills and
- teaching you how to test the theoretical relationships between dependent and independent variables.

Course Requirements

Your final grade will be determined by a weighted average of a mid-term exam (35 percent), a final exam (45 percent) and the quality of your class participation (20 percent).

The exams will consist of a set of problems and a set of short essays.

Homework will be assigned and the solutions will be reviewed in class, but I will not collect them and I will not grade them. If you read the course material and do the homework regularly, you will develop a

good understanding of the course material and you will score higher on the exams. If you only read the course material the night before the exam, don't expect to pass.

Finally, in evaluating the quality of your class participation, I will consider:

1. your attitude towards the course material,
2. how well you demonstrate an understanding of the required readings and homework assignments and
3. how often you ask intelligent questions in class.

Saying "I don't understand" and explaining what you don't understand and why you don't understand it is one of the most intelligent things you can do. It demonstrates curiosity and interest in the course material. By contrast, sitting in silence when you don't understand is one of the dumbest things you can do.

One Cigarette Rule

Two and a half hours is a long time to sit and listen to me talk. To keep you fresh, I will give you a break about halfway through the class session. The break will be just long enough to run downstairs, smoke ONE cigarette and come back.

Do not smoke two cigarettes. Do not go to McDonald's. Do not come back late.

Attendance Policy

Come and go as you please, but keep in mind that the lectures are an important part of the course. If you're not here, it's going to be a lot harder to understand the course material. Poor attendance will also adversely affect my evaluation of your class participation.

For example, if you never come to a single class, but somehow manage to ace both exams (which is highly unlikely), your final grade would be a B-plus – that's 80 percent of an A (4.0).

Exam Make-Up Policy

Any student who is either unable to attend class on the day of the exam or simply doesn't feel like coming to class on the day of the exam, doesn't have to come. There's no need to contact me or explain the reason for your absence. Just don't come.

If you miss the mid-term exam, you will be expected to submit a take-home examination within two weeks of the class immediately following the mid-term exam. No exceptions.

If you miss the final exam, you will have to make it up during departmental exams next semester.

In deciding whether or not to come to class on the day of the exam, keep in mind that I see absolutely no reason why the difficulty of the take-home exam or the departmental exam should be comparable to that of the in-class exam.

If I were in your shoes, I would come to class on the day of the exam.

Instant Replay Rule

If you do not do well on an exam and would like to improve your grade by doing the make-up exam, I'll look very favorably upon your efforts.

For those of you who would like to improve your grade by haggling with me over points, we'll play by the "Instant Replay Rule." If your complaint has merit, I'll fix your grade. If your complaint does not have merit, it will cost you one whole letter grade.

Policy on Cheating

Don't even think about it. I will catch you and I will pursue the harshest penalty that the college allows.

What you should think about is the reputation of your school. If Brooklyn College were to develop a reputation for tolerance of cheating, then potential employers would consider completion of a degree at Brooklyn College to be a trivial accomplishment and your investment of time, money and energy at this school will have been squandered.

Use of notes during an in-class exam is cheating. Don't do it. Copying material from a website on a take-home exam is cheating. Don't do it.

If you think I won't know if you copied material from a website on a take-home exam, you're wrong.

What to Expect

I have an easy-going attitude, but don't expect an easy A. I work hard and I expect the same from you.

I'll give you all the help you need, but don't expect me to spoon-feed you the answers. This is college. Come prepared to ask me questions. Don't waste my time.

Graduate students are expected to read ALL of the assigned material. I have not cluttered the syllabus with hundreds of articles. Instead I have assigned a short list, so that I can reasonably expect you to develop a strong comprehension of each chapter and article.

I don't see things in black and white. I am incapable of answering a question with a simple "yes" or "no." I look for the complexity in an issue and seek to understand it.

If you get impatient with someone who takes their time to answer a question or goes into too much detail, then I'm probably not the professor for you.

On the other hand, if you want to learn how to analyze an issue and come to a well-reasoned conclusion, then you're in the right place.

Textbooks

- Krugman, Paul R. and Maurice Obstfeld. (KO) *International Economics: Theory and Policy*. Addison Wesley. ISBN: 0-321-27884-4
- Pearce, David W. (ed.) *The MIT Dictionary of Modern Economics*. ISBN: 0-262-66078-4

Graduate students are also expected to read:

- Feenstra, Robert C. *Advanced International Trade*. Princeton University Press. ISBN: 0-691-11410-2



Part One – Why do Nations Trade?

Lecture 1: Introduction and the Ricardian Model

- The Ricardian Model introduces you to the key elements of trade theory: unit labor requirements, opportunity costs, comparative advantage, relative prices and gains from trade.

read: **KO chaps. 1 and 2** and do: **HW #1**

also read: **Krugman. “Competitiveness ...”**

Krugman, Paul. “Competitiveness: A Dangerous Obsession.” *Foreign Affairs*. Mar-Apr 1994, Vol. 73 Issue 2, p. 28-44.

Lecture 2: the Specific Factors Model and the Distribution of Income

- This Specific Factors Model incorporates two more factors of production into a trade model to explain how trade can affect the distribution of income within a country. It gives us a first look at the reasons why some groups of people oppose free trade.

read: **KO chap. 3** and do: **HW #2**

Lecture 3: the Heckscher-Ohlin Model, the Stolper-Samuelson Effect and the Rybczyński Effect

- According to the Heckscher-Ohlin Model, the pattern of trade between two countries depends on their relative abundance of factors of production. The country exports goods whose production is relatively intensive in factors of production in which the country is relatively well-endowed. Owners of those factors gain from trade. Owners of relatively scarce factors lose.
- Graduate students should pay particular attention to Feenstra’s discussion of tests of the model.

read: **KO chap. 4** and do: **HW #3**

readings for graduate students

Feenstra chaps. 1, 2 and 3

Jones, Ronald W. “The Structure of Simple General Equilibrium Models.” *Journal of Political Economy*. vol. 73, no. 6. Dec. 1965. p. 557-72.

Jones, Ronald W. and Jose A. Scheinkman. “The Relevance of the Two-Sector Production Model in Trade Theory.” *Journal of Political Economy*. vol. 85, no. 5. Oct. 1977. p. 909-36.

Part Two – More Trade Theory

Lecture 4: Economies of Scale and Imperfect Competition

- The Ricardian, Specific Factors and Heckscher-Ohlin Models all assume constant returns to scale and perfect competition, but when firms in an industry face increasing returns to scale (i.e. average costs decreases over all ranges of output), large firms will have an advantage over small firms and industries will become monopolized.
- If firms specialize in producing a unique variety however, trade creates competition among the monopolies which reduces the number of firms operating in each country, raises the real wage and increases the number of varieties available to consumers.

read: **KO chap. 6**

Lecture 5: International Factor Movements

- In all of the models discussed up until this point, we assumed that factors of production (like labor and capital) are bound to a certain country. In reality however, people migrate and firms set up subsidiaries overseas. Trading factors as embodied in goods therefore may not be a perfect substitute for importing those factors directly.

read: **KO chap. 7**

also read: **Downes. “Terrible, Horrible ...”**

Downes, Lawrence. “The Terrible, Horrible, Urgent National Disaster That Immigration Isn’t.” *New York Times*. 20 June 2006. <http://select.nytimes.com/2006/06/20/opinion/21talking-points.html>

readings for graduate students

Feenstra chaps. 5 and 11

Card, David. “Immigrant Inflows, Native Outflows, and the Local Market Impacts of Higher Immigration.” *Journal of Labor Economics*. vol. 19, no. 1. Jan. 2001. p. 22-64.

Friedberg, Rachel M. and Jennifer Hunt. “The Impact of Immigrants on Host Country Wages, Employment and Growth.” *Journal of Economic Perspectives*. vol. 9, no. 2. Spring 1995. p. 23-44.



Part Three – Trade Policy

Lecture 6: the Instruments of Trade Policy

- An introduction to the policy tools that interfere with trade (tariffs, quotas and export subsidies), the effective rates of protection offered by such policies and the welfare effects of those policies.

read: **KO chap. 8**

Lecture 7: the Political Economy of Trade Policy

- Why the politicians don’t listen to the economists.

read: **KO chap. 9**

Lecture 8: Trade Policy in Developing Countries

- Many developing countries tried to build domestic industries by protecting them from competition with imports. Other countries industrialized by exporting. This lecture examines the reasons why import-substituting industrialization failed to raise levels of economic development and export-led growth strategies succeeded.

read: **KO chap. 10**

readings for graduate students

Feenstra chaps. 7 and 8

Dornbusch, Rudiger. "The Case for Trade Liberalization in Developing Countries." *Journal of Economic Perspectives*. vol. 6, no. 1. Winter 1992. p. 69-85.



Final Exam: Thurs. 21 Dec. from 6:00 to 8:00 pm