International Economic Cooperation

Lecture I

Introduction

International economic is an applied economics requiring study of gains from trade, patterns of trade, protectionism, balance of payments, exchange rate determination, coordination in international policy & international capital market.

International economics studies how independent economies of world interact with one another in the process of allocating the scarce resources to satisfy human wants.

Scope of International Economics

Focuses on the flow of goods, services, payments, money, and people between nations.

Examines policies regulating these flows and their impact on national welfare.

Explores the effects of economic and financial interdependence on:

Political, social, cultural, and military relations among nations.

Scope of International Economics

- Two Main Areas (Traditional View):
  - International Trade
  - International Finance
- Four Windows on the Modern World Economy:
  - International Trade
  - International Production
  - International Finance
  - International Development

International Trade

- Focuses on microeconomic aspects of international economics.
- Deals with:
  - Individual nations as single units.
  - Relative prices of individual commodities.
- Trade Theories and Policies:
  - Absolute advantage, comparative advantage, etc.

International Production

- Involves the production of goods across multiple countries.
- Two Modes of International Production:
  - Contracts:
    - Licensing
    - Franchising
  - Foreign Direct Investment (FDI):
    - Undertaken by multinational enterprises.

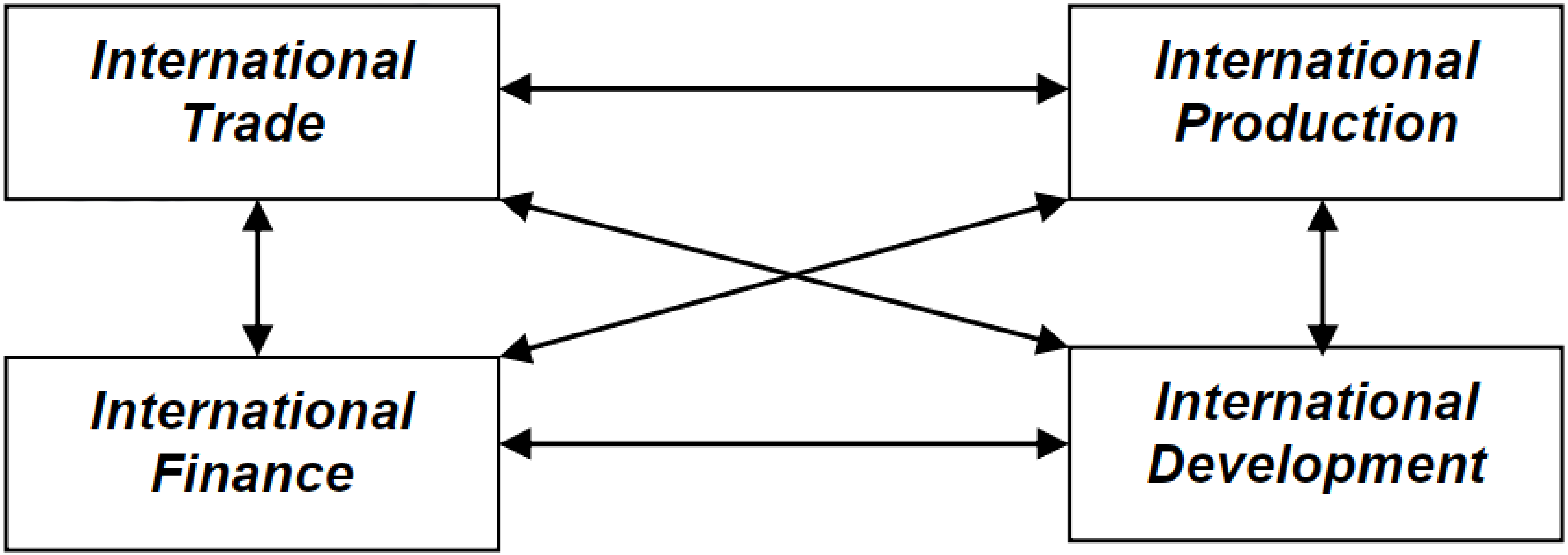
International Finance

- Focuses on macroeconomic aspects of international economics.
- Involves the exchange of assets among countries.
- Key Topics:
  - Balance of Payments (BoP): Total receipts and payments.
  - Adjustment policies affecting national income and general prices.
- Also called **Open Economy Macroeconomics**.

International Development

- Final window on the global economy.
- Evaluates how trade, production, and finance:
  - Contribute to improved welfare and living standards.
  - Support or undermine **global development goals**.
- Aims for equitable development across nations.

Connecting Windows



Common fallacies of International Trade

1.Trade is a zero sum activity

2.Imports are bad and exports are good

3. Tariffs and quotas save jobs and promote higher level of employment

Historical Development

- Emerged as a specialized field over the past two centuries.
- **Thomas Munn** (1571–1641) was perhaps the most influential of the mercantilist writers, and his **England's Treasure by Foreign Trade** was the outstanding exposition of mercantilist thought on trade.
- Pioneered by economists such as: Adam Smith and David Ricardo (**early foundations**).
- John Stuart Mill, Alfred Marshall, John Maynard Keynes, and Paul Samuelson (**expanded theory and practice**).

Mercantilists' View on Trade

- Emerged during 17th–18th centuries in **England**, **Spain**, **France**, **Portugal**, and **The Netherlands**.
- *According to Gray, mercantilism was conditioned by two things:*
  - *perpetual neediness of government and*
  - *effect of discoveries of precious metals and their inflow to European economies.*
- Mercantilists maintained that a nation can become rich and powerful if it exports more than it imports.
- The resulting export surplus would then be settled by an inflow of bullion or precious metals primarily gold or silver.

Core Principles of Mercantilism

Export > Import:

Nations should export more than they import.

Goal: Accumulate bullion (gold and silver).

Government Role:

Stimulate exports.

Discourage or restrict imports.

Zero-Sum Perspective:

Wealth (gold and silver) is fixed at any point in time.

One nation's gain = Another nation's loss.

Features of Mercantilism

- Wealth and Prosperity:
  - Accumulate gold (bullion) as the essence of wealth.
  - Maintain a trade surplus for economic prosperity.
- Trade and Industry:
  - Regulate foreign trade to maximize social welfare.
  - Encourage exports of manufactured goods.
  - Restrict imports of manufactured goods with high tariffs.
  - Import cheap raw materials, but not food items.
- Colonialism and Power:
  - Promote colonialism for resources.
  - Use gold reserves to maintain larger and stronger armies.
- State Intervention:
  - State plays a central role in regulating all economic activity.
  - Advocates for economic nationalism, as one nation’s gain is at the expense of others.

Key Criticisms of Mercantilism

1. Excessive Focus on Bullion:
   - Overemphasized gold and silver as the essence of wealth.
2. Neglect of Agriculture:
   - Prioritized commerce and trade, undermining the importance of agriculture.
3. Misconceptions About Trade:
   - Believed that only favorable trade balances lead to prosperity.
   - Incorrectly assumed trade is a zero-sum game, where one nation's gain is another's loss.
4. Ignored Adverse Effects:
   - Overlooked long-term negative effects of continuous favorable trade.
   - Exception: Recognized by Thomas Mun.
5. Short-Term Policy:
   - Temporary approach but laid the foundation for capitalism.

Overview of Trade Restrictions

Claim vs. Reality

- Nations advocate **free trade**, but many impose restrictions.
- **Protectionist Policies:**
  - Import restrictions on agricultural goods, textiles, shoes, steel, etc., to protect domestic jobs.
  - Subsidies to key industries (e.g., computers, telecommunications) for competitiveness.
- Shift from overt protection (tariffs, quotas) to indirect methods:
  - **Tax benefits**
  - **R&D subsidies**
- Result: Ongoing trade disputes globally.

Key Trade Disputes (U.S. vs. EU)

- Hormone-Treated U.S. Beef:
  - EU prohibits imports.
- Banana Import Preferences:
  - EU favors African suppliers over U.S.-owned Central American plantations.
- Airbus vs. Boeing:
  - EU subsidies for Airbus' super-jumbo jet affect Boeing’s 747 sales.
- Steel Tariffs and Tax Rebates:
  - U.S. tariffs on steel; tax incentives for exporters.