

International Trade ECO7332

Fall 2013

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Class meetings: Tuesday and Thursday 2:00-3:20. **Caruth Hall 0384.**

Office Hours: Tuesday and Thursday 10-11, also by appointment. Umphrey Lee room 301Z.

Course website: <https://courses.smu.edu/>

Student learning objectives

- Demonstrate a strong ability to use economic theory to explain why countries engage in trade.
- Demonstrate a strong ability to use economic theory to explain how geography affects the extent to which countries engage in trade.
- Demonstrate a strong ability to use economic theory to explain how trade affects factor allocation both within and across industries.
- Demonstrate a strong ability to use economic theory to explain how political economy affects trade policy.
- Demonstrate a strong ability to use economic theory to explain why countries form trade agreements.
- Demonstrate a strong ability to analyze the distributional implications of international trade, both within and across countries, through the use of economic theory and empirical methods.
- Strengthen the ability to relate economic theory and empirical methods to new problems surrounding international trade.

Course description

This is a topics course in advanced international trade. After briefly reviewing the traditional models of international trade (Ricardo, Heckscher–Ohlin–Samuelson and Specific Factors models), the course will cover topics including the role of geography and technology in shaping international trade, the role of constant returns to scale and firm heterogeneity in explaining patterns of international trade, the role of political economy in determining trade policy, and the labor market distributional effects created by international trade. The course has a theoretical focus but also discusses empirical methods.

Course requirements and assessment

Naturally, I expect that you will attend all classes. In addition to this, there are three requirements for the course.

1. Problem sets (20%)

I will distribute three or four problem sets. They will largely be based on the papers from class and will often include deriving or proving aspects of the paper that were not presented in the paper or in class. The problem sets will be graded on a check plus, check and check minus scale. These problem sets are your best guide for potential midterm questions.

2. Midterm exam (30%)

The midterm will take place in-class the day immediately following the class in which I finish teaching the class material. As such, the date of the midterm is flexible. In the current timetable, I have scheduled the midterm for 10/26. The exam will be closed book and will contain similar problems to the problem sets.

3. Student presentation and discussion initiation (30%)

Each student will present one paper from the list below. Each student will also be the “discussion initiator” for one paper from the list below (obviously, the paper you will present is different from the paper for which you are the discussion initiator). A student presentation will last for the entire lecture but you should probably treat it as a 50-60 minute presentation to leave time for discussion and questions from your classmates as well as myself.

When presenting the paper, treat it as if you are an newly hired Assistant Professor teaching it to second year PhD students in an international trade field course. You

should try to be clear about the question posed, how the question and results fit into the existing literature, the model (theoretical or empirical) used, the results and especially the key insight of the paper. You are not expected to understand everything in the paper, so it's OK to point out areas of the paper where you didn't follow or could not understand.

You should prepare slides preferably using some type of scientific word processing software such as LATEX (not a WYSIWYG program meaning that you don't see your equations in the interface but rather you have to type your equations in code. LATEX is free), Scientific Word or Lyx (these are both WYSIWYG programs so you see your equations in the interface. Lyx is free but Scientific Word is not). You will end up writing your dissertation and giving presentations using such software so it's best to start using it sooner rather than later.

When you are assigned as the "discussion initiator" you are expected to have read the paper carefully. Since the presenter should have read the paper more carefully and had the opportunity to further their understanding by preparing slides, your role is to lead the class in terms of asking questions of the presenter in parts where you were confused or you thought the paper was unclear. The rest of the class should have looked at the paper as well to the extent that they can participate in the discussion by asking questions of the presenter.

4. Attendance at department seminars when the speaker is an international trade economist (20%)

To receive credit for this part of the assessment you must attend all 4 trade based seminars. The only exception is if you write to me beforehand with a valid excuse. It is your responsibility to follow the seminar schedule and make sure you attend the relevant seminars. The seminar schedule is available here: <http://www.smu.edu/Dedman/Academics/Departments/Economics/Events/Seminars>. The trade seminars are:

- 8/29: Tibor Besdes (Georgia Tech, <http://www.prism.gatech.edu/~tbesedes3/>) **during classtime on Thursday 8/29**. The normal seminar room will be occupied, so the seminar is in **McCord Auditorium, Dallas Hall, Room 306**.
- 10/4: Klaus Desmet (Carlos Madrid III, <http://www.eco.uc3m.es/~desmet/>)
- 10/25: Ray Riezman (U of Iowa, <http://www.biz.uiowa.edu/faculty/rriezman/>). Ray is the organizer of the Midwest Trade meetings which are held twice annually (Fall and Spring). If you pursue international trade in your dissertation, this is

a conference you should certainly try to attend before you go on the job market (<http://myweb.uiowa.edu/rriezman/>)

- 11/8: Kyle Bagwell (Stanford, <http://www.stanford.edu/~kbagwell/>)

Textbook

The nature of the class, which is more of a “topics” class means that we will not use a primary textbook. However, to the extent that we do use such a book it will be “Advanced international trade: theory and evidence” by Feenstra (2003).

University policies

Disability Accommodations

Students needing academic accommodations for a disability must first be registered with Disability Accommodations & Success Strategies (DASS) to verify the disability and to establish eligibility for accommodations. Students may call 214-768-1470 or visit <http://www.smu.edu/alec/dass.asp> to begin the process. Once registered, students should then schedule an appointment with the professor to make appropriate arrangements.

Religious Observance

Religiously observant students wishing to be absent on holidays that require missing class should notify their professors in writing at the beginning of the semester, and should discuss with them, in advance, acceptable ways of making up any work missed because of the absence.

Excused Absences for University Extracurricular Activities

Students participating in an officially sanctioned, scheduled University extracurricular activity should be given the opportunity to make up class assignments or other graded assignments missed as a result of their participation. It is the responsibility of the student to make arrangements with the instructor prior to any missed scheduled examination or other missed assignment for making up the work.

Plagiarism

All students are expected to abide by the SMU honor code <http://smu.edu/honorcouncil/>, including those sections related to plagiarism. Plagiarism is a serious academic offense and ignorance is not an excuse. Further information regarding plagiarism can be found at <http://smu.edu/honorcouncil/othersites.asp>. Consequences include failure of the particular

assessment task in question, failure of the course and disciplinary referral to the SMU Honor council.

Course topics and reading guide

The course consists of three sections.

1. **Brief review of the three standard models of international trade**

The three models are the Ricardo model, the Heckscher Ohlin model and the Ricardo–Viner (a.k.a. specific factors) model. This should not take more than two lectures. While the material will have been covered in Professor Osang’s ECO7333 class, we review it here both as a refresher and also to ensure everyone is familiar with the basic models.

2. **Topics in international trade**

This middle section of the course is more like a topics course. It will emphasize recent developments in the field. Four topics form the basis of the course. The first two sections of the course should take about 8 weeks.

(a) **Geography and technology in trade**

We will cover two papers. The first is the seminal paper by Dornbusch, Fischer and Samuelson (1977) which extends the basic Ricardo model to a continuum of goods (but still only two countries). The second is the seminal paper by Eaton and Kortum (2002) who extend the Dornbusch, Fischer and Samuelson model to N countries and stochastic technology. Their theoretical model allows them to undertake a structural empirical analysis.

(b) **The role of increasing returns to scale and firm heterogeneity**

We will cover two and perhaps three papers here. The first is the seminal paper by Krugman (1980) who introduces a simple model with increasing returns to scale that is not only able to explain intra–industry trade but also the casual observation that having a large home market gives exporters a head start in foreign markets. The second paper is the seminal paper by Melitz (2003) who extends the Krugman (1980) model by adding firm heterogeneity to explain a number of stylized facts about firm level exporter characteristics that, until that time, the trade literature could not explain. The third paper (depending on time constraints) is the contemporaneous paper by Bernard, Eaton, Jensen and

Kortum (2003) that uses a Ricardian type model to explain similar stylized facts as Melitz.

(c) **The political economy of trade policy**

We will cover two papers here. The first is the seminal paper of Grossman and Helpman (1994) which uses a small open economy model to show how the domestic distributional effects of international trade and the desire of politicians to raise campaign contributions can lead to trade policy that deviates from free trade even though free trade maximizes the welfare of the country. The second is the seminal paper by Bagwell and Staiger (1999) showing the terms of trade externality (or “beggar thy neighbor” effects) that exists between large countries is the only reason such countries do not implement efficient trade agreements and that the principles of GATT help sustain efficient trade agreements.

(d) **The labor market distributional effects of trade liberalization**

We will cover two papers here. The first is a recent paper by McLaren and Hakobyan (2012) looking at how NAFTA affects local labor market outcomes. The second is the recent article by Autor, Dorn and Hansen (2012) which is actually forthcoming in the AER and looks at the effect of the recent increase in Chinese imports on labor market outcomes.

3. Student presentations

The student presentations will occupy approximately the final 10 classes. The expectations for these presentations was described above.

Course outline

Date	Lectures	Topics	Readings
8/27	1	Preliminaries and standard trade models	
8/29	2	Tibor Besedes seminar (during class time)	
9/3	3	Preliminaries and standard trade models	
9/5, 9/10,9/12,9/17	4-7	Geography, technology and trade	
9/19, 9/24,9/26,10/1	8-11	Increasing returns to scale and firm heterogeneity	
10/3,10/8,10/10	12-14	The political economy of trade policy	
10/15		FALL BREAK (NO CLASS)	
10/17,10/22,10/24	15-17	The labor market distributional effects of international trade	
10/26	18	Midterm	
10/29-12/9	19-28	Student presentations	
11/28		THANKSGIVING (NO CLASS)	
12/9		Final day of class	

Reading list

Note that * means required reading as these are the papers that we will work through in class.

Preliminaries

*Feenstra, R. C., 2003. Advanced international trade: theory and evidence. Princeton University Press.

- Ricardo model: pp.1–4
- HOS model: pp.4–29 (but use the notes from class as a guide of the necessary material for review since the chapter goes beyond this)
- Specific factors model: pp. 71–75

Geography, technology and trade

*Dornbusch, R., Fischer, S., Samuelson, P. A., 1977. Comparative advantage, trade, and payments in a ricardian model with a continuum of goods. *The American Economic Review* 67 (5), 823–839.

*Eaton, J., Kortum, S., 2002. Technology, geography, and trade. *Econometrica* 70 (5), 1741–1779.

Chaney, T., 2008. Distorted gravity: the intensive and extensive margins of international trade. *The American Economic Review* 98 (4), 1707–1721.

Increasing returns to scale and firm heterogeneity

*Krugman, P., 1980. Scale economies, product differentiation, and the pattern of trade. *The American Economic Review* 70 (5), 950–959.

*Melitz, M. J., 2003. The impact of trade on intra-industry reallocations and aggregate industry productivity. *Econometrica* 71 (6), 1695–1725.

Krugman, P. R., 1979. Increasing returns, monopolistic competition, and international trade. *Journal of international Economics* 9 (4), 469–479.

Bernard, A., Eaton, J., Jensen, J., Kortum, S., 2003. Plants and productivity in international trade. *American Economic Review*, 1268–1290.

Bernard, A. B., Jensen, J. B., Redding, S. J., Schott, P. K., 2007. Firms in international trade. *The Journal of Economic Perspectives* 21 (3), 105–130.

- Melitz, M. J., Ottaviano, G. I., 2008. Market size, trade, and productivity. *The Review of Economic Studies* 75 (1), 295–316.
- Helpman, E., Itskhoki, O., 2010. Labour market rigidities, trade and unemployment. *The Review of Economic Studies* 77 (3), 1100–1137.
- Demidova, S., Rodríguez-Clarez, A., 2011. The simple analytics of the Melitz model in a small open economy. NBER Working Paper no. 17521.
- Arkolakis, C., Costinot, A., Rodríguez-Clare, A., 2012. New trade models, same old gains? *American Economic Review* 102 (1), 94–130.
- Krishna, P., Poole, J., Senses, M., 2012. Trade, labor market frictions, and residual wage inequality across worker groups. *The American Economic Review* 102 (3), 417–423.
- Helpman, E., Itskhoki, O., Muendler, M., Redding, S. J., 2012. Trade and inequality: From theory to estimation. NBER Working Paper no. 17991.
- Melitz, Marc J, and Stephen J Redding. Forthcoming. Heterogeneous Firms and Trade. In *Handbook of International Economics*, 4th ed.

Political economy of trade policy

- *Grossman, G., Helpman, E., 1994. Protection for sale. *American Economic Review* 84 (4), 833–850.
- *Bagwell, K., Staiger, R., 1999. An economic theory of GATT. *American Economic Review* 89 (1), 215–248.
- Trefler, D., 1993. Trade liberalization and the theory of endogenous protection: an econometric study of U.S. import policy. *Journal of Political Economy* 101 (1), 138–160.
- Grossman, G. M., Helpman, E., 1995. Trade wars and trade talks. *The Journal of Political Economy* 103 (4), 675–708.
- Krishna, P., 1998. Regionalism and multilateralism: A political economy approach. *Quarterly Journal of Economics* 113 (1), 227–251.
- Gawande, K., Krishna, P., 2003. The political economy of trade policy: Empirical approaches. *Handbook of international trade* 1, 139–152.
- Feenstra, R. C., 2003. *Advanced international trade: theory and evidence* (Chapter 9). Princeton University Press.
- Ludema, R.D., Mayda, A.M., Mishra, P., 2011, Protection for Free? The Political Economy of US Tariff Suspensions, mimeo.
- Facchini, G., Silva, P., Willmann, G., 2012. The customs union issue: Why do we observe so few of them? *Journal of International Economics* 90 (1), 136–147.

The labor market distributional effects of international trade

*McLaren, J., Hakobyan, S., 2010. Looking for local labor market effects of NAFTA. National Bureau of Economic Research Working Paper no. 16535.

*Autor, D. H., Dorn, D., Hanson, G. H., 2012. The China syndrome: Local labor market effects of import competition in the United States. NBER Working Paper no. 18054.

Artuc, E., Chaudri, S., McLaren, J., 2010. Trade shocks and labor adjustment: A structural empirical approach. *The American economic review* 100 (3), 1008–1045.

Kovac, B., 2011. Local labor market effects of trade policy: evidence from Brazilian liberalization. Mimeo.

Kosar, K., 2013. Adjusting to trade liberalization: reallocation and labor market policies. Mimeo.

Kovac, B., 2013. Regional Effects of Trade Reform: What is the Correct Measure of Liberalization? *American Economic Review* 103 (5), 1960–1976.

Student presentations

I will send an email later today that has a link for you to sign up for which paper you will present and which paper you will be the discussion initiator.

Note: ^ indicates that the paper has a substantial empirical component.

Firm heterogeneity

Melitz, M. J., Ottaviano, G. I., 2008. Market size, trade, and productivity. *The review of economic studies* 75 (1), 295–316.

Helpman, E., Itskhoki, O., 2010. Labour market rigidities, trade and unemployment. *The Review of Economic Studies* 77 (3), 1100–1137.

Arkolakis, C., Costinot, A., Rodríguez-Clare, A., 2012. New trade models, same old gains? *American Economic Review* 102 (1), 94–130.

^Krishna, P., Poole, J., Senses, M., 2012. Trade, labor market frictions, and residual wage inequality across worker groups. *The American Economic Review* 102 (3), 417–423.

Political economy of trade policy

^Gawande, K., Krishna, P., Olarreaga, M., 2012. Lobbying competition over trade policy. *International Economic Review* 53 (1), 115–132.

^Trefler, D., 1993. Trade liberalization and the theory of endogenous protection: an econometric study of U.S. import policy. *Journal of Political Economy* 101 (1), 138–160.

Trade agreements

Grossman, G., Helpman, E., 1995. The politics of free-trade agreements. *The American Economic Review* 85 (4), 667-690.

Ornelas, E., 2008. Feasible multilateralism and the effects of regionalism. *Journal of International Economics* 74 (1), 202–224.

Facchini, G., Silva, P., Willmann, G., 2012. The customs union issue: Why do we observe so few of them? *Journal of International Economics* 90 (1), 136–147.

Labor and trade/off-shoring

Artuc, E., Chaudri, S., McLaren, J., 2010. Trade shocks and labor adjustment: A structural empirical approach. *The American economic review* 100 (3), 1008–1045.

Helpman, E., Itskhoki, O., 2010. Labour market rigidities, trade and unemployment. *The Review of Economic Studies* 77 (3), 1100–1137.

Grossman, G. M., Rossi-Hansberg, E., 2008. Trading tasks: A simple theory of offshoring. *American Economic Review* 98 (5), 1978.