

Chapter 01

International Economics Is Different

Overview

The introduction to the subject of international economics has three major purposes:

1. Show that international economics addresses important and interesting current events and issues.
2. Show why international economics is special.
3. Provide a broad overview of the book.

We begin with four controversies that show the importance of current issues addressed by international economics.

The first controversy began with the rise in U.S. imports of automobile tires from China during 2004-2008. With rising imports, U.S. tire production decreased and some U.S. tire workers lost their jobs. The union that represented about half of U.S. tire workers filed a petition seeking temporary import protection, and the investigation concluded that the surge of tire imports from China was harming the U.S. industry. President Obama had the final decision about what to do. Here the controversy gets more interesting. The President could use the law to raise tariffs against tire imports from China, but should he? Key themes for the course arise in this case. Helping some domestic groups (U.S. tire makers and workers) harms other domestic groups (U.S. tire buyers). And, the basic conclusion is that the losers lose more than the winners win. President Obama did impose higher tariffs, and most of the predicted effects did seem to occur. However, the decline in tire imports from China led less to an increase in domestic production and employment and more to an increase in tire imports from other countries. And, it appears that the Chinese government retaliated against U.S. exports of chicken and auto parts to China. Overall, the United States and China lost some of the mutual gains from international trade.

The second controversy arises from international migration, especially the increasingly vehement complaints about immigrants in many of the major receiving countries. In these countries a rather large (10 percent or more) and rising percentage of the population is foreign-born, including many who are in their new countries illegally. Opponents accuse immigrants of causing general economic harm, imposing fiscal costs as immigrants use government services, and increasing crime. International economics is often about emotional issues like immigration, yet we do our best to use economic analysis to think objectively about actual economic effects. In a preview of the analysis of Chapter 15, we can reach two key conclusions about the effects of immigration on the receiving country. First, as with many issues in international economics, there are both winners and losers in the receiving country. Second, we can determine the net effect on the receiving country. As we often conclude when we examine freer international exchange, the net national effect of immigration is positive according to the basic economic model, in this case even if we ignore the gains to the immigrants themselves.

The third controversy is the exchange rate value of the Chinese yuan. From the mid-1990s to 2005, the Chinese government maintained a fixed exchange rate of the yuan to the U.S. dollar. As China's trade surplus increased and the Chinese government continually had to enter the foreign exchange market to buy dollars and sell yuan to keep the exchange rate steady, the United States and the European Union increasingly complained about the fixed rate. In 2005 the Chinese government began to allow gradual increases in the exchange-rate value of the yuan. In mid-2008, in response to the worsening global crisis, the Chinese government reverted to a fixed exchange rate. Then, as the Chinese economy resumed its rapid growth and China's government continued to amass international reserves through its intervention to defend the fixed exchange rate, foreign pressures reemerged. In mid-2010 China's government again began to allow gradual appreciation of the yuan.

In the controversy over China's exchange rate policy, we can see many of the issues that we will examine in Parts Three and Four of the book, including the measurement and meaning of a country's balance of payments (including its trade balance), government policies toward the foreign exchange market and how a government defends a fixed exchange rate against market pressure for the exchange rate value to change, foreign financial investments and the role of currency speculators, political pressures that can place limits on how long a country with a fixed exchange rate and a trade surplus can maintain the fixed rate value, and how exchange rates affect not only a country's trade balance, but also its national macroeconomic performance (including production, employment, and inflation).

The fourth controversial development is the global financial and economic crisis. It began in the United States, which had experienced a credit boom and a bubble in house prices. As the house price bubble began to deflate in 2006, an increasing number of mortgages went into default. In August 2007 problems at BNP Paribas signaled the depth of losses on securities backed by these mortgages. Furthermore, financial institutions became reluctant to lend to each other, because potential lenders became worried that the borrowing institutions may hold dodgy assets that made it more likely that they could not service their debts in the future. With the failure of Lehman Brothers in September 2008, short-term financial markets and lending among financial institutions froze, and the crisis entered a much worse phase. The crisis shows a controversial downside to globalization. Problems in one sector (housing) in one country can spread to much of the rest of the world, through losses on their foreign investments and through declines in international trade in goods and services. The discussion of the crisis in Chapter 1 forms the backdrop for a series of six new boxes that are interspersed in the book's remaining chapters.

These four controversies show that international economics addresses important current issues. They also can be used to show why international economics is special—why national boundaries matter in economics. The first reason that international economics is special is that some resources do not move freely between countries. Land is essentially immobile. There are substantial impediments to the movement of labor internationally, as we see in the analysis of international migration, because of the personal and economic costs to people of moving from one country to another, and because of restrictive government policies. Financial capital moves more freely, but there still seems to be a home bias to many people's financial investments.

The second reason that international economics is special is that national government policies matter—in fact, they matter in two ways. One way is that national governments can adopt policies toward international transactions, as we see in the political decision to limit U.S. tire imports from China. The other way is that national governments adopt different economic policies. These national policies usually are designed to serve national interests, but they often have international effects. We see the tension between national interests and international effects in the discussion of China's exchange rate policy.

Tips for teaching

One good way to begin the first class session is with a look at current events, even before the mechanics and requirements of the course are presented. The instructor might use the day's newspaper (for instance, the *Financial Times* or *Wall Street Journal*) or the week's magazine (for instance, the *Economist* or *Business Week*) to highlight a few stories related to the content of the course. We have found that this is good way to get the students' attention and interest. Another good beginning would be to provide a discussion that updates one or more of the four controversies in Chapter 1. For example, the instructor could look at the most recent information on China's trade balance and the exchange rate value of its yuan.

You may want to consider beginning other class sessions of the course (not only the first class session) with a look at one or two stories in that day's newspaper. The stories should relate in some way to the material covered in the course, but they do have to relate to the specific material covered in that day's session. We have found that this look at current events reinforces the relevance of international economic analysis. It also encourages students to read a good newspaper or magazine and to keep up with current events. In addition, we can model critical reading, if we both summarize the article's information and offer our own opinion or analysis (or ask the students for their opinions).

The instructor may also point out that there is a lot of information on international issues available on the Web. Figure A.1 in Appendix A provides a list of some important sites.

One issue in teaching is to get students to “take ownership” of the learning of the material. One good way to accomplish this is to get them to teach some of the material. In doing so they gain greater understanding as well as appreciation for the applicability of what sometimes sound like dry concepts and abstract issues. You may want to consider an assignment like the one that Pugel (and others at New York University) have been using successfully. It asks students working in groups to choose a topic based on current and recent events or developments and prepare and make a brief presentation to the rest of the class, during the second half of the course term. The accompanying pages under the heading “Sample Assignment” show a version of this assignment. It is good to get such an assignment set up early in the term, so that students have enough time to gather information and prepare the talk. One more thought—in evaluating each presentation, you may want to get the students in the audience involved by asking each to complete a brief evaluation form for each presentation.

Sample assignment

NEW YORK UNIVERSITY
Stern School of Business

The Global Economy

Group Presentations

Each group will give a presentation to the class about one of the topics listed below. Your presentation is an opportunity to hone your research and presentation skills, to apply concepts from this course (and possibly from other courses), to attack a real issue, and to show off your creativity.

A presentation will last no longer than 15 minutes. In addition, you will have 3 minutes for questions from the class. I suggest you plan a talk that fills about 14 minutes to ensure that you finish within time. Going over the time limit for the presentation will result in a lower evaluation score for “style” and overall assessment.

For the oral part of the presentation, all group members must be involved in speaking. One aspect of the presentation is the ability to transition from one group member to the next as each in turn makes part of the presentation.

Evaluation will be based on three criteria:

- **Informativeness:** Information and data—how much did we learn from your presentation?
- **Analysis and interpretation:** Did you effectively use concepts and relationships from the course (and possibly from other courses) to analyze and/or interpret the information that you have? Were your conclusions sound? Did we gain novel insights into the topic?
- **Style:** Was your presentation logically structured, clear, and compelling? Were the slides effective? Did you keep within the time limit?

Above all, keep your classmates interested. If you use PowerPoint or similar slides, you should bring your presentation file to class on a USB memory stick.

Presentation Topics

Choose your topic from the list below. Topics will be allocated on a first-come, first-served basis. If you prefer a topic of your own devising, let me know and we’ll discuss it.

Each topic comes with a set of questions. There is some scope to modify the questions, if you think it would lead to a more interesting presentation. Just ask me first.

After you know your topic, the group should search for information and start to plan the presentation. After you have an idea of what you will talk about, make an appointment to meet with me. You should come to speak with me at least once before giving your presentation. For many topics you can find much information on the Web. With Web research, it is up to you to verify that a source is credible and accurate.

Here are the suggested topics.

International Outsourcing/Offshoring of Services

Beginning in the 1990s, firms in the United States and other industrialized countries increasingly shifted service activities and jobs to developing countries, especially India. How large is this type of offshoring? How large could it be in the future? Why has it been controversial in the United States? Is it different from regular international trade? Should the U.S. government limit the ability of U.S. firms to send these jobs to other countries?

ASEAN

The member countries of ASEAN have committed to forming a true free trade area. What are the goals for this AFTA? How much progress has been made? Why has progress not been faster? Are there important issues that seem to thwart or limit the effort? What will happen over the next five years or so?

CAFTA

The United States, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic signed the Central American Free Trade Agreement in 2004. What are the key features of the agreement? Why did the various national governments push to reach the agreement? Why has the agreement been controversial in some of the member countries? What effects has CAFTA had in its first years? What will happen in the next three to five years?

Cotton

U.S. policies toward cotton have become globally controversial. What are these policies? What effects do they have on the global cotton market? Why have the policies become controversial? How has the WTO been involved in efforts to alter U.S. cotton policies? How have U.S. policies toward cotton changed in recent years? What is the outlook for the next several years?

Russia and the WTO

After years of negotiations, Russia joined the WTO in December 2011. What was the process for Russia to accede to membership? Why did it take so long for Russia to become a member? What were the major issues that had to be resolved? What have been, and what will be, the major effects of Russia becoming a WTO member?

Oil Prices

Since the late 1990s crude oil prices generally have been higher, sometimes much higher, than they were in the previous decade or so. Has this been the result of the reemergence of OPEC as an effective cartel? What is the evidence that OPEC has had an impact in driving crude oil prices? What is the evidence that other factors matter? What do you think will happen to oil prices in the next five to ten years?

Malaysia: Did Capital Controls Work?

Thailand and Malaysia followed different paths during the Asian crisis, with Malaysia imposing capital controls while Thailand maintained capital mobility. Which worked better? Did Malaysia benefit from reducing its “exposure” to international capital flows?

Ecuador

Ecuador dollarized in 2000. Why did the Ecuadorian government choose this policy? In what ways does it seem to have helped the Ecuadorian economy? In what ways has it hurt or caused problems or costs? Do you think that it was a good or bad idea for Ecuador to dollarize?

China's Yuan Exchange Rate

Foreign countries have been pressing China's government to alter its exchange rate policy to allow more flexibility, presumably so that the yuan will appreciate by a substantial amount. What has been and are China's policies toward the foreign exchange market? From the point of view of China's government and the well-being of the Chinese economy and people, what are the main reasons for the Chinese government to allow more flexibility and (probably) substantial yuan appreciation? What are the main reasons for China's government to maintain its current exchange rate policy? What do you think will actually happen in the next three to five years?

Sovereign Wealth Funds

Some national governments use sovereign wealth funds to invest in a wide range of international financial assets. How large are these funds? What are their funding sources? Are they like other international investors? Should countries receiving their investments be concerned? How should sovereign wealth funds be regulated?

Greece

The euro area crisis began in Greece in 2010. What do you see as the key government macroeconomic and financial policies implemented or used by the Greek government during 1999 to early 2010? Should it have been clear that Greece was heading for a national crisis? Or, was the national crisis mainly bad luck (for instance, spillover from the global crisis that began in the United States)? Why did a national crisis in this very small country become a much bigger crisis for the entire euro area?