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Class time, location	M,W 1.15-3.05pm, Braun Lec
TA:	TBA

## Econ 165: International Economics

**Course Description:** The aim of this class is to give students the tools necessary to read critically and understand discussions of international trade and macroeconomic policy found in popular media such as *The Economist* magazine, the *Wall Street Journal* and the *Financial Times*. The course is organized around several questions of current interest to policy makers, business leaders and the general public. It covers selected basic models in international trade and international macroeconomics relevant to these questions. Recent research on the empirical and practical relevance of these models is also discussed.

**Prerequisites:** Econ 50, 51, 52. I do not have discretion to waive these prerequisites. If you have not completed these classes, contact the Economics Undergraduate Office.

**Assessment:** Problem sets (20%); In-class midterm (30%); Final exam (50%). Out of 6 problem sets, only your best 5 scores will contribute to the final grade. Late problem sets will receive a score of zero. Attendance at both the midterm and final exam is mandatory. No make-up exams will be offered. In marginal cases, class attendance will be taken into account.

**Final exam:** Monday December 10, 8.30-11.30am. If you cannot make this time, do NOT take this class.

**Readings:** There is no required textbook for this class. Lecture notes and required readings will be posted on the class webpage. You may find certain chapters of the following textbook useful: *International Economics: Theory and Policy*, 7th edition, by Krugman and Obstfeld (K&O). Some recommended readings will be taken from *Pop Internationalism* by Paul Krugman, *Free Trade Under Fire* (2nd edition) by Douglas Irwin and *Foundations of International Macroeconomics*, by Maurice Obstfeld and Kenneth Rogoff (O&R). These texts are on reserve at the library. Other recommended readings and resources will be made available through links on the class webpage.

**Webpage:** <http://coursework.stanford.edu>

**Discussions:** Where noted, once a week the last 15 minutes of class will be devoted to general discussion of a set topic of current interest. If you do no other reading, at least do the readings to prepare for these discussions. I will call on students at random to participate in the discussion (cold calling). What you say in the discussion will not affect your grade. Unexplained absences, however, may count against you.

**Instructor's office hours:** My office hours are Mondays 4pm-6pm. Please let me know in advance if you plan to attend. If you e-mail me, put Econ 165 in the subject line.

**Section:** Details on times and locations will be announced in the first week of the quarter.

## Frequently asked questions

- *How much math is used in this class?* Familiarity with basic algebra and calculus is assumed. No accommodation will be made for students who do not have this familiarity.
- *How much reading should I do?* Required readings have been kept to a minimum, but required means required. Note that discussion readings are also required, and should be done before the class for which they are assigned. If you are particularly interested in a topic, you are invited to explore the recommended readings.
- *When will lecture notes be posted?* In general, lecture notes will be posted shortly before class. But please do not complain if there is a delay. Note that class attendance is mandatory, and reading the lecture notes is no substitute for attending.
- *Do I have to go to section?* Yes. Attendance will be taken, and in marginal cases, may count towards your final grade. Where indicated, the TA will cover new material. The TA will also go through the solutions to the previous problem set, and discuss any questions you have on problem sets, readings or lectures.
- *Can my friends and I work together on the problem sets?* Yes. The problem sets are intended to be learning experiences, so feel free to work in groups. However you may find it useful to attempt the problems on your own before working with others. Each student must submit their own problem set solutions. Doing the problem sets is the best way to prepare for the exams. If you copy another student's answers without understanding the material, your exam performance will suffer.
- *How are the problem sets graded?* The problem sets are graded on a scale of check plus, check, check minus and zero (if no problem set is handed in, or it is submitted late). Legibility is important. Typewritten problem sets are much appreciated. Where appropriate, graphs (drawn by hand) are very useful.
- *Can I turn a problem set in late?* No. I have instructed the TA not to grade problem sets turned in after the deadline (12 noon on Mondays).
- *What if I cannot take the midterm?* There will be no make up exams. You should contact me in advance if you cannot make a midterm.
- *What material will be covered on the midterm and final exam?* The midterm will cover the material from the first half of the quarter. The final will cover material from the entire quarter.
- *What do I do if a mistake was made in grading my exam?* After the exam is returned, you will have one week to submit a written account of your problem or concern to the TA. Beyond this deadline, no complaints will be entertained. Note that regrades will not be confined to the disputed part of the exam.

# Schedule and Readings

## 1. Monday 24th September 2007: Introduction

- (a) What is international economics?
- (b) Motivating facts and questions
- (c) Review of budget sets, utility maximization and demand

- **Key concepts:** marginal rate of substitution; Relative demand

- **Required reading:**

- Paul Krugman: “What do Undergrads Need to Know about Trade?,” *American Economic Review*, May 1993, p. 23-26 (also in *Pop Internationalism*)

- **Recommended reading:**

- K&O Chapter 2
- Hal Varian: *Intermediate Microeconomics* 7th edition, Chapters 2-6 (or similar material in an alternative intermediate micro textbook)
- Douglas Irwin: *Free Trade Under Fire*, Chapter 1

- **Problem set:** No problem set this week

## 2. Wednesday 26th September 2007: Endowment economies I

- (a) Aggregation over consumers – some useful results with homothetic preferences
- (b) Free trade vs autarky in a 2-good small open endowment economy
- (c) A 2-country 2-good endowment world

- **Key concepts:** Homothetic preferences; Terms of trade; Perfect competition; Small open economy; Gains from trade; Comparative advantage

- **Recommended reading:**

- Hal Varian: *Intermediate Microeconomics* 7th edition, Chapters 2-6 and 31 (or similar material in an alternative intermediate micro textbook)
- Alan Deardorff: “Benefits and Costs of Following Comparative Advantage,” 1998

- **Section:** No section this week

### 3. Monday 1st October 2007: Endowment economies II

- (a) Analysis of gains from trade using the Edgeworth Box
- (b) Evidence on trade liberalization and relative prices from Japan and the US
- (c) The redistributive effects of trade
- (d) Introduction to economies with production

- **Key concepts:** Pareto efficiency; Contract curve

- **Recommended reading:**

- Hal Varian: *Intermediate Microeconomics* 7th edition, Chapters 31 and 32 (or similar material in an alternative intermediate micro textbook)
- Douglas Irwin (2005), “The Welfare Cost of Autarky: Evidence from the Jeffersonian Trade Embargo,” *Review of International Economics* 13 (4) 631-645
- Daniel Bernhofen and John Brown (2004), “A Direct Test of the Theory of Comparative Advantage: The Case of Japan,” *Journal of Political Economy* 112 (1) 48-67

- **Problem set:** No problem set this week

### 4. Wednesday 3rd October 2007: The standard trade model (introducing production)

- (a) Economies with production
- (b) The effect of terms-of-trade changes in the short and long run
- (c) Evidence on trade liberalization, shifts in production and welfare
- (d) What explains changes in the terms-of-trade

- **Key concepts:** Production possibility frontier; Immiserizing growth

- **Recommended reading:**

- Hal Varian: *Intermediate Microeconomics* 7th edition, Chapter 32
- K&O Chapter 5
- Douglas Irwin: *Free Trade Under Fire*, Chapters 2 and 3

- **Discussion:** Should trade policy be used as a tool for domestic redistribution?

- **Reading 1:** White House statement on the steel industry
- **Reading 2:** The Economist: “Just Say No”

- **Section:** Trade policy

5. **Monday 8th October 2007:** No class

- **Required reading:**

- Robert Baldwin (1989), “The Political Economy of Trade Policy,” *Journal of Economic Perspectives* 3 (4), 119-135

- **First problem set:** Due at 12 noon on Monday 8th October

6. **Wednesday 10th October 2007:** Ricardo I

- (a) Introduction to technology and production
- (b) 2-good small open Ricardian economy
- (c) 2-good 2-country Ricardian world

- **Key concepts:** Factors of production; Production function; Marginal rate of transformation; Constant returns to scale; Unit input requirements; Relative supply; Absolute advantage

- **Required reading:**

- Paul Krugman: “Ricardo’s Difficult Idea”

- **Recommended reading:**

- K&O Chapter 3, pages 24-39

- **Discussion:** Does China’s growth hurt the US?

- **Reading 1:** Martin Wolf in the *Financial Times* on the costs and benefits of globalization
- **Reading 2:** Paul Krugman: “Does Third World Growth Hurt First World Prosperity?” *Harvard Business Review*, July-August 1994 (also in *Pop Internationalism*)

- **Section:** Solution to first problem set.

## 7. Monday 15th October 2007: Ricardo II

- (a) Gains from trade in the 2-good 2-country model
- (b) Wages in the 2-good 2-country model
- (c) Sketch of a more general model
- (d) Evidence on the Ricardian view of the world
- (e) What the Ricardian model cannot explain

- **Key concepts:** Derived demand

- **Recommended reading:**

- K&O Chapter 3, pages 40-47
- Bela Belassa (1963), “An Empirical Demonstration of Classical Comparative Cost Theory,” *Review of Economics and Statistics* 45 (3), 231-238

- **Second problem set:** Due at 12 noon on Monday 15th October

## 8. Wednesday 17th October 2007: Specific factors model

- (a) More about production
- (b) Autarky in the specific factors model
- (c) A small open economy with specific factors
- (d) Distribution of gains from trade
- (e) Application: the trade and wages debate
- (f) Political economy of trade policy

- **Key concepts:** Marginal product; Diminishing marginal product

- **Recommended reading:**

- Hal Varian: *Intermediate Microeconomics* 7th edition, Chapter 18

- **Discussion:** Are sweatshops good for workers in developing countries?

- **Reading 1:** Paul Krugman: “In Praise of Cheap Labor,” *Slate*, March 1997
- **Reading 2:** Nicholas Kristof in the NYT (you can find this through Lexis-Nexis if you don’t have a New York Times subscription)

- **Section:** Immigration and inequality in the US; Solution to second problem set.

9. **Monday 22nd October 2007:** Increasing-returns-driven specialization I

- (a) Motivation: Evidence on intra-industry trade, trade between similar countries
- (b) What are increasing returns/ economies of scale?
- (c) Imperfect competition – monopoly
- (d) Imperfect competition – monopolistic competition

- **Key concepts:** Imperfect competition; Differentiated products; Increasing returns to scale; Profit maximization; Pure monopoly; Monopolistic competition; Fixed costs; Markups; Free entry

- **Recommended reading:**

- K&O Chapter 6, pages 110-113
- Hal Varian: *Intermediate Microeconomics* 7th edition, Chapters 18 and 24
- Paul Krugman “Talking About a Revolution”

- **Third problem set:** Due at 12 noon on Monday 22nd October

10. **Wednesday 24th October 2007:** Increasing-returns-driven specialization II

- (a) Gains from trade under increasing returns
- (b) Evidence on trade liberalization and variety
- (c) External economies and the agglomeration of economic activity
- (d) Infant industry protection – theory and evidence
- (e) The evidence on trade liberalization, trade and growth

- **Key concepts:** External economies; Path dependence

- **Recommended reading:**

- K-O, Chapter 6, pages 136-143 and Chapter 10
- Douglas Irwin (2000), “Did Late Nineteenth-Century US Tariffs Promote Infant Industries? Evidence from the Tinplate Industry,” *Journal of Economic History* 60, 335-360
- Jeffrey A. Frankel and David Romer, “Does Trade Cause Growth?” *American Economic Review*, June 1999, pp. 379-399.
- Pinelope Goldberg and Nina Pavcnik, “Distributional Effects of Trade Liberalization in Poor Countries”

- **Discussion:** Should developing countries embrace free trade?
    - **Reading 1:** Dani Rodrik, “Globalization for Whom?” *Harvard Magazine*, Jul-Aug 2002.
    - **Reading 2:** *The Economist*, “More or Less Equal?”
  - **Section:** Review for midterm; Solution to third problem set.
11. **Monday 29th October 2007:** Midterm exam
- **Problem set:** No problem set this week
12. **Wednesday 31st October 2007:** Intertemporal trade I
- (a) A small 2-period endowment economy
  - (b) The role of government consumption
  - (c) Adding investment to the model
    - **Key concepts:** Intertemporal preferences; Discount factor; Interest rate; Trade balance; Current account
  - **Recommended reading:**
    - K&O Chapter 12
    - O&R Chapter 1, Sections 1 and 2
    - Hal Varian: *Intermediate Microeconomics* 7th edition, Chapter 10
  - **Section:** Solution to midterm exam. Review of national income accounting in an open economy.

13. **Monday 5th November 2007:** Intertemporal trade II

- (a) More on the small 2-period economy with investment
- (b) A 2-region world economy

- **Key concepts:** Elasticity of intertemporal substitution

- **Required reading:**

- Economic Report of the President (2006), Chapter 6: The U.S. Capital Account Surplus, pp. 125-147
- Maurice Obstfeld “America’s Deficit, the World’s Problem”

- **Recommended reading:**

- O&R Chapter 1, Sections 2 and 3

- **Problem set:** No problem set this week

14. **Wednesday 7th November 2007:** Sovereign debt I

- (a) A 2-state model with full commitment
- (b) Absence of commitment
- (c) Lack of commitment and sanctions
- (d) Why do countries repay their debts?
- (e) Investment and sanctions

- **Key concepts:** Commitment

- **Recommended reading:**

- O&R Chapter 6, Sections 1 and 2
- Hal Varian: *Intermediate Microeconomics* 7th edition, Chapter 12, Chapter 37, section 7

- **Discussion:** Is the US current account deficit sustainable?

- **Reading 1:** *The Economist* “Stop Worrying and Love the Deficit”

- **Section:** Review of insurance and incentive compatibility

15. **Monday 12th November 2007:** Sovereign debt II

- (a) Investment and sanctions – debt overhang
- (b) Debt buybacks

• **Required reading:**

- Jeremy Bulow and Kenneth Rogoff (1990), “Cleaning Up Third World Debt Without Getting Taken to the Cleaners,” *Journal of Economic Perspectives* 4, 31-42.

• **Recommended reading:**

- O&R Chapter 6, Sections 1 and 2
- Jeremy Bulow and Kenneth Rogoff (1988), “The Buyback Boondoggle,” *Brookings Papers on Economic Activity* 2, 675-698

• **Fourth problem set:** Due at 12 noon on Monday 12th November

16. **Wednesday 14th November 2007:** Crises in financial markets

- (a) A model of a bank run
- (b) Moral hazard and the lender of last resort
- (c) Case study: the East Asian Crisis

• **Required reading:**

- “What caused East Asia’s crisis?” *FRBSF Economic Letter* 98-24
- Paul Krugman (1998), “What happened to Asia?”

• **Recommended reading:**

- Hal Varian: *Intermediate Microeconomics* 7th edition, Chapter 37, section
- Paul Krugman “Fire-sale FDI”
- Douglas Diamond and Philip Dybvig (1983), “Bank Runs, Deposit Insurance and Liquidity,” *Journal of Political Economy* 91 (3), 401-419.

• **Discussion:** Should we forgive Third World debt?

- Reading 1: William Easterly “Debt Relief,” *Foreign Policy*, Nov-Dec 2001

• **Section:** Solution to fourth problem set.

17. **Monday 26th November 2007:** Price levels and the exchange rate in the long run

- (a) What is the exchange rate
- (b) Facts about exchange rates
- (c) Theory of purchasing power parity
- (d) Evidence on purchasing power parity
- (e) The Balassa-Samuelson effect

• **Required reading:**

- *The Economist*: “McCurrencies” (text only from Proquest).

• **Recommended reading:**

- K&O Chapter 15, pages 369-372, 379-388
- Kenneth Rogoff, "The Purchasing Power Parity Puzzle," *Journal of Economic Literature* 34, June 1996, 647-68

• **Fifth problem set:** due at 12 noon on Monday 26th November

18. **Wednesday 28th November 2007:** The asset approach to exchange rate determination

- (a) The foreign exchange market
- (b) Demand for foreign currency assets
- (c) Market equilibrium
- (d) Evidence on interest parity conditions

• **Recommended reading:**

- K&O Chapter 13, (including pages 335-337)

• **Discussion:** How should central banks respond to the sub-prime crisis?

- **Reading 1:** TBA

• **Section:** Open economy IS-LM (Mundell-Fleming)

19. **Monday 3rd December 2007:** A model to analyze monetary and exchange rate policy I

- **Reading:** TBA

- **Sixth problem set:** due at 12 noon on Monday 3rd December

20. **Wednesday 4th December 2007:** A model to analyze monetary and exchange rate policy II

- **Reading:** TBA

- **Section:** Review for final exam