International Economics

BSc in Economics / Management

Fall 2020

Lecture 1

ISEG - Lisbon School of Economics and Management
Universidade de Lisboa

About me

Name: Paulo Bastos

Associate Professor, Department of Economics, ISEG-Lisbon School of Economics and Management, since 2019

Spent previous 7 years as Senior Economist at the Research Department of the World Bank, Washington DC

My main areas of expertise

International Trade, Labor Economics, Industrial Organization

More specifically:
– Firm performance in global markets
– Impacts of globalization on labor markets
– Multinational firms
– Links between globalization and technological change

More info on my research on: https://sites.google.com/view/paulobastos/

Introduction

Course outline: Methods and Topics

Course requirements: Grading, exam

International Trade: Some important facts

Main topics of this course

Study international trade in goods and services

Learn the economic forces that determine what that trade looks like:

- what products/services are traded?
- who trades them? (which countries? which firms? worker types?)
- what are the benefits and costs of trade?
- how does trade impact inequality?

Learn about policies that governments use to shape trade patterns.

Trade and investment policy: recent examples

Trade liberalization / Economic Integration:
- GATT (Uruguay round), now called WTO
- Unilateral trade liberalization (e.g. Latin America in the 1980s)
- Demise of communist bloc
- NAFTA (and current renegotiations)
- US/China trade war
- Brexit

Openness to Foreign Investment:
- Mostly high-income countries
- Eastern Europe
- East Asia, etc.

Think “General Equilibrium”

A key objective of this course: Learn how to think in terms of *general equilibrium*

Various markets adjust at the same time:

- **Import-competing vs. export-oriented goods markets**
- **Labor markets for different type of workers**
- **Capital markets**
- **Markets for land**
- **Trade balance**

If you focus just on one market and ignore adjustments in the others, you will likely get to the wrong conclusions

Bibliography

Main textbook:

Robert Feenstra and Alan Taylor, *International Economics*, 4th Edition, Worth Publishers (you can also use 2nd and 3rd editions, or *International Trade* by the same authors)

Other similar textbooks:

Paul Krugman, Maurice Obstfeld and Marc Melitz, *International Economics: Theory and Policy,* 11th Edition, Pearson.

Appleyard, D., Field, A. (2014), *International Economics*, 8th ed., McGraw-Hill.

Grading

Course outline: Methods and Topics

Course requirements: Grading, exams

International Trade: Some important facts

Road Map

- **Introduction**
  What are the objectives of this course? What are the fundamental issues? (Ch 1)

- **Comparative Advantage**
  Why do country differences create gains from trade?
  How does trade affect income distribution? (Chapters 2-4)

- **Multinational Firms and FDI**
  What effect does foreign investment have on wages?
  Why do some firms become multinationals while others do not? (Chapter 5)

- **Offshoring, Trade and Wages**
  What is offshoring?
  How is this trend different from earlier trends in globalization? (Chapter 7)

Road Map (cont.)

- **Increasing returns to scale & Imperfect Competition**

Does trade reduce monopoly power?
What are the gains from increasing variety of consumption goods?
Why is free trade with Spain is less controversial than free trade with China? (Chapter 6)

- **Trade Policy**

What types of policies affect international trade and how?
How trade policies of one country affect well-being in another? (Chapters 8 – 10)

- **Political Economy**

Why countries do not maximize welfare?
Why some interest groups are favored over others?

- **International Trade Agreements and Economic Integration**

What to make of the WTO?
What to make of the EU?
Why do we or do we not need agreements like the Kyoto protocol, TPP or TTIP? (Chapter 11)

Assessment and grading

Normal Period

1. Group presentation of a paper (30%);
2. Final written exam, without consultation, covering the full syllabus (70%);

The final exam is composed of:

(i) a first section with multiple-choice questions with four alternative answers. Each question correctly answered gives one point; each question incorrectly answered deducts 0.25 points.

(ii) a second section with open-ended questions.

The final grade is a weighted average of the grade in the group presentation and the final exam. The weight of the presentation is 30% and that of the final exam is 70%.

All students can take the final exam in the normal period. Grade of the group presentation will only be considered if it benefits the student.

Group presentation (3-5 students)

- You will join groups of 3-5 members to jointly prepare seminars for each practical session (which will be held on Tuesdays).

- You will be assessed collectively as members of a group. Groups will prepare a dynamic and engaging presentation of a paper.

- The specific paper and date for each presentation are indicated below. All papers will be made available for download in Aquila.

- Presentations will be made via MS Teams and will be streamed to all students (those in class and those attending online). Presentations can be made remotely or in class (if the student is allowed to attend in that week).

- The presentation should last about 40 minutes and will be followed by questions and answers from the audience.

- The slides should be submitted to the instructor by email at least 24 hours before the corresponding presentation.

Today, a file will be made available for you to form groups and select the paper/session in which you will be presenting;

Papers/calendar of presentations

Date	Paper
29/09/2020	Bernhofen, Daniel and John C. Brown (2004), "A direct test of the theory of comparative advantage: the case of Japan", Journal of Political Economy 112(1): 48-67.
13/10/2020	Autor, David, David Dorn and Gordon Hanson (2016), "The China Shock: Learning from Labor Market Adjustment to Large Changes in Trade," Annual Review of Economics, 8: 205-240.
20/10/2020	Bernard, Andrew, J. Bradford Jensen, Steve Redding and Peter Schott (2007), "Firms in International Trade", Journal of Economic Perspectives, 21(3), 105-130.
27/10/2020	Bastos, Paulo and Joana Silva (2012), "Networks, firms, and trade," Journal of International Economics, 87(2), 352-364.
03/11/2020	Atkin, David, Khandelwal and Adam Osman (2017), "Exporting and Firm Performance," Quarterly Journal of Economics, 132(2): 551-615.
10/11/2020	World Bank (2020), Trading for Development in the Age of Global Value Chains, World Development Report 2020 (Overview)
17/11/2020	Redding, Steve and Daniel Sturn (2008), "The Costs of Remoteness: Evidence from German Division and Reunification," American Economic Review, 98(5), 1766-1797.
24/11/2020	Bloom, Nicolas, Raffaella Sadun and John Van Reenen (2012), "Americans do I.T. Better: US Multinationals and the Productivity Miracle", American Economic Review, 102(1): 166-171.
07/12/2020	Javorcik, Beata and Torfinn Harding (2011), "Roll Out the Red Carpet and They Will Come: Investment Promotion and FDI Inflows," Economic Journal, 121(557): 1445-1476.
15/12/2020	Amiti, Mary, Steve Redding and David Weinstein (2019), "The Impact of the 2018 Trade War on U.S. Prices and Welfare," Journal of Economic Perspectives, 33(4): 187-210.

Assessment and grading

Appeal period

Final written exam, without consultation, covering the full syllabus of the course;

The final exam is composed of:

(i) a first section composed of multiple-choice questions with four alternative answers (each question correctly answered gives one point; each question incorrectly answered deducts 0.25 points);
(ii) a second section with open-ended questions;

If student was not approved in normal period, grade of the group presentation will be considered if it benefits the student.

Some important stylized facts about

- International Trade

- Foreign Direct Investment

Some basic definitions…

- Exports: Product sold from one country to another.
- Imports: Product purchased by one country from another.
- Trade surplus (resp. deficit): Total exports minus imports (resp. imports minus exports)
- Foreign Direct Investment (FDI): Investment and control in overseas affiliates

True of false?

“We live in a globalized world where international trade has become largely predominant.”

True of false?

"We live in a globalized world where international trade has become largely predominant."

Partly true

- In most countries, there is not that much international trade compared to domestic (local) transactions (especially in the US)
- The ratio of **Trade/GDP is small** for most large countries, but relatively large for small countries

Note:
Ratio can be > 100%
for some countries

Data (2010):
(Import + exports) / GDP

Country	Trade/GDP (%)	GDP ($ billion)
Hong Kong (China)	216	229
Singapore	193	213
Malaysia	85	247
Hungary	83	129
Thailand	68	319
Austria	52	377
Denmark	48	313
Sweden	46	463
Switzerland	46	552
Germany	44	3,284
Norway	35	418
United Kingdom	32	2,256
Mexico	31	1,035
Canada	30	1,577
China	29	5,931
Spain	28	1,380
Italy	28	2,044
South Africa	27	364
Greece	27	292
France	27	2,549
Russian Federation	26	1,488
India	25	1,684
Turkey	24	731
Indonesia	24	708
Venezuela	23	394
Argentina	20	369
Pakistan	17	176
Japan	15	5,488
United States	15	14,419
Brazil	11	2,143

True of false?

"Globalization is a new phenomenon."

True of false?

"Globalization is a new phenomenon."

False

- A first Globalization episode occurred in the late 19th century
- Great Britain, Shanghai, and various other regions were truly "globalized"

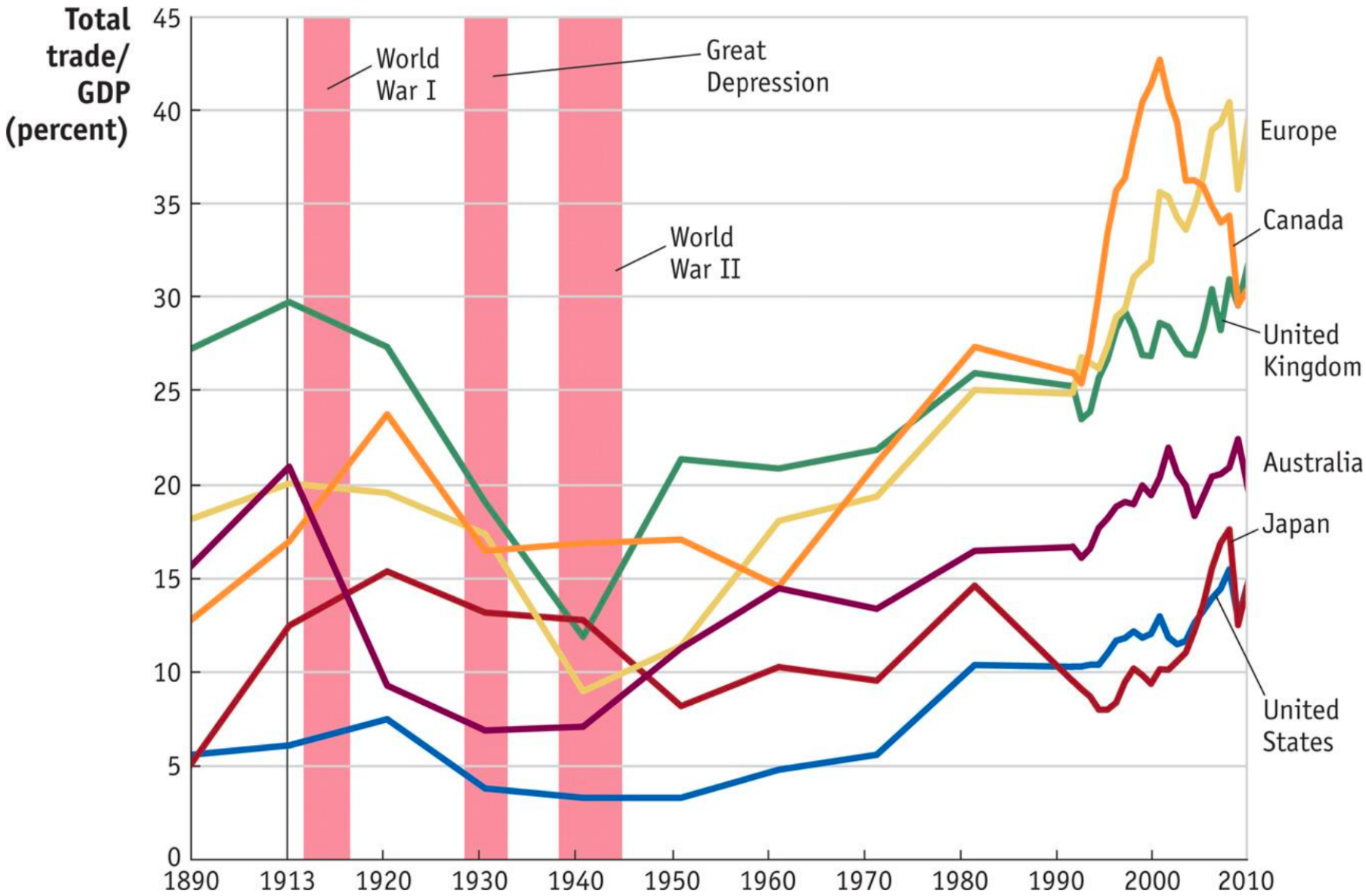


Figure 1.3 Trade in Goods and Services Relative to GDP

First Golden Age of Trade

- The period from 1890 until World War I (1914–1918) is often referred to as a “golden age” of international trade:
- Dramatic improvements in transportation (e.g. steamship and railroad) and communication (phone, telegraph)

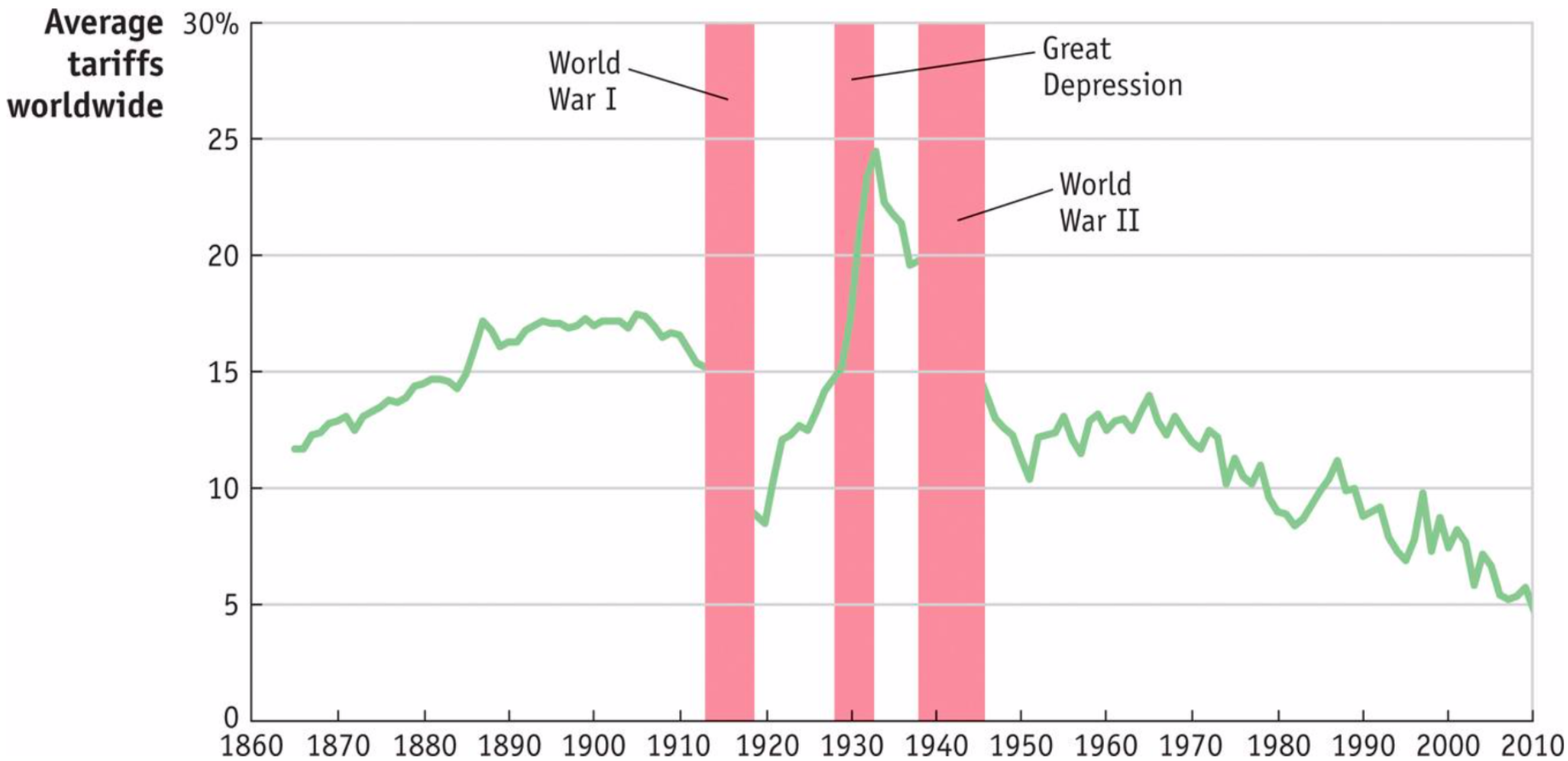


Figure 1.4 Average Worldwide Tariffs, 1860–2010

“Second Golden Age” of Trade

- In addition to the end of World War II and tariff reductions under the *General Agreement on Tariffs and Trade*, improved transportation costs contributed to the growth in trade
- e.g. shipping container invented in 1956
- World trade grew steadily after 1950 in dollar terms and as a ratio to GDP. For this reason, the period after 1950 is called the “***second golden age***” of trade and globalization.

“Globalization” over the past decades:

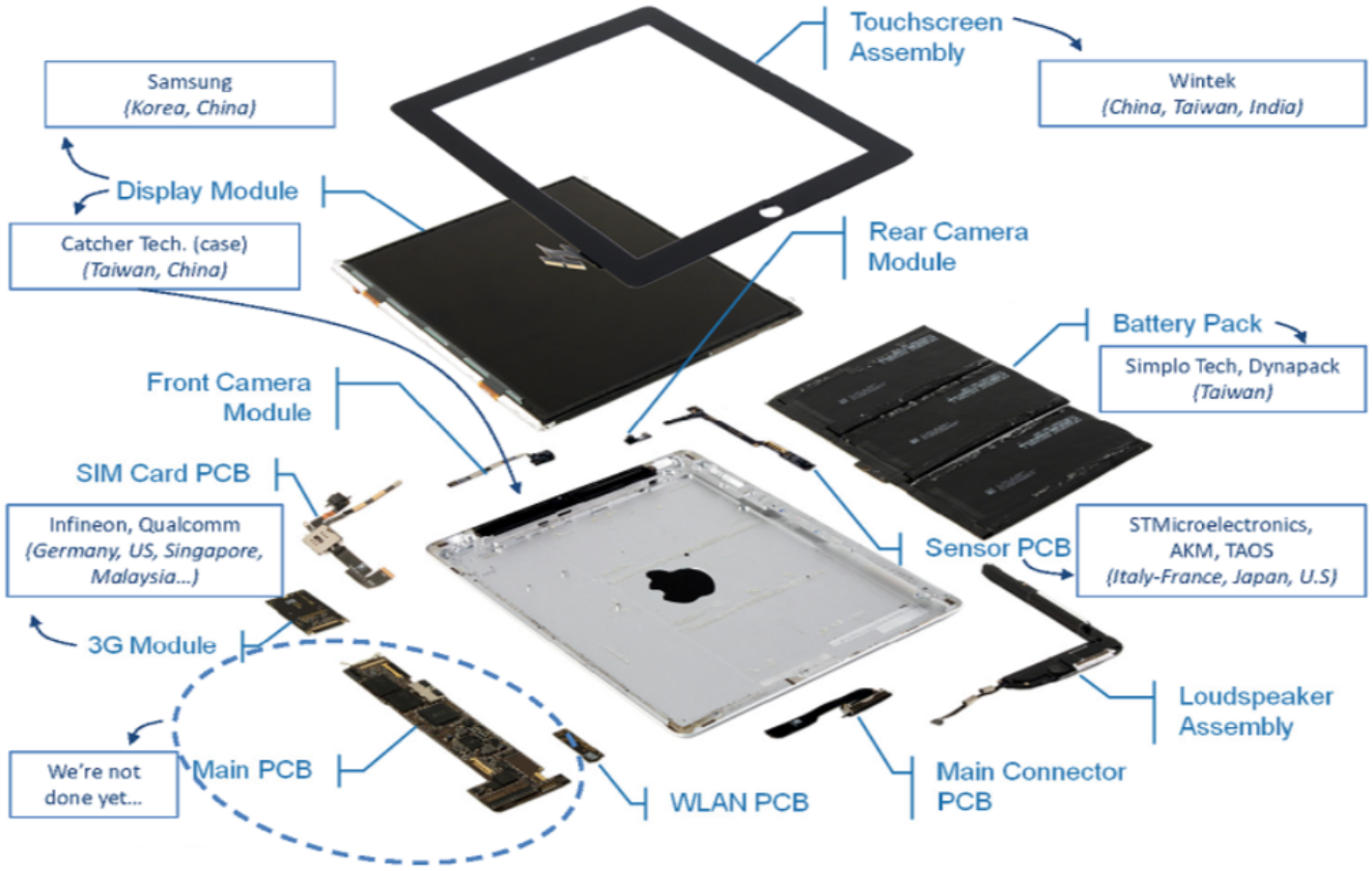
- Increasing flow of goods
- Increasing flow of services
- Increasing flow of capital
- Increasing flow of information, etc.

What’s new?

- Magnitude of trade flows and capital flows
- Communication technologies
- Fragmentation of production (e.g. ipad production chain)

Ipad global value chain – “Made in the world”

Designed by Apple in California, Assembled in China



Boeing global value chain – “Made in the World”

Forces shaping globalization

Technology

- Communication-enhancing (cell phones, email, internet, ...)
- Productivity-enhancing (computers, containerization,...)

Policy

- Trade liberalization
- FDI liberalization
- International Migration

True or False?

“we mostly trade consumer good such as food or iphones”

True or False?

“we mostly trade consumer good such as food or iphones”

False

Most trade is industrial supplies and capital goods (e.g. machinery)

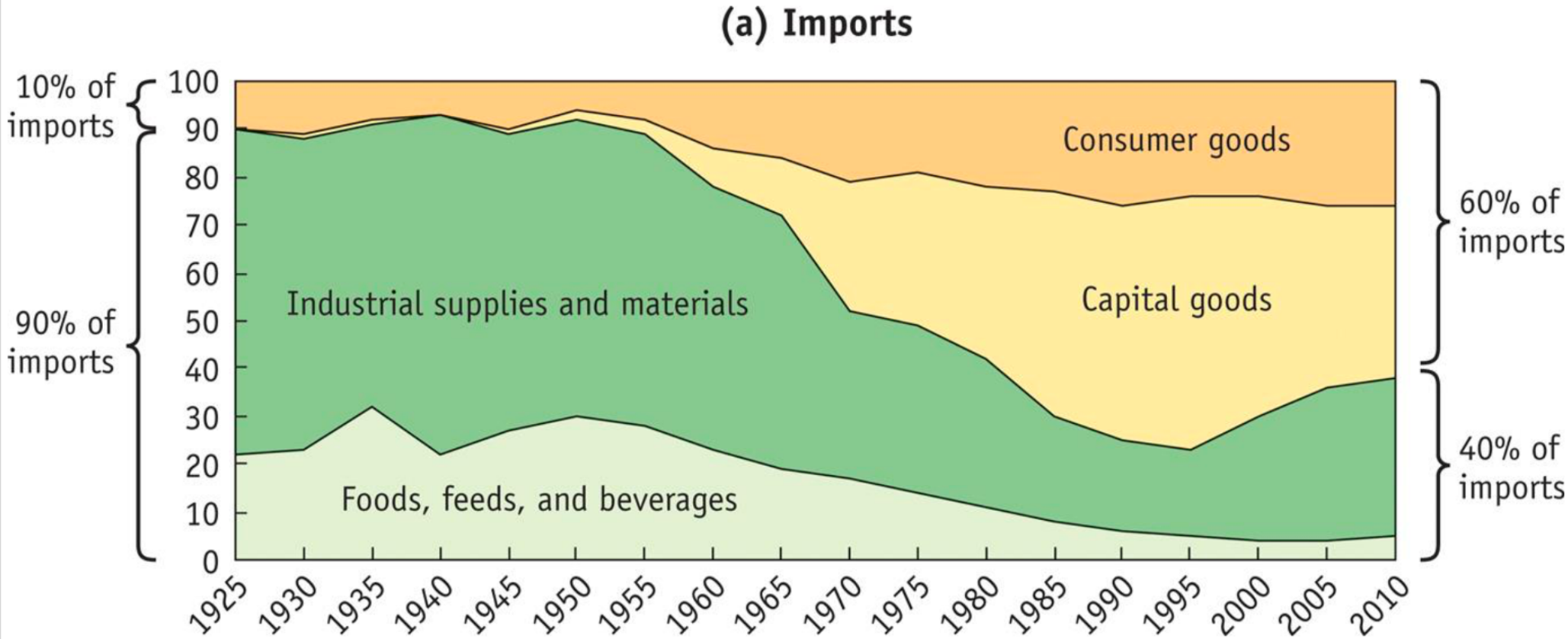


Figure 1.1 (a) The Changing Face of U.S. Import and Export Industries, 1925–2010

True or False?

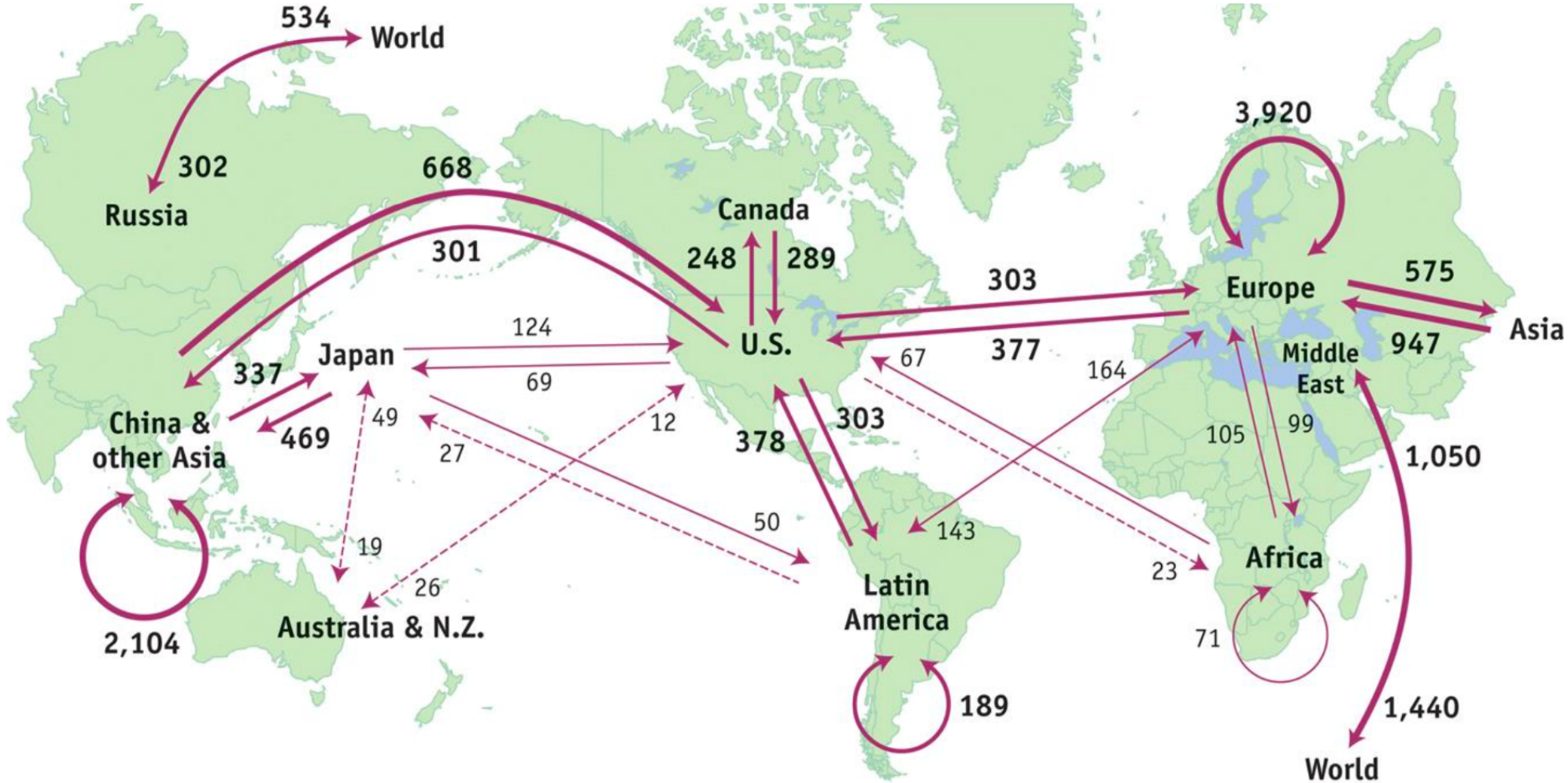
“Most trade is between rich and poor countries”

True or False?

“Most trade is between rich and poor countries”

False

Most trade is between rich countries that are close to each other

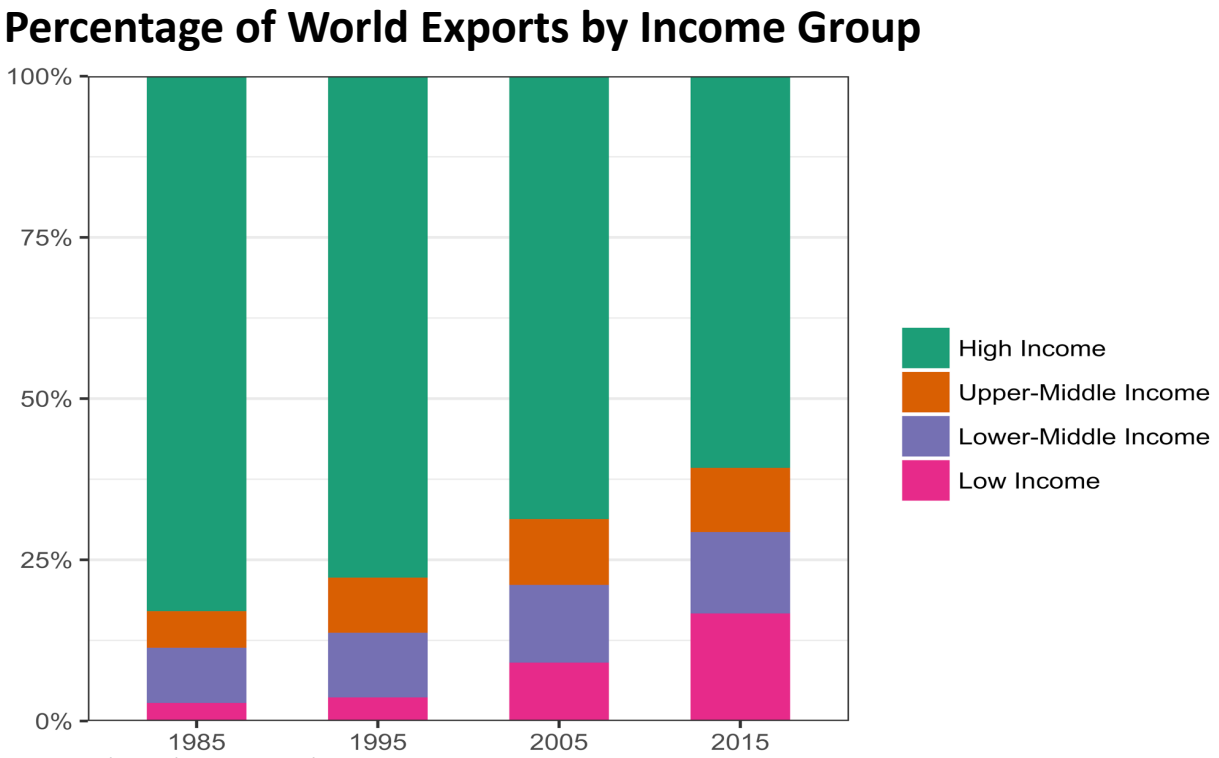


Total world trade flows in 2010: $16,800 billion

World Trade in Goods

- < $50 billion
- $50–150 billion
- $150–500 billion
- > $500 billion

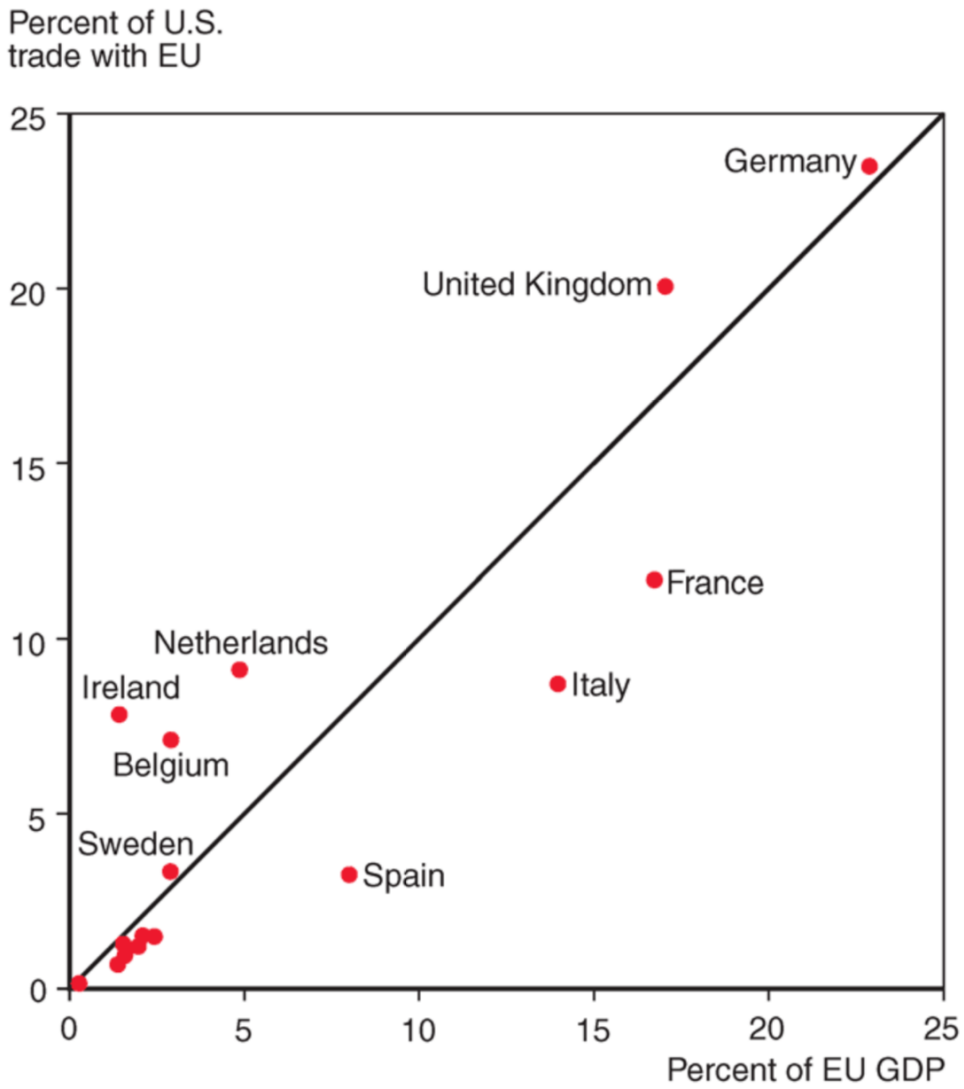
But the share of high-income countries is falling



Source: WDI, Pavcnik (2017); a country's time-invariant income category based on 1987 WB income groups.

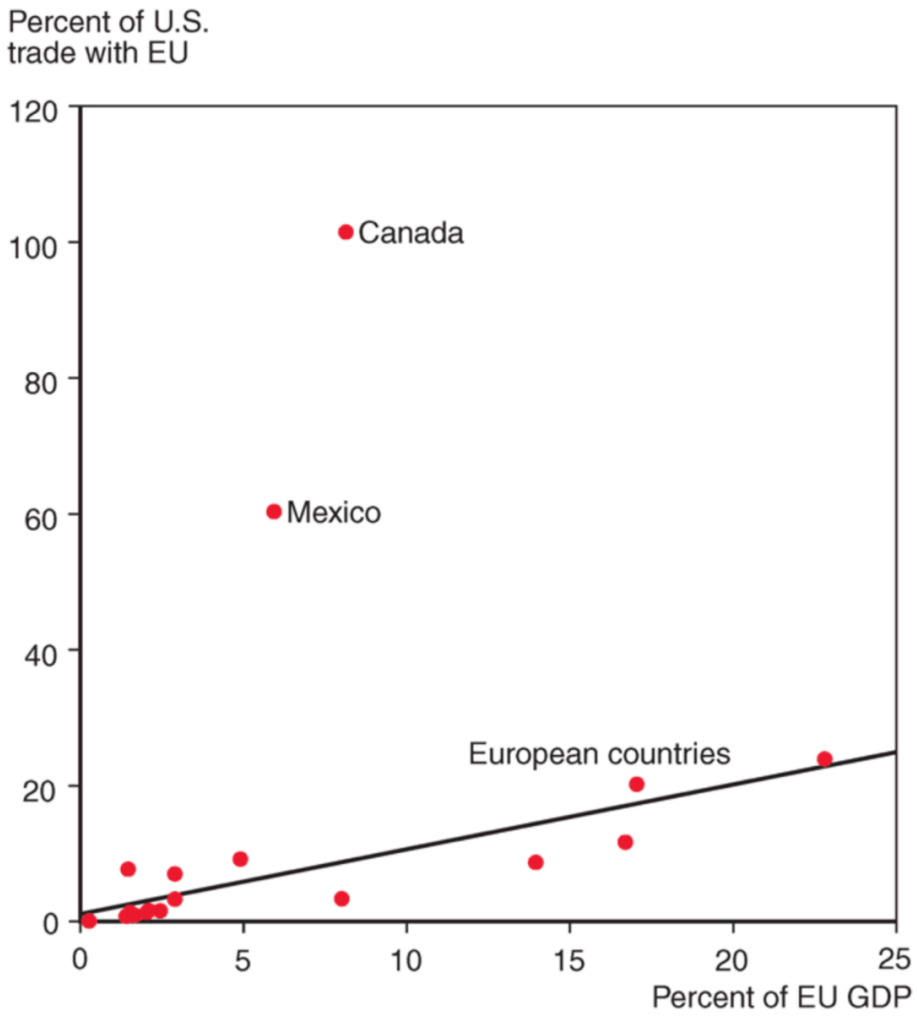
- Only 12% of world trade is among developing countries.
- Exports to GDP ratios: 24% for low-income, 37% for middle-income, and 42% for high-income countries

Market size matters for trade



Source: Krugman and Obstfeld (2009)

And distance as well!



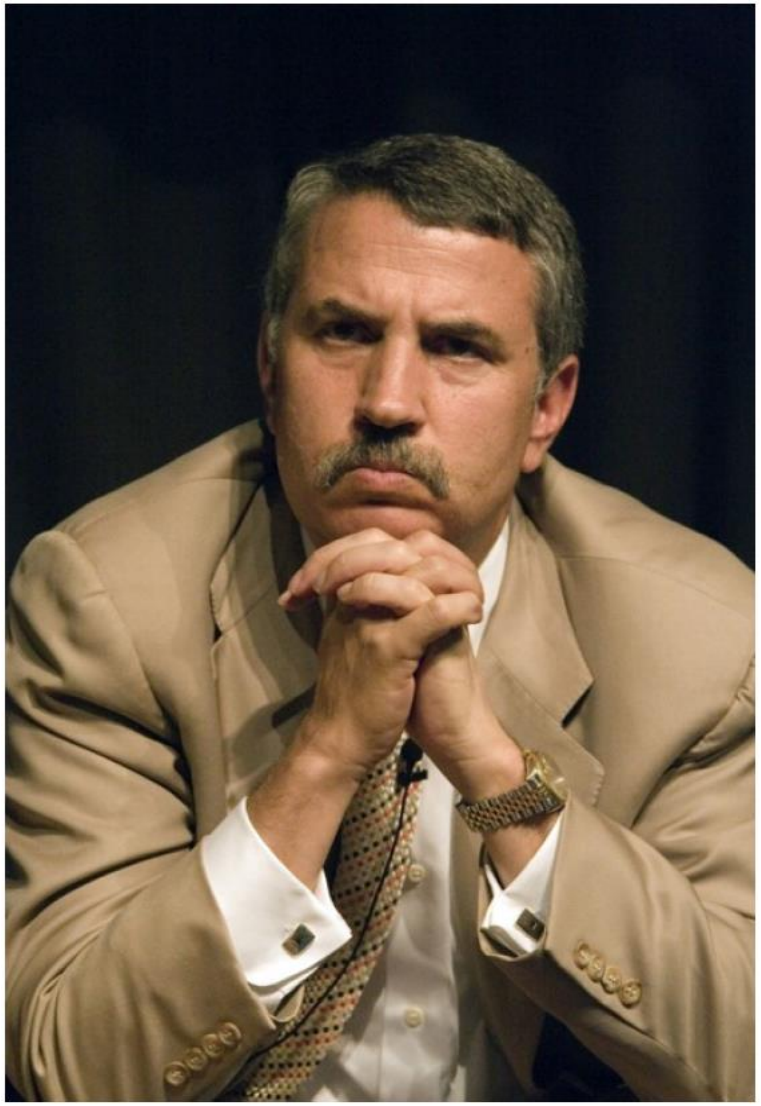
Source: Krugman and Obstfeld (2009)

True or False?

“In recent decades, distance has become less important for trade”

"The death of distance and the communications revolution will be among the most important forces shaping economies and society in the next fifty years or so."

-Frances Cairncross, *The Economist*



The world is flat?

- "...what the flattening of the world means is that we are now connecting all the knowledge centers on the planet together into a single global network... "
- "Search engines flatten the world..."
- "Just as the national highway system flattened the US...and made it so much easier to relocate in lower-wage regions, like the South...the laying of global fiber highways flattened the developing world"

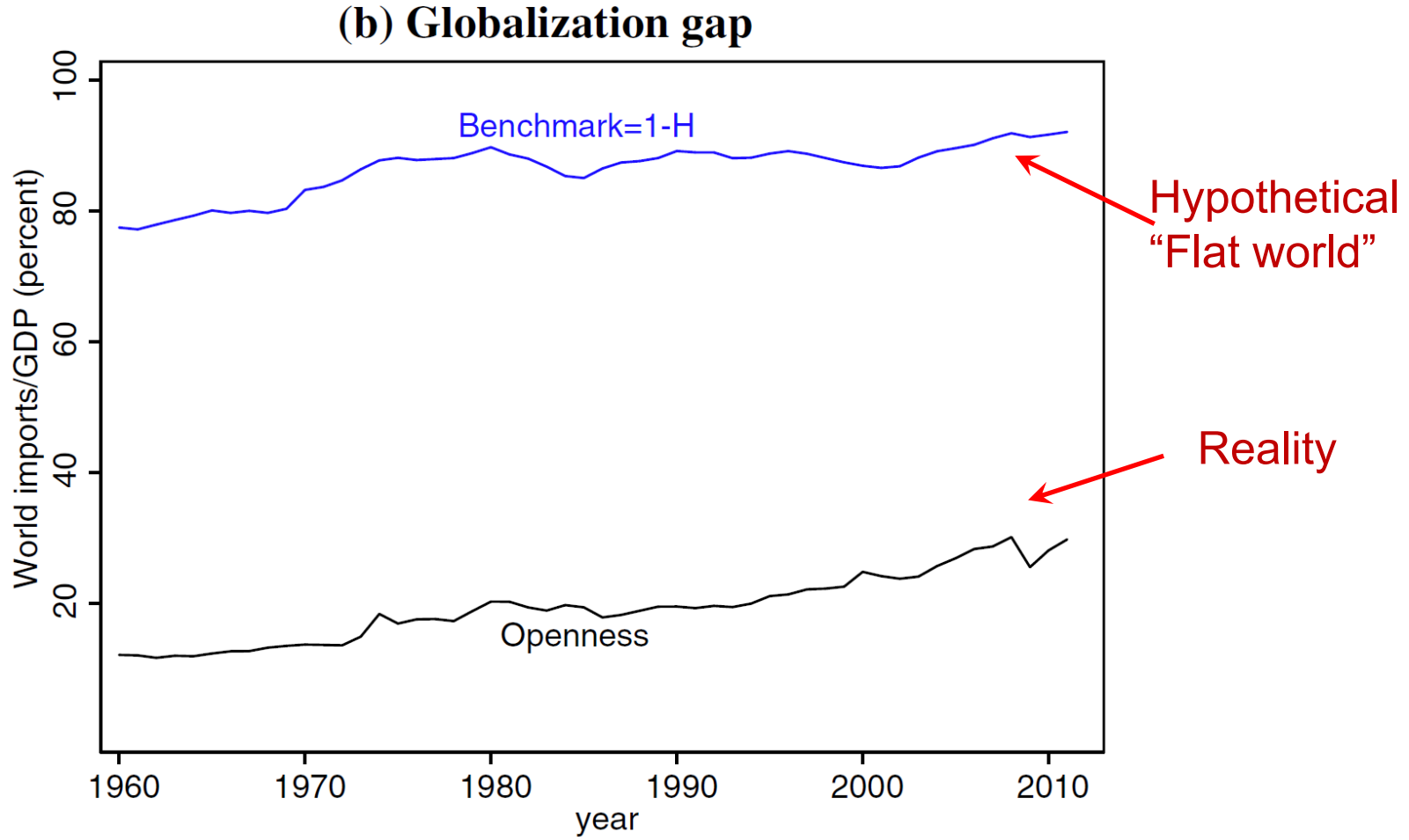
True or False?

“Distance has become less important for trade in recent decades”

False

Trade is more sensitive to distance now compared to several decades ago

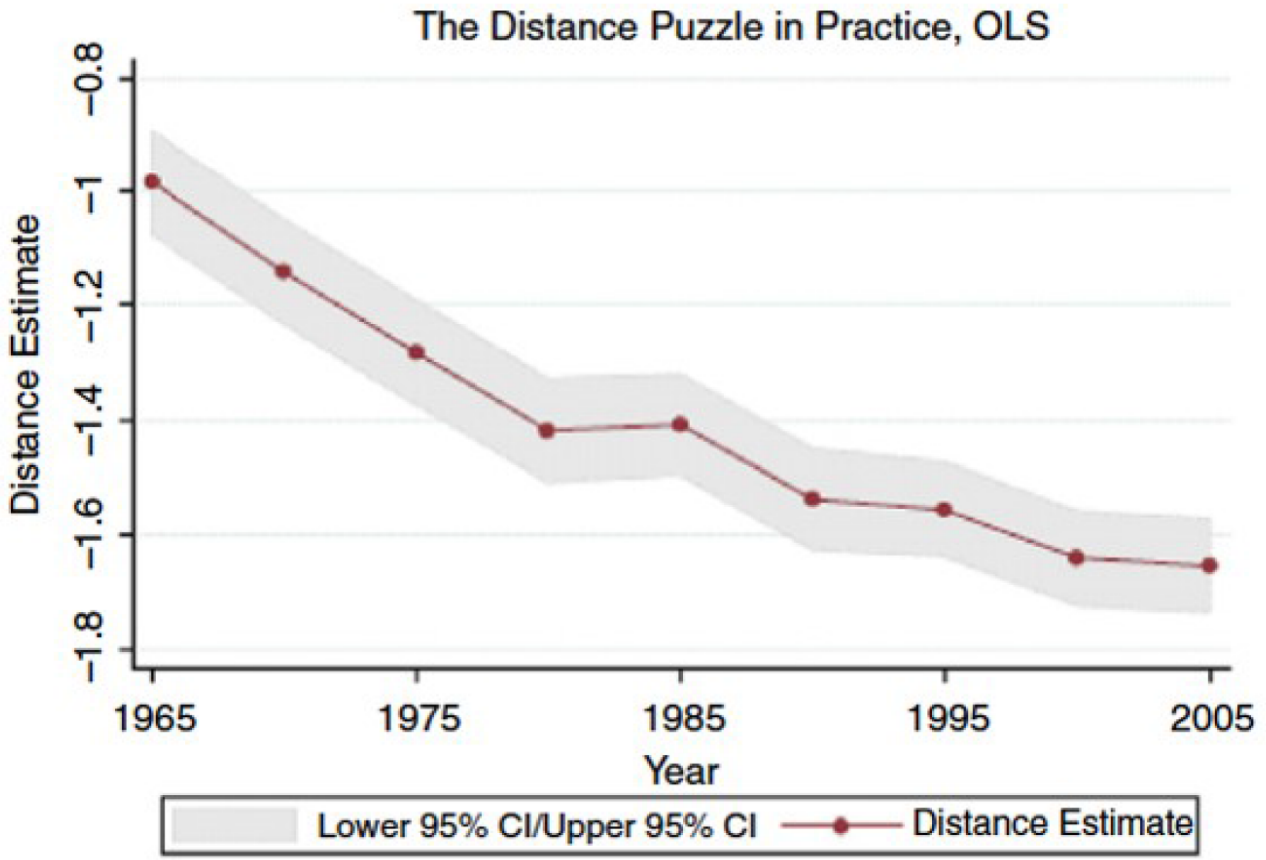
YET: Big gap between actual openness and what it would be without borders and without distance:



Source: Head and Mayer ("What separates us?" CJE 2013)

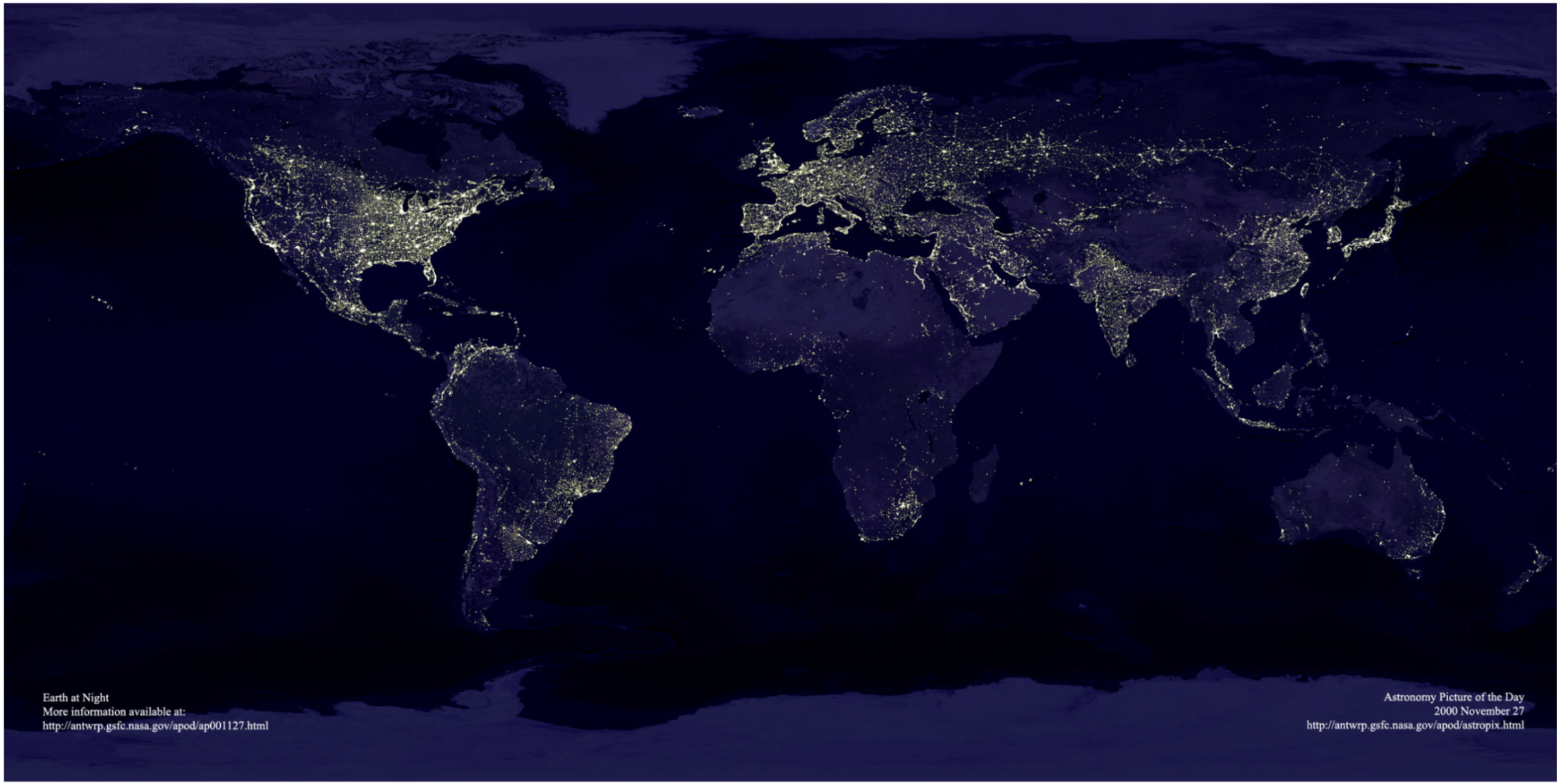
In the data:

The negative effect of distance on trade has increased



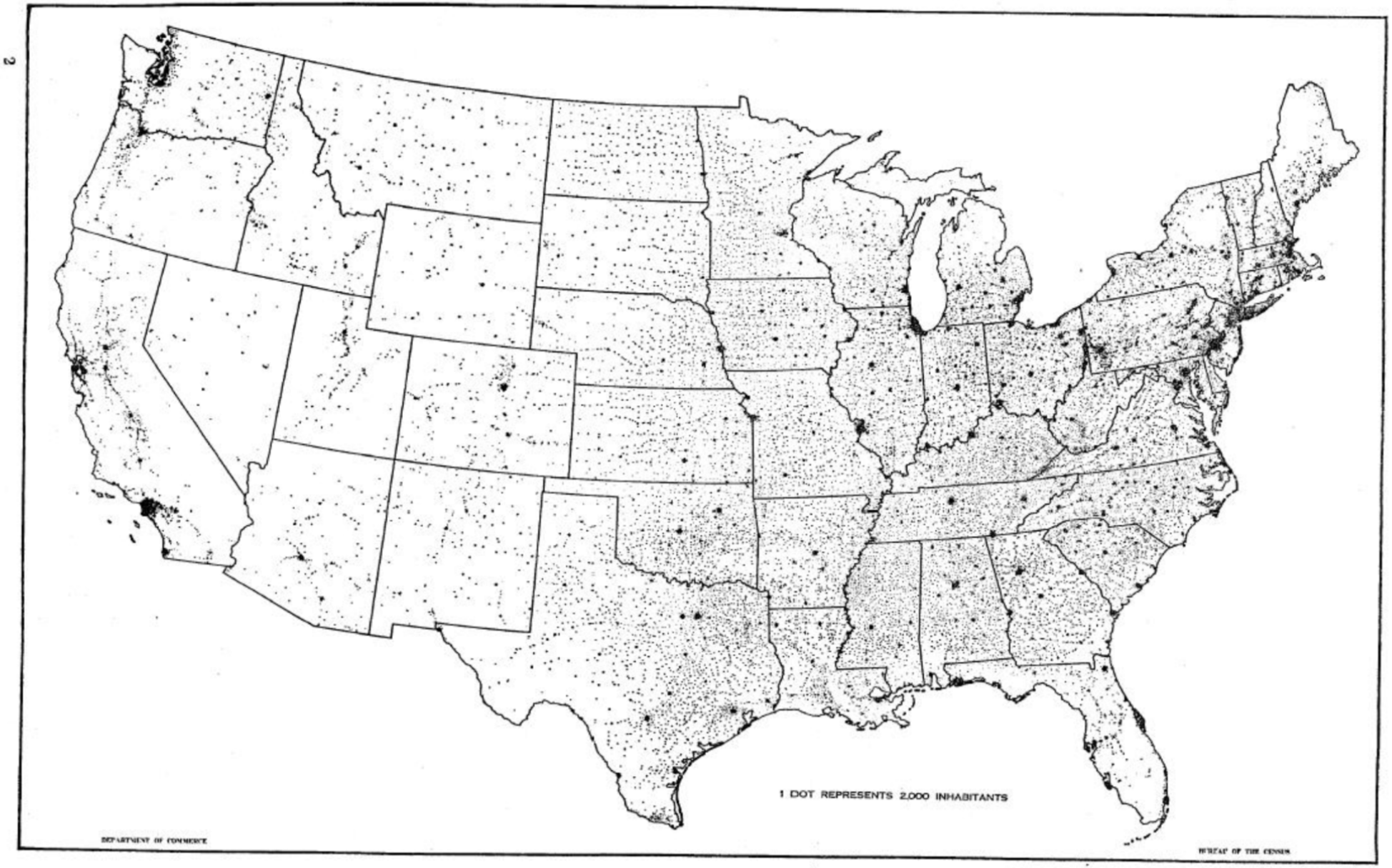
Yoto V. Yotov, Economic Letters 117 (2012)

The earth at night



The United States at night

MAP OF THE UNITED STATES SHOWING POPULATION DISTRIBUTION IN 1940



Why does distance matter?

What "distance" may capture:

Cultural	Administrative	Geographic	Economic
Language	Colonial Ties	Physical distance	Endowments
Ethnicity	Regulation	Common borders	Market Size
Religion	Hostilities	Access to Ports	FX Volatility
Norms	Currency Regime	Climate	Infrastructure

True or False?

“Most FDI from rich countries goes to lower income countries like China”

True or False?

“Most FDI from rich countries goes to lower income countries like China”

False

Most FDI is comes from and goes to rich countries

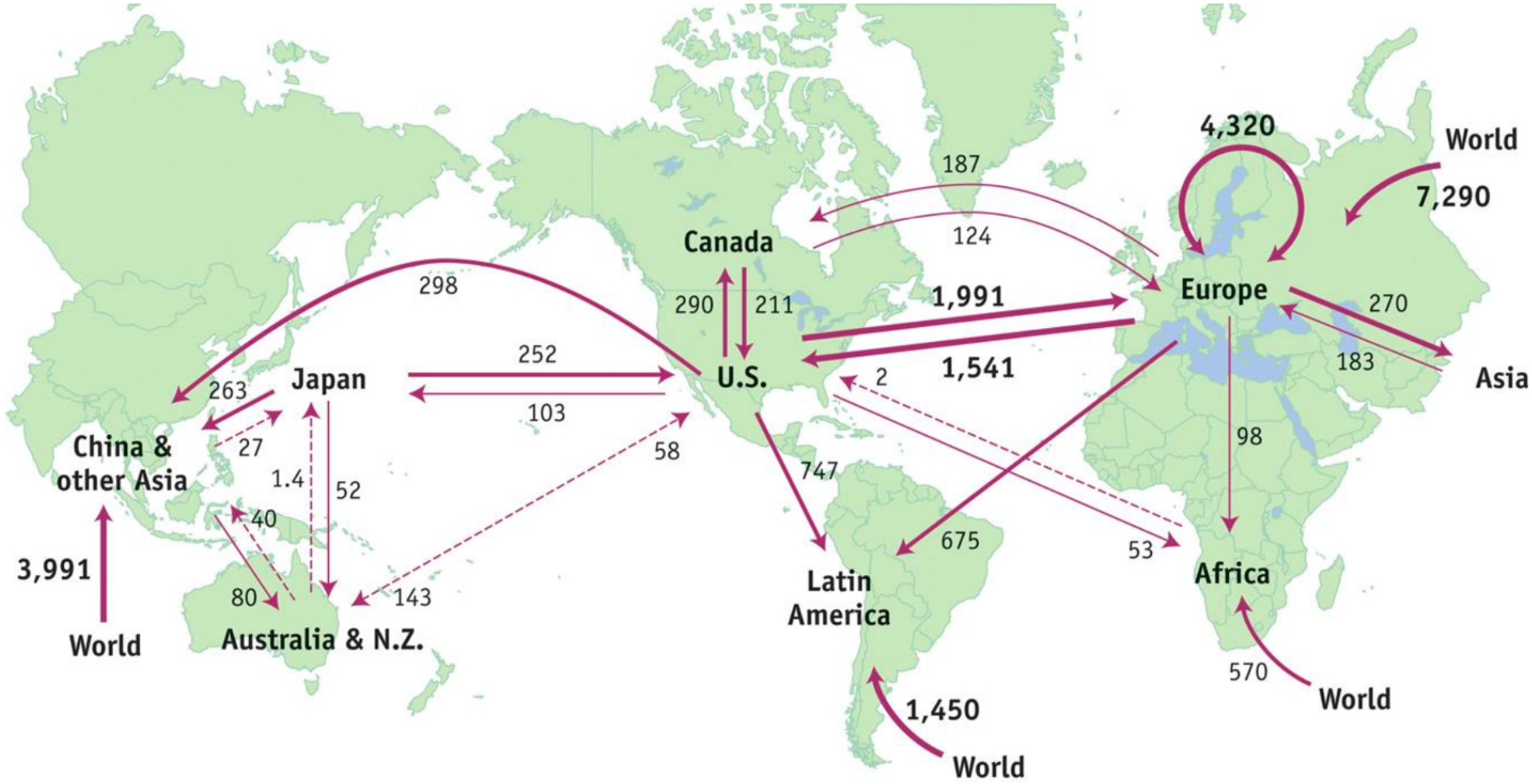


Figure 1.6 Stock of Foreign Direct Investment, 2010

Foreign Direct Investment

In 2010 more than one-third of the world flows of FDI:

- were within Europe
- or between Europe and the United States,

... and 90% of the world flows of FDI were into or out of the OECD countries.

Two main forms of Foreign Direct Investment (FDI)

1. Horizontal FDI

- when a firm from one country owns a company in another country to sell the same goods
- Tends to be between industrialized countries

2. Vertical FDI

- When a firm from a country owns a plant in another country who produced inputs for the parent company
- Parent company tends to be in industrialized country
- Affiliate tends to be in developing country

True or False?

“Trade is a zero sum game: some countries win, others lose”

True or False?

“Trade is a zero sum game”

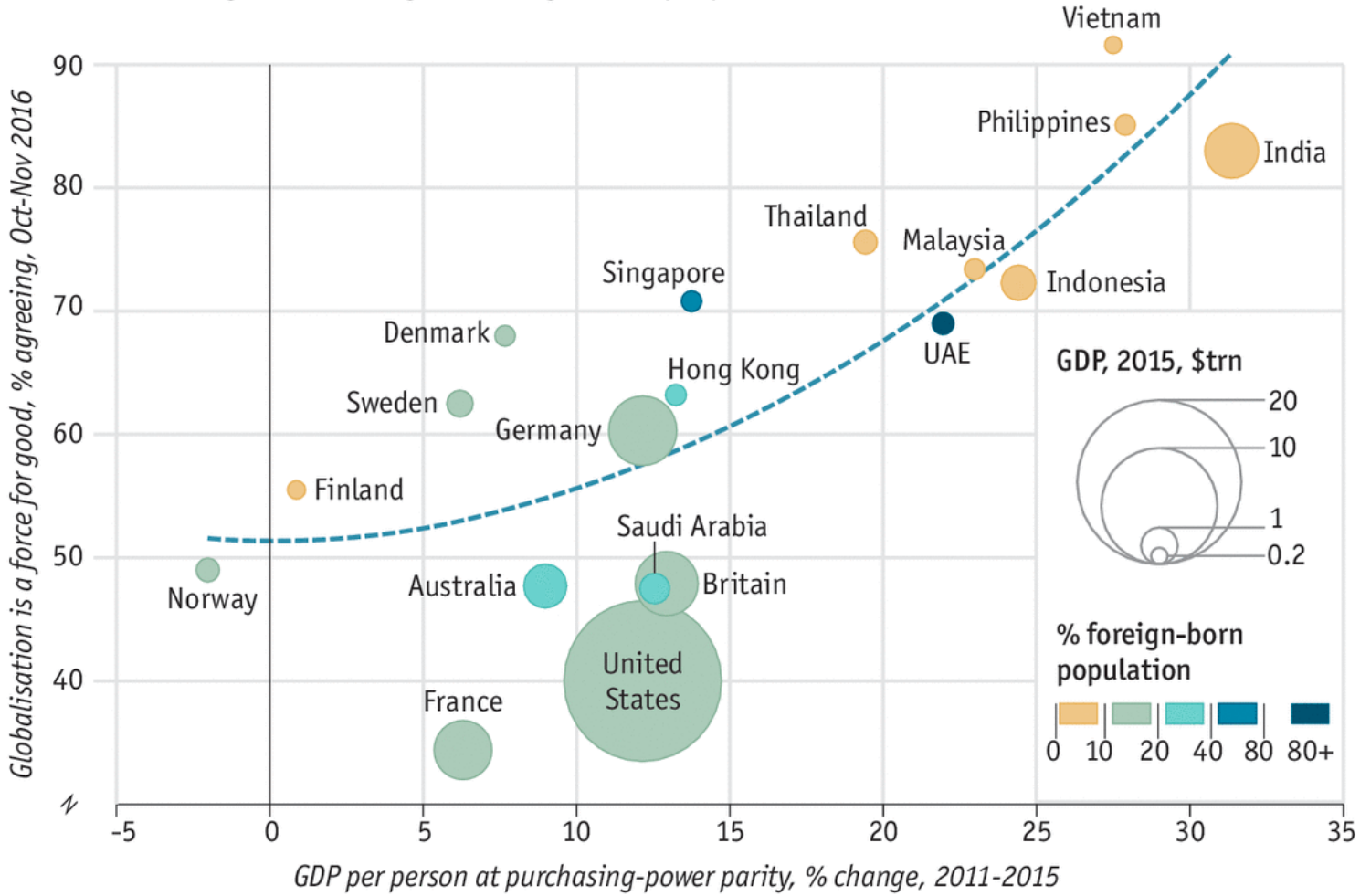
False

There is a general consensus among economists that all countries gain from international trade

But there is less consensus among non-economists

Enough to go around?

Attitudes towards globalisation against change in GDP per person



Sources: YouGov/*The Economist;* World Bank; UN

Why?

Labor market consequences of globalization and technological change have become a major source of anxiety