

UNIVERSITY OF WATERLOO
Econ 637, Winter 2008
Economic Analysis and Global Governance

January 3, 2008

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Class Meeting Time and Place: 03:30-04:50 MW, PAS 2086

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Office Hours: MW 2:00-3:30

Course Website: All materials and announcements will be posted on [UW-ACE](#)**Course Objective**

This course uses economic analysis to study the causes and consequences of international trade and investment, as well as key policy debates relating to trade and investment issues. The class starts with introducing international trade theory: why nations trade, what they trade, and who gains from this trade. We will then analyze the motives for countries or organizations to restrict or regulate international trade and study the effects of such policies on economic welfare. Further, topics on other policy issues, foreign direct investment (FDI) and trade organizations are also explored.

Structurally, the course is divided into five parts. Part I studies models of trade – how the trade patterns are decided or causes of trade. The reasons that cause international trade include difference in technology (Ricardian model), difference in factor endowments (Heckscher-Ohlin model), government policies, difference in consumer tastes, income per capita, and technology advancement, and increasing-returns-to-scale in production. Learning these models can help you understand the patterns, determinants, and consequences of international trade, and further examine the effects of trade on growth, wages and income distribution, and also the relationship between trade and FDI. At the end of this part we will discuss if empirical work on international trade and evidence support theoretical models. Part II analyzes the tools used by governments to conduct trade policy (e.g., tariffs and quotas) and their impacts on trade volumes and countries' welfare. We will also study decision makings of these trade policies and how they have involved over time. Part III further introduces other trade policy issues such as trade and wages and trade and country development. Part IV is about the trade agreement and organizations. Special emphasis is put on WTO and preferential trade agreements. Part V focuses on FDI theories, empirical evidence and patterns of FDI, and FDI policies.

Course Materials and Recommended Readings

There are no required text books for this course. All the readings and notes will be posted on line. However, the following books will be helpful in different ways for this class. All these four books will be available through the semester at the reserve shelf in UW Dana Porter library.

- James R Markusen, James R Melvin, William M Kaempfer, and Keith Maskus, *International Trade: Theory and Evidence* (McGraw-Hill/Irwin, November 1, 1994), Hardcover, ISBN-10: 007040447X ISBN-13: 978-0070404472
 - This is an intermediate level text book in international trade theory. (Referred to as MMKM in this syllabus). The theoretical part of trade and FDI of this class will follow the guide lines of some chapters in this book.
- Robert C. Feenstra, Gene M. Grossman, and Douglas A. Irwin, *The Political Economy of Trade*

Policy: Papers in Honor of Jagdish Bhagwati (The MIT Press, August 1996). ISBN-10: 0-262-06186-4, ISBN-13:978-0-262-06186-5

- This book (referred to as FGI in this syllabus) is a collection of papers written by a bunch of top international economists. The topics include market distortions, income distribution, and the political process of policy-making. In some papers, complicated economic model is used as the only tool to explain how or why policy works. If you are interested in more advanced works in policy issue research in economics, this book can give you a general idea from the point view of economists.

• Bernard Hoekman and Michel M. Kostecki, *The Political Economy of the World Trading System*, 2nd Edition (Oxford University Press, 2001). Hardcover, ISBN-10: 0198294344, ISBN-13: 978-0198294344

- This book (referred to as H-K in this syllabus) involves minimum economics theory but gives a generalization of trading system and devotes most of its parts to WTO and how it functions. 'It is a comprehensive textbook account of the economics, institutional mechanics, and politics of the world trading system. The second edition has been expanded and updated to cover the period since the creation of the World Trade Organization in 1995, presenting the essentials of multilateral trade negotiations and the prevailing WTO rules and disciplines.'

• Graham Bannock, R.E. Baxter, and Evan Davis, *The Penguin Dictionary of Economics. 7th edition* (Penguin UK, Aug 30 2004). Paperback, ISBN-10: 0141010754, ISBN-13: 978-0141010755

- Students with limited background in international economics and economics may find this book helpful as a reference guide.

Recommended readings for each sector include contents from the above listed books, as well as journal articles.

Assessment

Assessment in the course will consist of:

Two problem sets	20%	PS 1 due on Feb. 13; PS2 due on March 26
One literature review and Q&A	20%	
Mid-term exam	20%	March 3, in class
Final exam	40%	as scheduled by registra's office

Two problem sets will be assigned. Each will be posted around ten days before the due date. No late assignments will be accepted. Feel free to work in groups as problem sets are supposed to be learning experiences. But each student must submit their own problem set solutions.

Throughout the course students will write one paper review, which should summarize and critique papers on one of the topics covered in this class. The paper review should be based on the assigned readings or other journal articles that you come across. In the first class we will decide the assignment of topics for the paper review based on student choice to the extent possible. Review paper should be submitted through UW-ACE two nights before the discussion (e.g. if your paper will be discussed on Monday, you will have to submitted on ACE by Saturday night; if discussion is on Wednesday, then by Monday night), such that everybody can read it before the discussion. There will be around 10-15 minutes of Q&A. The rest of the class must be prepared to ask questions and the writer must be prepared to answer these questions. The grade for paper review will be based on

your writing, your performance in answering questions, and your performance in asking questions for other students' paper review.

Economics Review

We will use some economics graphing skills and knowledge for this course, especially part I and part II. However, it would be difficult to cover this part in class considering your different backgrounds. Therefore, I expect that the review of this knowledge should be done outside class room. I will post a lecture note on review of economics at the beginning of the class. Please make sure you study this as early as you can, as I will assume you have all the necessary background knowledge in economics when lecturing. The other good source of this review is the first four chapters of MMKM book.

Course Outline

Part I International Trade Theory (7 lectures)

A. Introduction

- MMKM Chapter 5 and 6

B. Explaining Trade Patterns—Technology

- MMKM Chapter 7
- G. D. A. MacDougall "[British and American Exports: A Study Suggested by the Theory of Comparative Costs. Part I](#)" *The Economic Journal*, Vol. 61, No. 244. (Dec., 1951), pp. 697-724.
- G. D. A. MacDougall, "[British and American Exports: A Study Suggested by the Theory of Comparative Costs. Part II](#)" *Economic Journal*, 1952(Sept.), Vol.LXII, No.247 pp. 487-521
- Robert M. Stern "[British and American Productivity and Comparative Costs in International Trade](#)", *Oxford Economic Papers*, October 1962, 14(3), pp. 275-296

C. Explaining Trade Patterns-- Factor Endowments

- MMKM Chapter 8
- Leontief, W.W. (1953). "[Domestic Production and Foreign Trade: The American Capital Position Re-examined.](#)" *Proceedings of the American Philosophical Society* 97: 332-349
- Beaulieu, Eugene (2002). [The Stolper-Samuelson Theorem Faces Congress.](#) *Review of International Economics* 10-2: 343-360.
- Heller, P.S.(1976). "[Factor Endowment Changes and Comparative Advantage: The Case of Japan, 1959-1969.](#)" *Review of Economics and Statistics* 58: 283-292
- Baldwin, R.E (1971). "[Determinants of Commodity Structure of U.S. Trade](#)". *American Economic Review* 61:126-146
- Stern, R. M., and Maskus, K.E. (1981). "[Determinants of the Structure of U.S. Foreign Trade, 1958-76.](#)" *Journal of International Economics* 11: 207-224
- Harry P. Bowen; Edward E. Leamer; Leo Sveikauskas, (1987) "[Multicountry, Multifactor Tests of the Factor Abundance Theory,](#)" *American Economic Review*, 77:791-809.
- Trefler, D. (1993) "[International Factor Price Differences: Leontief was Right!](#)" *Journal of Political Economy*, 101: 961-987.

D. Explaining Trade Patterns—Consumers' tastes, income per capita and technology advancement

- MMKM Chapter 13
- Hunter, L. (1991). "[The Contribution of Nonhomothetic Preferences to Trade.](#)" *Journal of International Economics* 30: 345-358

E. Explaining Trade Patterns--Economy of Scales Trade

- MMKM Chapter 12
- Lancaster, Kelvin “[Intra-industry trade under perfect monopolistic competition](#)” *Journal of International Economics*, Volume: 10, Issue: 2 May, 1980, pp. 151-175
- Paul Krugman “[Scale Economies, Product Differentiation, and the Pattern of Trade](#)” *The American Economic Review*, Vol. 70, No. 5. (Dec., 1980), pp. 950-959.
- Paul R. Krugman “[Intraindustry Specialization and the Gains from Trade](#)” *The Journal of Political Economy*, Vol. 89, No. 5. (Oct., 1981), pp. 959-973.

F. Explaining Trade Patterns—Government Policies

- MMKM Chapter 10
- Feenstra, R. C. (1980). “[Monopsony Distortions in an Open Economy: A Theoretical Analysis](#)”. *Journal of International Economics* 10: 213-236
- Friedlaender, A., and Vandendorpe, A. (1968). “[Exercise Taxes and Gains from Trade.](#)” *Journal of Political Economy* 76: 1058-1068
- Melvin, J.R. (1970). “[Commodity Taxation as a Determinant of trade.](#)” *Canadian Journal of Economics* 3: 62-78
- Melvin, J.R. (1979). “[Short-Run Price Effects of the Corporate Income Tax and Implications for International Trade.](#)” *American Economic Review* 69; 765-774

G. Empirical work of trade—Evidence

- MMKM Chapter 14
- Leamer, E. and J. Levinsohn (1995), “[International Trade Theory: The Evidence](#)”, NBER Working paper #4940.
- Davis, Donald and David E. Weinstein (2001), “[What Role for Empirics in International Trade](#)”, NBER Working paper #8543.
- Leamer, E. (1990) “[Testing Trade Theory](#),” NBER Working Paper # 3957
- Helpman, Elhanan (1999) “[The Structure of Foreign Trade,](#)” *Journal of Economic Perspectives*, 13(2), pages 121-44.

Part II Trade Policy (6 lectures)**A. The Instruments of Trade Policy**

- MMKM Chapter 15-16
- W. M. Corden “[The Structure of a Tariff System and the Effective Protective Rate](#)”, *The Journal of Political Economy*, Vol. 74, No. 3. (Jun., 1966), pp. 221-237.

B. Trade policy decision making—why and what?

- FGA pp147-173
- Robert Feenstra, “[How Costly is Protectionism?](#)”, *Journal of Economic Perspectives*, Vol. 6, No. 3. (Summer, 1992), pp. 159-178.
- Robert Baldwin, “[The Political Economy of Trade Policy](#)”, *Journal of Economic Perspectives*, Vol. 3, No. 4. (Autumn, 1989), pp. 119-135.
- Gawande, Kishore and Pravin Krishna (2003), “[The Political Economy of Trade Policy: Empirical Approaches](#)”, *Handbook of International Trade*, James Harrigan and E. Kwan Choi (eds.). Basil Blackwell, 2003, 213-250.
- Mansfield, Edward D., and Marc L. Busch (1995). [The Political Economy of Nontariff Barriers: A Cross-National Analysis](#)” *International Organization* 49-4: 723-749.

- Caves, Richard (1976), "[Economic Models of Political Choice: Canada's Tariff Structure](#)", *Canadian Journal of Economics* 9-2: 278-300.
- Ray, Edward (1981), "[The Determinants of Tariff and Non-Tariff Trade Restrictions in the U.S.](#)", *Journal of Political Economy* 89-1: 105-121.
- Robert E. Baldwin "[The Case against Infant-Industry Tariff Protection](#)", *The Journal of Political Economy*, Vol. 77, No. 3. (May - Jun., 1969), pp. 295-305.
- O'Rourke, Kevin, and R. Sinnott (2001), "[The Determinants of Individual Trade Policy Preferences: International Survey Evidence](#)", *Brookings Trade Policy Forum* 2001: 157-206.
- Scheve, Kenneth and Matthew Slaughter (2001), "[What Determines Individual Trade Policy Preferences](#)", *Journal of International Economics* 54-2: 267-292.
- Mayda, Anna Maria and Dani Rodrik, "[Why Are Some People \(and Countries\) More Protectionist than Others?](#)", *European Economic Review*, Volume: 49, Issue: 6, August, 2005, pp. 1393-1430

C. Trade Policy Reforms

- Fernandez, Raquel and Dani Rodrik (1991), "[Resistance to Reform: Status Quo Bias in the Presence of Individual-Specific Uncertainty](#)", *American Economic Review* 81-5: 1146-1155.
- Cukierman, Alex, and Mariano Tommasi (1998), "[When Does it Take a Nixon to Go to China?](#)", *American Economic Review* 88-1: 180-197.
- Hellman, Joel (1998), "[Winners Take All: The Politics of Partial Reform in Postcommunist Transitions](#)", *World Politics*, 50 (2).
- Vinod Thomas and John Nash, "[REFORM OF TRADE POLICY: Recent Evidence from Theory and Practice](#)", *World Bank Research Observer*, Vol 6(2), 1991: 219-240
- Dani Rodrik, "[Trade Policy Reform as Institutional Reform](#)", Working paper, August 2000
- Ann Harrison and Ana Revenga, "[The Effects of Trade Policy Reform: What Do We Really Know?](#)", NBER Working Paper No. 5225

Part III Other Trade Policy Issues (4 lectures)

A. Trade and Wages

- Slaughter, Matthew J. (1999), "[Globalization and Wages: A Tale of Two Perspectives](#)", *The World Economy* 22-5: 609-630.
- Bhagwati, Jagdish (1995), "[Trade and Wages: Choosing Among Alternative Explanations](#)", *FRBNY Economic Policy Review* / January 1995.
- Lawrence, Robert Z. and Matthew Slaughter (1993), "[International Trade and American Wages in the 1980s: Giant Sucking Sound or Small Hiccup?](#)", *Brookings Papers on Economic Activity. Microeconomics* 1993-2: 162-226.
- Richard Freeman, "[Are Your Wages Set in Beijing?](#)", *Journal of Economic Perspectives*, Vol. 9, No. 3. (Summer, 1995), pp. 15-32.
- Paul Krugman, "[Does Third World Growth Hurt First World Prosperity?](#)", *Harvard Business Review*, July-August 1994.
- Robbins, Donald J. (1996), "[HOS Hits Facts: Facts Win; Evidence on Trade and Wages in the Developing World](#)", *Harvard Institute of International Development*, Development Discussion Paper No. 557.
- Robert C. Feenstra and Gordon Hanson, "[Global Production Sharing and Rising Inequality: A Survey of Trade and Wages](#)", June 2001, Kwan Choi and James Harrigan, eds., *Handbook of International Trade*, Basil Blackwell.

- Gary Burtless, “[International Trade and the Rise in Earnings Inequality](#)”, *Journal of Economic Literature*, Vol. 33, No. 2. (Jun., 1995), pp. 800-816.

B. Trade and Development

- Jeffrey A. Frankel and David Romer, “[Does Trade Cause Growth?](#)” *American Economic Review*, June 1999, pp. 379-399.
- Romain Wacziarg and Karen Horn Welch, “[Trade Liberalization and Growth: New Evidence](#),” NBER Working paper 10152.
- Penny Goldberg and Nina Pavcnik, “[Trade, Inequality and Poverty: What Do We Know?](#)” *Brookings Trade Forum* 2004, 223-269.
- Dollar, David and Aart Kraay (2001), “[Trade, Growth and Poverty](#),” *Finance and Development*, Washington: Sep 2001. Vol. 38, Iss. 3; p. 16
- Rodrik, Dani (2001), “[The Global Governance of Trade: As If Development Really Mattered](#),” United Nations Development Programme Background Paper.
- Sachs, Jeffrey D. and Andrew Warner (1995), [Economic Reform and the Process of Global Integration](#), Brookings Papers on Economic Activity, no. 1, pp. 1-118.
- Rodríguez Francisco and Dani Rodrik (2000) “[Trade Policy and Economic Growth: A Skeptic's Guide to the Cross-National Evidence](#)” NBER Working Paper No. 7081

Part IV International Institutions of Trade (3 lectures)

A. Multilateral Institutions of Trade—GATT/WTO

- MMKM Chapter 20
- H-K pp 9-44, 49-72
- Alan Deardorff and Robert Stern, “[What the Public Should Know about Globalization and the World Trade Organization](#),” *RESEARCH SEMINAR IN INTERNATIONAL ECONOMICS Discussion Paper No. 460*, School of Public Policy, The University of Michigan ,
- WTO website (2006), “[Understanding the WTO](#).”
- Staiger, Robert W., and Guido Tabellini (1999), “[Do GATT Rules Help Governments Make Domestic Commitments?](#)”, *Economics and Politics* 11-2: 109-144.
- Maggi, Giovanni (1999), “[The Role of Multilateral Institutions in International Trade Cooperation](#)”, *American Economic Review* 89-1: 190-214.
- Bagwell, Kyle and Robert W. Staiger (1999), “[An Economic Theory of GATT](#)”, *American Economic Review* 89-1: 215-248.
- Andrew K. Rose “[Do We Really Know That the WTO Increases Trade?](#)”, *The American Economic Review* , Vol. 94, No. 1 (Mar., 2004), pp. 98-114

B. Regional Trade Agreements

- MMKM Chapter 18
- H-K pp 346-367
- FGA pp 265-284
- Paul Krugman, “[The Uncomfortable Truth about NAFTA](#),” *Foreign Affairs*, November 1993.
- Anne O. Kruger, “[Trade Creation and Trade Diversion Under NAFTA](#)”, NBER Working Paper No. 7429
- Jagdish Bhagwati and Arvind Panagariya, “[The Theory of Preferential Trade Agreements: Historical Evolution and Current Trends](#)”, *The American Economic Review*, Vol. 86, No. 2,

Papers and Proceedings of the Hundredth and Eighth Annual Meeting of the American Economic Association San Francisco, CA, January 5-7, 1996 (May, 1996), pp. 82-87

- Ronald J. Wonnacott, “[Free-Trade Agreements: For Better or Worse?](#)”, *The American Economic Review*, Vol. 86, No. 2, Papers and Proceedings of the Hundredth and Eighth Annual Meeting of the American Economic Association San Francisco, CA, January 5-7, 1996 (May, 1996), pp. 62-66
- Philip I. Levy, “[A Political-Economic Analysis of Free-Trade Agreements](#)”, *The American Economic Review*, Vol. 87, No. 4 (Sep., 1997), pp. 506-519
- Gary P. Sampson, “[Compatibility of Regional and Multilateral Trading Agreements: Reforming the WTO Process](#)”, *The American Economic Review*, Vol. 86, No. 2, Papers and Proceedings of the Hundredth and Eighth Annual Meeting of the American Economic Association San Francisco, CA, January 5-7, 1996 (May, 1996), pp. 88-92

Part V Foreign Investment (4 lectures)

A. FDI & MNEs, model and theory

- MMKM Chapter 22
- James Markusen, “[The Boundaries of Multinational Enterprises and the Theory of International Trade](#)”, *Journal of Economic Perspectives*, Vol. 9, No. 2. (Spring, 1995), pp. 169-189.
- Robert Feenstra, “[Integration of Trade and Disintegration of Production in the Global Economy](#),” *Journal of Economic Perspectives*, Vol. 12, No. 4. (Autumn, 1998), pp. 31-50.
- John Dunning “[The Eclectic \(OLI\) Paradigm of International Production: Past, Present and Future](#)”, *International Journal of the Economics of Business*, Volume 8, Issue 2 July 2001, pages 173 – 190
- Horstmann, I.J. and J.R. Markusen. 1987. “[Strategic Investments and the Development of Multinationals](#).” *International Economic Review* 28: 109-121.
- Markusen, J.R. 1984. [Multinationals, Multi-Plant Economies, and the Gains from Trade](#). *Journal of International Economics* 16: 205-226.
- Markusen, J.R. and K. Maskus. 1999. “[Discriminating among Alternative Theories of the Multinational Enterprise](#).” NBER Working Paper No. 7164.
- Markusen, J.R., A.J. Venables, D.B. Konan, and K. Zhang. 1996. “[A Unified Treatment of Horizontal Direct Investment, Vertical Direct Investment, and the Pattern of Trade in Goods and Services](#).” NBER Working Paper No. 5696.
- Carr, D.L., J.R. Markusen, and K.E. Maskus. 2001. “[Estimating the Knowledge-Capital Model of the Multinational Enterprise](#).” *American Economic Review*, 91: 693-708.

B. FDI and Patterns

- Hanson, Gordon H., Raymond Mataloni, and Matthew J. Slaughter (2001), “[Expansion Strategies of U.S. Multinational Firms](#)”, *NBER Working Paper* 8433.
- Lipsey, Robert E. (2001). “[Foreign direct investment and the operations of multinational firms: concepts, history, and data](#)”, *NBER Working Paper* 8665.
- Feenstra, R.C. and G.H. Hanson. 1999. [The Impact of Outsourcing and High-Technology Capital on Wages: Estimates for the United States, 1979-1990](#). *Quarterly Journal of Economics* 114: 907-940.
- Grubert, H. and J. Mutti. 1991. [Taxes, Tariffs, and Transfer Pricing in Multinational Corporation Decision Making](#). *Review of Economics and Statistics* 73: 285-293
- Wheeler, D. and A. Mody. 1992. [International Investment Location Decisions](#). *Journal of*

International Economics 33: 57-76.

C. FDI Policies

- FGA pp 199-220
- Blonigen, B. and R. Feenstra (1996), "[Protectionist Threats and Foreign Direct Investment](#)", *NBER Working Paper* 5475.
- Jensen, Nathan (2003), "[Democratic Governance and Multinational Corporations: Political Regimes and Inflows of Foreign Direct Investment](#)", *International Organization* 57-3: 587-616.
- Moran, Theodore (1978), "[Multinational Corporations and Dependency](#)", *International Organization* 32: 79-100.
- Hanson, G.H. 2001. [Should Countries Promote Foreign Direct Investment?](#) G-24 Discussion Paper Series No. 9.

School Policies

• Courses Drops and Adds:

Students may freely add courses for the first two weeks of term, and freely drop courses for the first three weeks. Courses dropped during weeks four to eight will automatically receive a grade of WD (withdraw); courses dropped from week nine onwards will automatically receive a grade of WF (withdraw, fail). **Instructor does not have the authority to "drop" a student from a course.** Students will automatically receive either WD or WF, unless they petition to the Examinations & Standings Committee.

• Note on avoidance of academic offenses:

All students registered in the courses of the Faculty of Arts are expected to know what constitutes an academic offense, to avoid committing academic offenses, and to take responsibility for their academic actions. When the commission of an offense is established, it will be acknowledged by disciplinary penalties. *For information on categories of offenses and types of penalties, students are directed to consult the summary of Policy #71 (Student Academic Discipline) which is supplied in the Undergraduate Calendar (p.1:11).* If you need help in learning how to avoid offenses such as plagiarism, cheating, and double submission, or if you need clarification of aspects of the discipline policy, ask your course instructor for guidance. Other resources regarding the discipline policy are your academic advisor and the Undergraduate Associate Dean.

- Students who believe that they have been wrongfully or unjustly penalized have the right to grieve; refer to Policy #70, Student Grievance <http://www.adm.uwaterloo.ca/infosec/Policies/policy70.html>
- **How to Avoid Plagiarism and Other Written Offences:** A Guide for Students and Instructors – Go to <http://watarts.uwaterloo.ca/~sager/plagiarism.html>
- **Note for students with disabilities:** The Office for Persons with Disabilities (OPD), located in Needles Hall, Room 1132, collaborates with all academic departments to arrange appropriate accommodations for students with disabilities without compromising the academic integrity of the curriculum. If you require academic accommodations to lessen the impact of your disability, please register with the OPD at the beginning of each academic term.