📌 CHAPTER 1.1 — Introduction to International Economics

1. What Is International Economics?

International economics studies how nations interact through:
• Trade of goods & services
• Money flows
• Investment flows

It consists of two main branches:
1. International Trade (micro-based)
– Gains from trade
– Trade patterns
– Trade policy (tariffs, quotas, subsidies)
2. International Finance (macro-based)
– Balance of payments
– Exchange rates
– Capital markets
– Policy coordination

2. Why It Matters

Countries today are more interconnected than ever, and trade is a growing share of GDP globally.

3. Gains from Trade

Core insight: Voluntary exchange benefits both sides.
• Specialization improves efficiency.
• Countries export goods made with abundant resources, and import those requiring scarce resources.
• Workers in import-competing sectors may lose, even if the country as a whole gains.

4. Pattern of Trade

Explained by:
• Climate & natural resources
• Labor productivity differences

• Factor endowments (labor, capital, land)

5. Government Policy Effects

Policies that change trade flows:
• Tariffs
• Quotas
• Export subsidies
• Regulations

Trade restrictions usually:
• Benefit protected industries
• Harm consumers
• Reduce efficiency

6. Exchange Rates

Exchange rate changes affect import and export prices, influencing:
• Competitiveness
• Trade balances

7. Key Assumptions Used in the Course
• Full employment
• Perfect competition (P = MC)
• Factors immobile internationally
• No transportation costs (initially)
• Money is only a “veil” (real variables matter)

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📌 CHAPTER 2.1 — Ricardian Model & Classical Trade Theory

1. Reasons Countries Trade
• Technology differences (Ricardian model)
• Resource differences
• Offshoring costs
• Geographical proximity

2. Absolute vs. Comparative Advantage
• Absolute Advantage: produce more with same inputs.
• Comparative Advantage: lower opportunity cost → main driver of trade.

3. Ricardian Model Setup
• Two countries, two goods
• Labor is the only input
• Goods produced using labor → constant MPL
• PPF is linear

4. No-Trade (Autarky) Equilibrium
• Production = Consumption
• Occurs at tangency between PPF & indifference curve
• Relative price = opportunity cost = slope of PPF

5. Trade Equilibrium
• Countries export the good with lower opportunity cost.
• World relative price falls between autarky prices of the two countries.

6. Gains from Trade
• Specialization → higher world output
• Consumption at higher indifference curve
• Both countries gain even if one is more productive in everything.

7. Wages in the Ricardian Model
• Wage = P × MPL
• Home with higher productivity earns higher real wage, but:
Workers in both countries still gain from trade

8. Export Supply & Import Demand
• Home export supply increases when world price of wheat rises.
• Foreign import demand increases when price of wheat falls.
• Equilibrium determined by intersection of both curves.

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📌 CHAPTER 3.1 — Standard Trade Model (Increasing Opportunity Costs)

1. Increasing Opportunity Cost
• PPF is bowed out → MRT increases as more of a good is produced.
• Reason: factors are not equally suited to producing both goods.

2. Autarky (No Trade)
• Country produces/consumes where PPF tangent to indifference curve.
• Autarky relative price = slope of tangent.

3. Comparative Advantage
• Determined by lower opportunity cost, not productivity alone.

4. Trade with Increasing Costs
• Countries partially specialize, not fully.
• Relative price moves between both countries' autarky prices until trade is balanced.

5. Gains From Trade

Two types:
1. Gains from Exchange:
Trading along world price line → higher consumption.
2. Gains from Specialization:
Moving production toward comparative advantage.

6. Offer Curves (Reciprocal Demand)
• Show how much a country is willing to import/export at each relative price.
• Intersection of two offer curves → equilibrium terms of trade.

7. Terms of Trade (ToT)

\text{ToT} = \frac{P_{\text{exports}}}{P_{\text{imports}}}
• Higher ToT → country gains (exports buy more imports).
• Lower ToT → country loses.

8. Shifts in Offer Curves
• More willingness to trade → curve shifts outward.
• Less willingness → curve shifts inward.
• Affects ToT and volume of trade.

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📌 CHAPTER 4.1 — Specific-Factors Model & Income Distribution

1. Purpose of the Model

To show how trade affects income distribution within a country.

2. Structure of the Model

- Two sectors: Manufacturing & Agriculture
- Three factors:
- Labor (mobile)
- Capital (specific to manufacturing)
- Land (specific to agriculture)

3. Key Mechanism

When relative price of a good rises (e.g., manufacturing):

- Sector expands → hires more labor
- Wage rises but by less than the price increase
- Specific factors gain/lose asymmetrically:
- Capital owners (manufacturing) → gain
- Landowners (agriculture) → lose
- Workers → ambiguous effect

(depends on their consumption mix)

4. Gains From Trade

- Country gains overall (higher indifference curve).
- But income distribution becomes uneven → winners & losers.

5. Political Implications

- Explains support for protectionism
- Supports policies like Trade Adjustment Assistance (TAA)

6. Wage Determination

- Wage = value of marginal product:

$W = P \cdot MPL$

- Labor moves between sectors until wages equalize.

7. Short-Run vs. Long-Run

- Short run: factors specific → uneven impacts.
- Long run: factor mobility reduces distributional effects.