ECON 441-001 (Spring 2010)

International Economics

Franklin P. Perdue School of Business
Salisbury University

I. Instructor Information

Professor:	Dr. Ying Wu
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Office Hours:	Monday & Wednesday: 9:30am-12:30pm

II. Lecture

Lecture Room:	Caruthers Hall 111
Lecture Day & Hours:	Tuesday & Thursday: 9:30am-10:45am

III. Course Description

This course provides a balanced coverage of international trade and international money. The part of international trade addresses the issues such as why nations trade, how trade patterns are determined, and what economic effects trade generates and how trade barriers can change them; it answers the questions of ***what*** (goods does a country export?), ***how*** (are exports produced?), and ***who*** (are the winners of trade?). The part of international money discusses a country's balance of payments, the short-run and long-run exchange rate theories, open-economy macroeconomic policies, and the fixed and flexible exchange rate regimes; it answers the questions of ***why*** (are there trade imbalances?), ***how*** (is the exchange rate determined?), and ***when*** (will a currency crisis occur?).

IV. Readings

Textbook: Paul R. Krugman and Maurice Obstfeld (2006), *International Economics – Theory and Policy*, 7th ed., Boston: Pearson-Addison-Wesley.

Case-study material (handout)

V. **Course Evaluation**:

Grades will be based upon the following components and their weights:

Case study	10%
Quizzes	15%
Exam on International Trade	25%
Exam on International Money	25%
Project Presentation	25%
	100%

Case study

The case study serves to connect the course material with the current evolving economic and financial conditions. All the case materials are to be handed out in advance for prior reading. For each case study, one group is going to do presentations (PowerPoint presentation is encouraged) and another group is designated to serve as a panel of judges to give comments and ask questions; following the panel's comments, there will also be a session for Q&A open to the whole class. Besides, some case materials will also be used in questions of the two course exams.

Quizzes

In-class quizzes will be given for groups to complete within a limited time interval during the class; and the quizzes are open-book type questions based on the lecture content and textbook material. In addition, practice problems are to be assigned in class after each topic is covered in lectures; although they are not to be collected, the answers will be made available before the in-class quizzes.

Exam on International Trade

This exam is intended to test students' learning of topics one through three covered in the course. Exam questions will be in the form of short-answer problems.

Exam on International Money

This exam is to be conducted in the final exam week; it is intended to test students' learning of topics four through eight covered in the course. Exam questions will be in the form of short-answer problems.

Project and Presentation

Each group will complete a written project and present the project in the final phase of the course. The project theme is: “Road toward Recovery: How International Trade and Money Matter?” The pertinent presentation material is to be turned in to the course instructor one week before presentation. The main text of each project (absolutely not beyond fifteen double-spaced 8×12 pages) should have one particular focus; the 11 suggested focuses below are for your reference:

1. How does a country’s comparative advantage evolve over time? What will be the implications to economic structure and the pattern of trade?
2. How has global integration affected US producers and workers, and overall growth and inflation?
3. Why does the US trade deficit persist in the long run? Is a chronic and widening trade deficit sustainable?
4. What changes need to be made to increase US competitiveness in global trade?
5. How has the U.S. savings influenced its imbalances in international trade and money? How changes can be made in this regard?
6. How can the ongoing recession correct structural economic imbalances?
7. What are the pros and cons of the strong dollar policy?
8. What are the pros and cons of the dollar’s reserve currency position?
9. To what extent does the nominal exchange rate matter to real economic performance?
10. What will be the net impact of fiscal stimulus on asset prices such as the interest rate and exchange rate?
11. What will be the net impact of money expansion on asset prices such as the interest rate and exchange rate?

The written portion of the project accounts for 50% of the project grade (each team member’s share of duty needs to be clearly specified in the written project), and the oral-presentation portion (including Q&A) accounts for the other 50%. For the portion of oral presentation, both the instructor and the panel groups reward a maximum of 100 points to each project using the rubric attached in the next page; and the instructor’s score carries 60% weight and the panel’s carries 40% weight.

Instructor's Score Sheet (Rubric)

Instructions: For each of the five criteria below, give a score between 1-20
(1-4=poor, 5-8=fair, 9-12=good, 13-16=very good, 17-20=superior)

Criteria	**Score 1-20 (no fractions)**	**Comments**
A. **Evidence of knowledge:** • Presents accurate information • Combines appropriate theory with empirical evidence		
B. **Responses to questions:** • Demonstrates ability to defend positions challenged • Shows poise under pressure • Demonstrates good listening skills		
C. **Presentation:** • Well organized • Creative • Persuasive • Clear • Does not read from notes or script		
D. **Quality of the research and analysis:** • Uses a variety of sources • Uses an adequate number of sources • Selects important information • Draws logical conclusions		

VI. Course Content

Part One International Trade

Topic 1 Labor Productivity and Comparative Advantage

1.1 Comparative advantage vs. absolute advantage: the Ricardian model
1.2 Gains from international trade
1.3 Misconceptions and puzzles about international trade

Textbook: Krugman and Obstfeld (2006), Chapters 3

Case 1 "Comparative Advantage", in Douglas A. Irwin (2009), *Free Trade under Fire*, 3rd ed., Princeton University Press, pp. 32-39 from Chapter 2 "The Case for Free Trade".

Topic 2 Resources, Comparative Advantage, and Income Distribution

2.1 Resource endowment and trade: the Heckscher-Ohlin model
2.2 Effects of international trade between two-factor economies
2.3 Trade and distribution of income

Textbook: Krugman and Obstfeld (2009), Chapter 4

Case 2 "Trade and Wages", in Douglas A. Irwin (2009), *Free Trade under Fire*, 3rd ed., Princeton University Press, pp. 118-127 from Chapter 4 "Trade, Jobs, and Income Distribution".

Case 3 "China's Economy: Behind All the Hype" (*BusinessWeek*, 10/22/09)

Case 4 "Tug-of-Car" (*Economist*, 10/24/09)

Topic 3 Tariff, Import Quota, and Export Subsidy

3.1 Tariff
3.2 Export subsidies
3.3 Import quotas

Textbook: Krugman and Obstfeld (2009), Chapter 8

Case 5 "US-China Trade Dispute about More Than Tires" (*The Christian Science Monitor*, 09/14/09)

Exam on International Trade (tentative): March 11 (Thursday), 2010

Part Two International Money

Topic 4 Balance of Payments

4.1 National income accounts for an open economy
4.2 The balance of payments accounts

Textbook: Krugman and Obstfeld (2009), Chapter 12

Case 6 "What Makes Mr. Zhang Save?" **(***Wilson Quarterly*, Summer 2009)

Topic 5 Foreign Exchange Rates: An Asset Approach

5.1 Interest-Rate Parity
5.2 Equilibrium in the foreign exchange market

Textbook: Krugman and Obstfeld (2006), Chapter 13

Topic 6 Money, Exchange Rates, and Purchasing Power Parity

6.1 Money and exchange rates in the short and long runs
6.2 Inflation and exchange rate dynamics
6.3 Purchasing power parity and the real exchange rate

Textbook: Krugman and Obstfeld (2006), Chapters 14 and 15

Case 7 "Carry on Speculating" (*Economist*, February 2, 2007)
Case 8 "Mother of All Carry Trades Faces an Inevitable Bust" (*The Financial Times*, 11/01/09)

Topic 7 **Macroeconomic Policies in the Short Run**

7.1 Output market and money market equilibrium
7.2 Monetary policy and fiscal policy

***Textbook readings*:** Krugman and Obstfeld, Chapter 16

Case 9 "Get Ready for Inflation and Higher Interest Rates" (*Wall Street Journal*, 06/11/09)

Topic 8 **Fixed Exchange Rates and Foreign Exchange Intervention**

8.1 Central bank intervention and money supply
8.2 Monetary policy dilemma with a fixed exchange rate
8.3 Managed floating and sterilized intervention

Textbook: Krugman and Obstfeld (2006), Chapter 17

Case 10 "Bubble Warning" (*Economist*, 01/09/10), and "The Danger of the Bounce" (*Economist*, 01/09/10)
Case 11 "America's Chinese Disease (Not Quite What You Think)" (*The New York Times*, 11/11/09)

Project Presentation: **May 6 (Thursday), and May 11 (Tuesday), 2010**

Project Theme: **"Road toward Recovery: How International Trade and Money Matter?"**

Exam on International Finance: May 17 (Monday), 2010 (8:00am – 10:30am)

Appendix Case Questions

Case 1 "Comparative Advantage", in Douglas A. Irwin (2009), *Free Trade under Fire*, 3rd ed., Princeton University Press, pp. 32-39 from Chapter 2 "The Case for Free Trade".

1. What is the connection point at which comparative advantage uses information contained in absolute advantage to explain the pattern of international trade?

2. How did apparel, textile mill, rubber and plastics, and leather and footwear become China's main exports to the U.S.? Explain with the theory of comparative advantage.

3. Using the employment-weighted relative productivity data, can you explain why Japan's per capita income is lower than its U.S. counterpart?

Case 2 "Trade and Wages", in Douglas A. Irwin (2009), *Free Trade under Fire*, 3rd ed., Princeton University Press, pp. 118-127 from Chapter 4 "Trade, Jobs, and Income Distribution".

1. Is the fact that imports destroy low-wage jobs compatible with Heckscher-Ohlin model? Explain.

2. Is the fact that exports expand high-wage jobs compatible with Heckscher-Ohlin model? Explain.

3. What are the implications of these observations to income impact of trade and protectionism?

Case 3: "China's Economy: Behind All the Hype" (*BusinessWeek*, 10/22/09)

1. Based on the article, what is the difference between the old economic growth model and the new one in China?

2. What are the pros and cons for foreign direct investment in China? Give your assessment in terms of China's economic development strategy at the current crossroad.

3. BYD's "batteries and electric motors are hand-assembled by long lines of blue-uniformed workers rather than the robots that have become standard in most of the industry." What does this paragraph mean about China's economic transition?

4. From China's endeavor in developing its commercial aircraft industry to semiconductor manufacturing, what opportunities and challenges do you see in the development strategy? How does the strategy match China's comparative advantage?

Case 4: "Tug-of-Car" (*Economist*, 10/24/09)

1. "Some of the first cars that the Chinese export might have an American brand name on them. … Another possibility is that some American brand names will become Chinese."

What does the duality here imply to changes in China's comparative advantage? Do you think it's healthy dynamics of comparative advantage?

2. Which role does the purchase of American brand names play in China's strategy of moving up in the value chain of exports? In addition, how about leapfrogging ahead in adopting cleaner car fuels while establishing China's own car manufacturing base?

Case 5: "US-China Trade Dispute about More Than Tires" (*The Christian Science Monitor*, 09/14/09)

1. How is the measures of "rebuilding commerce" different from those "aid specific hard-hit industries"?
2. Why did critics on the new US tariff say "the new tariff will hurt the economy more than it helps on the jobs front"?
3. How can the new tariff cost jobs in the U.S. auto-making industry while retaining jobs in the tire manufacturing sector in the U.S.?
4. Would the new tariff be likely to generate terms-of-trade gain? How?
5. How would you assess the two online comments (comment 1 and comment 2) toward the new tariff?

Case 6: "What Makes Mr. Zhang Save?" **(***Wilson Quarterly*, Summer 2009)

1. Do you think Asian savings behavior has anything to do with Confucianism?
2. Among the factors "beyond the direct influence of policymakers", which is most convincing factor that influence thrift?
3. How has the low-interest rate policy led to high saving through consumption and production in China? Is it income effect or substitution effect on consumers?
4. How has the undervalued RMB with respect to the dollar led to high saving through consumption and production in China? Is it income effect or substitution effect?
5. Why would the Chinese legendary savings habit have to change in the post-financial crisis era?

Case 7: "Carry on Speculating" (*Economist*, February 2, 2007)

1. What is carry trade?

2. How does the theory of "covered interest parity" explain high-interest-rate currencies at a discount in the forward market and low-interest-rate currencies at a premium? (Hint: forward discount refers to the depreciation of the high-interest-rate currencies in the forward market relative to the spot exchange rate, whereas forward premium refers to the appreciation of the low-interest-rate currencies in the forward market relative to the spot exchange rate)

3. Why has the "uncovered interest parity" not applied over the past 25 years? Alternatively, why has the forward rate not been a good guess of the likely future spot rate?

4. Following up the previous question, what are the two reasons discussed in the article for the discrepancy between the "uncovered interest parity" and the real financial world?

5. What is the major potential danger to the "carry trade"?

Case 8: "Mother of All Carry Trades Faces an Inevitable Bust" (*The Financial Times*, 11/01/09)

1. What does "borrowing at very negative interest rates" really mean?

2. Why is the perceived riskiness of individual asset classes declining when it is supposed to increase under speculative international investment?

3. What is the dilemma for emerging economies in dealing with massive capital inflow? What would be the outcome if they intervene in foreign exchange market? And what if they won't? Is there any substantial difference with regard to whether the foreign exchange intervention takes place or not?

4. How could the dollar appreciation trigger off the next round of bubble burst when the carry trades unravel?

5. Under what circumstances would the carry trades unravel? Why might the dollar appreciate when flight from risk occurs?

6. Against the backdrop of the dollar carry trade, do you think that RMB appreciation is a good idea?

Case 9 "Get Ready for Inflation and Higher Interest Rates" (*Wall Street Journal*, 06/11/09)

1. What are the pros and cons of U.S. fiscal stimulus package?

2. Could the Fed's current "panic-driven monetary policies" lead to a sort of stagflation observed in the 1970s? How?

3. Do you think that monetary policy is currently well-coordinated with fiscal policy in the U.S. in combating the ongoing Great Recession? Should the existing expansionary monetary policy start to phase out, as suggested by Mr. Laffer, to forestall the risk of potential "devastating" inflation in the future?

4. How effective is "quantitative easing" in the situation of liquidity trap? Should policymakers use monetary policy and fiscal policy to strike a balance between "the short-term pain of a deepened recession" and "the long-term consequences of double-digit inflation"? Explain.

Case 10 "Bubble Warning" (*Economist*, 01/09/10), and "The Danger of the Bounce" (*Economist*, 01/09/10)

1. What are the upside and downside of asset market rebound?

2. What does it mean by "Something's got to give" in the current seemingly turning point?

3. Why emerging markets are more plausible candidates for bubble status?

4. Explain the series of contradictions from government stimulus to deficit financing. What does that imply to the current stance of monetary and fiscal policies?

Case 11: "America's Chinese Disease (Not Quite What You Think)" (*The New York Times*, 11/11/09)

1. Why is the article entitled "America's Chinese Disease"?

2. In what way could the U.S. push for RMB revaluation hurt U.S. economy?

3. What is Fed's "quantitative easing"? In what way could the U.S. push for RMB revaluation be consistent with the Fed's current massive "quantitative easing"?

4. In what way do you see that RMB revaluation will help the U.S. economy by playing a role as one stone hitting two birds?