

ECO364H1S – International Trade Theory

2009 Fall Session

Your Instructor: Christian Dippel

Email: christian.dippel@utoronto.ca

Course-Website: <http://www.chass.utoronto.ca/~cdippel/teaching.html>

(I will mostly use Blackboard but you can find lecture notes and some selected materials here)

COURSE OBJECTIVES:

- This course will introduce students to international trade theory. What we strive to achieve in this course is to explain the patterns of trade flows as well as the welfare consequences of globalization in the form of less restricted trade in goods.
- Ultimately, at the end of this course you should (a) be able to explain to your grandparents why specific countries export some goods and import others and what determines the volume of bilateral trade between two countries, (b) be able to understand a sophisticated newspaper-commentary on trade and (c) be able to beat a crude (but not a sophisticated) anti-globalization activist in a debate.
- A rough course outline reads like this:
 - (1) The first section of the course is concerned with “old trade” models of inter-sectoral comparative advantage (i.e. why are some countries good at producing in some sectors/industries and some in others). These are the Ricardian and Heckscher-Ohlin models of trade and they are the traditional workhorses of international trade. The main forces that shape comparative advantages (and therefore trading patterns) in these models are differences in technologies (Ricardo) and differences in factor-endowments (Heckscher-Ohlin). These models are extremely powerful and will allow us to gain important intuition into trading patterns. However, there are important stylized facts in the data on trade patterns which cannot be explained by these models and which require us to expand our efforts.
 - (2) The first important such pattern is intra-industry trade (i.e. two countries importing and exporting goods in the same sector to and from each other). To rationalize this, we investigate the first generation of “new trade” models associated with Paul Krugman which incorporates imperfect competition (from both supply and demand side) and product differentiation as a force shaping trading patterns (Paul Krugman won the 2008 Nobel prize for this).
 - (3) Next, we investigate the motivation for countries to raise barriers to trade. We will investigate arguments for why a welfare-maximizing social planner might choose some protection and also look at the political economy explanations of protection. Finally we will look at the economic rationale for the World Trade Organization (WTO) and Free Trade Agreements (FTA) such as NAFTA.

- (4) (1)-(3) constitute the core material of any undergraduate course on trade and most courses do not go beyond these materials. But there is a tension here between the textbook treatment of trade and the real-world relevance of specific issues because issues that are not in the core-material currently constitute probably 90% of the research frontier and 80% of newspaper articles on trade. Many of the most interesting and hotly debated empirical regularities in trade-data cannot be explained by the traditional models. These patterns pertain primarily to (a) the within-sector distribution of firm characteristics and (b) the different organizational forms of production processes. To understand these patterns, we need to introduce really new “new trade” models where the unit of analysis is usually the firm instead of a sector or a country. There are no established ways of teaching many of these models at the undergraduate level and I will try to provide the main insights from this literature with reduced form partial equilibrium versions of these complicated general equilibrium models. The main forces shaping trading patterns in these models are (a) differences in firm-level productivity and (b) the splitting up of the production process into many intermediate steps and the resulting trend to outsource and offshore some of these steps.

COURSE CHARACTERISTICS

- This is not an algebra course! While most of the arguments are model-based, the thrust of the course will be on developing intuition that can be communicated with simple graphs.
 - Graphical intuition for where tangencies and intersections occur is at least as important as algebraic intuition in this course.
- Nonetheless, this is a difficult course!
- The source of this difficulty changes after the midterm:
 - Before the mid-term we cover the traditional old-trade theory which provides you with an elegant and cohesive intellectual framework. The main difficulty is that our analysis will be entirely in general equilibrium which means we model how all markets clear at the same time. This is considerably harder than the partial equilibrium analysis you see in most courses. To illustrate: we need to consider how factors of production are allocated across many industries in many countries, how much they get paid and how this equilibrium pattern varies between a situation with more or less integration/trade. For simplicity, we will typically consider the simplest 2 Factor, 2 Good, 2 Country version of this.
 - After the midterm, we will often use partial equilibrium models. The main difficulty will come from the fact that we will cover a much more diverse set of ideas most of which will be new to you so that you need to move fast to stay on top of the material.
- To give you a sense for the real-world importance of each topic, I will require you to read some selected readings/articles that I will post on Blackboard.

- There is a textbook for this course. This is a great book but it is not required reading as the lecture-notes are designed to be self-contained. The textbook also does not cover “new trade” topics.

Exclusion: ECO230Y1, ECO328Y

Prerequisites: Intermediate Microeconomics ECO200Y1/ECO204Y1/ECO206Y1
AND Statistics ECO220Y1/ECO227Y1 / (STA247H1, STA248H1) / (STA250H1, STA255H1) / (STA257H1, STA261H1)

- Please make sure you satisfy these. The University does check them after the course has started and students who do not have sufficient prerequisites are automatically excluded from the course (and there is nothing I can do about that).

LECTURES, TUTORIALS AND EXAMS:

- Lectures are based on self-contained lecture notes that will be regularly posted on Blackboard.
- Tutorials cover problem sets and solutions to these problem sets will be posted after a tutorial. If you find the algebra-side of the course easy to handle, then there is no need to attend the tutorial.
- The Final Exam is “partly comprehensive” in the sense that I will cover pre-midterm material only to the extent that it relates to post-midterm material. What that means will become clearer over time.
- I will post all important dates and locations on Blackboard but you can also check the examination time-table available at:
<http://www.artsci.utoronto.ca/current/undergraduate/exams>

EVALUATION SCHEME:

- The final mark is the average of the grades from Midterm and Final Exam.
- Each receives 50% of the weight.

OFFICE HOURS, EMAIL POLICY AND DISCUSSION FORUM:

1. I will hold weekly office hours
 - You may email me with brief questions. I will try to respond within 48 hours (but don't expect a response if you email me with last minute questions the night before the exam).
 - I strongly encourage you to use the discussion forum that I will set up on Blackboard to debate ideas. Most students tend to have questions on the same relatively small subset of topics that are either particularly hard or I explained particularly poorly.

EXAM PREPARATION:

- Most priority should be put on the **lecture slides**.
 - I will on occasion use the blackboard in class and that material will be exam-relevant as well so if you missed a lecture, you should get someone's write-up.
 - There will be some bullet-point questions that are based on lecture material and are designed to be very hard to answer. However, you should first make sure you get the big picture before filling in the gaps.
- Around one-third of each exam will be algebra-based questions that relate to the tutorials.
- Around one-third of each exam will also be multiple-choice and a subset of these questions will pertain to the required article-readings.

TEXTBOOK:

- Paul R. Krugman and Maurice Obstfeld, *International Economics: Theory and Policy*, 8th Edition, Addison Wesley, 2009 (referred to as **KO** in what follows) + the Student Access Kit to MyEconLab and eText which comes with the book when purchased at the UofT Bookstore.
- The old 7th edition - which is perfectly fine for this course - is available at the Short-Term Loan Service at the Robarts Library (3rd Floor) in limited numbers.
- **MyEconLab** is an online tool provided by the publisher of the course textbook. This tool contains many textbook resources for students and can be accessed at <http://www.myeconlab.com/>. I do not think these resources will be very useful but they are available to you if you buy the textbook.

ACADEMIC MISCONDUCT

- Students should note that I can not tolerate any form of academic misconduct.
- Any student caught engaging in such activities will be subject to academic discipline ranging from a mark of zero on the test or examination to dismissal from the university as outlined in the academic handbook.
- Any student abetting or otherwise assisting in such misconduct will also be subject to academic penalties.

MISSED EXAMS

- If you miss the Midterm due to illness or other excused absence, you must present a medical note within one week of the date of the test.
- Failure to produce a medical note in time will result in a mark of 0 on the midterm.
- Other excuses (e.g. funerals and car accidents) must be accompanied by a note from a responsible adult that I can verify *in order for excusal to even be considered* (this does not guarantee consideration). The validity of these excuses will then be evaluated by the undergraduate chair.

- The only acceptable medical notes are those provided by the University of Toronto Student Medical Certificate (see the Registration Handbook & Timetable for a copy of the certificate).
- Time conflicts due to travel, employment or other plans will not be accepted as grounds for writing a deferred exam. Instructors cannot make special arrangements with students who miss the final exam for any reason.

TEST SCORE APPEALS:

- Please *type* a short paragraph explaining the grievance and why you should obtain additional points.
- b) Give a hard copy of this document to me or your TA
- c) Conditional on this argument being found persuasive by me, the *entire* exam will be regraded.
- d) Your score can *go up or down*.

Note: This does not apply to trivial appeals such as points being added incorrectly.

“IDEALIZED” LECTURE SCHEDULE:

September 9:	Course Overview, Introduction to Ricardo
September 16:	Finish Ricardo
September 23:	Intro to Heckscher-Ohlin (HO)
September 30:	Finish HO
October 7:	Review HO and Standard Trade Model
October 14:	Midterm
October 21:	Trade and Wages
October 28:	IRS and Taste for Variety Models
November 4:	External IRS and Intro to Optimal Tariffs
November 11:	no class
November 18:	Optimal Tariffs and Trade Organization
November 25:	Firm Heterogeneity
December 2:	Organization of Production.

TUTORIAL SCHEDULE:

September 16:	Ricardo PS 1
September 23:	Ricardo PS 2
September 30:	HO PS 1
October 7:	HO PS 2
October 21:	midterm-review
October 28:	Factor Content PS
November 4:	MC PS
November 11:	no class
November 18:	Optimal Tariffs PS
November 25:	no Tutorial scheduled
December 2:	Review-Session

COURSE OUTLINE:

1. Introduction: Facts about trade, the assumption of balanced trade and the gravity model

- KO Chapters 1-2.

2. The Ricardian Model of Comparative Advantage

- KO Chapter 3.

3. The Factor Proportions/Heckscher-Ohlin Model of Comparative Advantage

- KO Chapter 4.

4. The Standard Trade Model: Growth and Terms of Trade effects in a Ricardian Heckscher-Ohlin World

- KO Chapter 5.

5. The Trade and Wages Debate

6. Monopolistic Competition and Intra-Industry Trade

- KO ch. 6

6. Increasing Returns to Scale and Agglomeration Economies

- KO ch. 6

7a. Trade Policy: Tariffs, subsidies, quotas, VETs

- KO ch. 8 (instruments)

- KO ch. 9 (politics)

7b Trade Institutions: the WTO and FTA

- KO ch. 9 (politics)

8. Heterogeneous Firms.

9. Organizational Forms and Trade in Intermediates