

## An Introduction to International Economics

### SECOND EDITION

This book is designed for a one-semester course in international economics, primarily targeting non-economics majors and programs in business, international relations, public policy, and development studies. It has been written to make international economics accessible to both students and professionals. Assuming a minimal background in economics and mathematics, the textbook goes beyond the usual trade–finance dichotomy to address international trade, international production, and international finance, and takes a practitioner point of view rather than a standard academic one, introducing students to the material needed to become effective analysts in international economic policy. This new edition features such additional topics as global production and global capital flows, migration, the Ricardian model, and international organizations such as the IMF. Examples have been updated to include recent developments (Brexit, for example) and all charts include the latest data.

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# An Introduction to International Economics

New Perspectives on the World Economy

SECOND EDITION

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*To Gelaye, Oda, and Ayantu*

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## Preface

This new edition of *An Introduction to International Economics: New Perspective on the World Economy* is again written for one- and two-semester courses in international economics, primarily targeting non-economics majors and programs in business, international relations, public policy, and development studies. The book assumes a minimal background in microeconomics, namely a familiarity with the supply and demand diagram and the production possibilities frontier, along with basic algebra. It goes beyond the usual trade–finance dichotomy to give equal treatment to three areas of inquiry: international trade, international production (including migration), and international finance. It also largely takes a practitioner’s point of view rather than a standard academic view.

This new edition to the book is significantly different from the previous edition. The previous single chapter on comparative advantage has been split into two: one on the Ricardian model and a second on the Heckscher–Ohlin model. The chapter on intra-industry trade now includes an introduction to the monopolistic competition model of intra-industry trade. Previous chapters on international production have been compressed to fewer. A new chapter has been included on global capital flows. A previous Part IV of the book on development has been eliminated, with the most popular chapters being subsumed into Parts I through III.

I have written the book to make international economics accessible to a wider student and professional audience than has been served by many international economics texts. E-mail correspondence from both instructors and students representing many countries suggests that I have been at least partly successful in this effort. I am grateful to these individuals for their support and input, as well as to the economics editorial team at Cambridge University Press.

Finally, this book went into production before the 2020 global pandemic. This event dramatically affected many aspects of international trade, international production, and international finance. These events will need to be addressed by instructors and students in their specific classes.

# Abbreviations

AANZFTA	ASEAN–Australia–New Zealand Free Trade Area
AC	average cost
ACP	African, Caribbean and Pacific
AD	anti-dumping
AEC	ASEAN Economic Community
AFTA	ASEAN Free Trade Area
AGE	applied general equilibrium
AMC	American Motor Corporation
AMS	aggregate measure of support
ARERAER	IMF’s Annual Report on Exchange Rate Arrangements and Exchange Restrictions
ASEAN	Association of Southeast Asian Nations
ATC	Agreement on Textiles and Clothing
BATNA	best alternative to a negotiated agreement
BAW	Beijing Auto Works
BCBS	Basel Committee on Banking Supervision
BI	Belassa index
BIS	Bank for International Settlements
BIT	bilateral investment treaty
BPM6	IMF’s <i>Balance of Payments and International Investment Position Manual</i>
CAMA	Central African Monetary Area
CAP	Common Agricultural Policy
CAR	capital account regulation or capital adequacy ration
CBD	Convention on Biological Diversity
CEC	Commission for Environmental Cooperation (North American)
CEPT	Culture, environment, politics and technology or Common Effective Preferential Tariff
CET	common external tariff
CFA	Communauté Financière Africaine
CFM	capital flow (management) measure
CIG	capital intensive good
CIP	covered interest rate parity
CITES	Convention on International Trade in Endangered Species of Wild Fauna and Flora
CMA	Common Monetary Area of Southern Africa (rand zone)

CMO	contract manufacturing organization
CO	certificate of origin
CRTA	Committee on Regional Trade Agreements
CTE	Committee on Trade and the Environment
CTH	change in tariff heading
CU	customs union
CVD	countervailing duty
DSB	Dispute Settlement Body
DSM	dispute settlement mechanism
DSU	Dispute Settlement Understanding
EC	European Community
ECB	European Central Bank
ECF	Extended Credit Facility
ECOFIN	European Council of Ministers of Economics and Finance
ECSC	European Coal and Steel Community
ECU	European currency unit
EEC	European Economic Community
EFF	Extended Fund Facility
EFSF	European Financial Stability Facility
EME	emerging market economy
EMI	European Monetary Institute
EMIT	(Working Group on) Environmental Measures and International Trade
EMS	European Monetary System
EMU	European Monetary Union
EPZ	export-processing zone
ERM	Exchange Rate Mechanism (European Union)
ESAF	Enhanced Structural Adjustment Facility
ESCB	European System of Central Banks
ESM	European Stability Mechanism
EU	European Union
FCL	flexible credit line
FDI	foreign direct investment
FOGS	Functioning of the GATT System
FTA	free trade agreement
FTAA	Free Trade Agreement of the Americas
FTZ	free trade zone
G10	Group of 10
GAB	General Agreement to Borrow
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GBT	Group on Basic Telecommunications

GCIM	Global Commission on International Migration
GDP	gross domestic product
GF	gravitational force
GFC	global financial crisis
GIIPS	Greece, Ireland, Italy, Portugal, and Spain
GNDI	gross national disposable income
GNI	gross national income
GNP	gross national product
GPN	global production network
GSIB	globally systemically important bank
GTAP	Global Trade Analysis Project
GVC	global value chain
HDI	Human Development Index
HIC	high-income country
HICP	Harmonised Index of Consumer Prices
HLD	United Nations High-Level Dialogue on International Migration and Development
ICT	information and communication technology
ICU	International Clearing Union
IDA	Industrial Development Authority (Ireland)
IDM	integrated device manufacturer
IFSC	International Financial Services Centre (Ireland)
IIA	international investment agreement
ILO	International Labour Organization
IMF	International Monetary Fund
IOM	International Organization for Migration
IP	intellectual property
IPC	Intellectual Property Committee
IRB	internal ratings-based (approach)
ISDS	investor–state dispute settlement
ISF	International Stabilization Fund
ITO	International Trade Organization
ITRI	Industrial Technology Research Institute (Taiwan)
JV	joint venture
LED	light-emitting diode
LIG	labor-intensive good
LMICs	low- and middle-income countries
M&A	mergers and acquisitions
MAI	Multilateral Agreement on Investment
MAL	minimum access level
MBS	mortgage-backed security
MC	marginal cost

ME	market economy
MEA	multilateral environment agreement
MFN	most favored nation
MNE	multinational enterprise
MR	marginal revenue
MTN	multilateral trade negotiation
NAAEC	North American Agreement on Environmental Cooperation
NAALC	North American Agreement on Labor Cooperation
NAB	New Agreement to Borrow
NAFTA	North American Free Trade Agreement
NGBT	Negotiating Group on Basic Telecommunications
NGO	non-governmental organization
NINA	no income, no asset (mortgage)
NINJA	no income, job, or asset (mortgage)
NME	non-market economy
NT	national treatment
NTB	non-tariff barrier
NTM	non-tariff measure
OCA	optimum currency area
ODA	official development assistance
OECD	Organisation for Economic Co-operation and Development
OTDS	overall trade distortion support
PCA	Permanent Court of Arbitration (The Hague)
PIIGS	Portugal, Italy, Ireland, Greece, and Spain
PPF	production possibilities frontier
PPP	purchasing power parity
PRGF	Poverty Reduction and Growth Facility
PTA	preferential trade agreement
QPC	quantitative performance criterion
R&D	research and development
RCF	Rapid Credit Facility
REE	rare earth element
REER	real effective exchange rate
RFI	Rapid Financing Instrument
RIT	regional investment treaty
RMAP	Responsible Minerals Assurance Process
RMB	Renminbi (China)
RoHS	Restriction of Hazardous Substances (EU directive)
ROO	rule of origin
RORE	rate of return to education
RSCA	revealed symmetrical comparative advantage
RTA	regional trade agreement

xxii      **List of Abbreviations**

RVC	regional value content
SAB	South African Breweries
SACU	Southern African Customs Union
SBA	Stand-By Arrangement
SCF	Standby Credit Facility
SDR	special drawing right
SITC	Standard International Trade Classification
SLIG	skilled labor-intensive good
SPS	sanitary and phyto-sanitary
SSM	special safeguard mechanism
STR	standards and technical regulations
TARP	Troubled Asset Relief Program
TBT	technical barrier to trade
TEU	Treaty on European Union (Maastricht Treaty)
TiSA	Trade in Services Agreement
TiVA	Trade in Value Added (project/database)
TLM	task, location, and mode (framework)
TNI	Transnationality Index
TPP	Trans-Pacific Partnership
TRIMs	trade-related investment measures
TRIPS	Trade-Related Aspects of Intellectual Property Rights (Agreement)
TRQ	tariff rate quota
TSMC	Taiwan Semiconductor Manufacturing Company
UIP	uncovered interest rate parity
ULIG	Unskilled labor-intensive good
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
UNHCR	United Nations High Commission for Refugees
UNU-IHDP	United Nations University – International Human Dimensions Programme
URR	unremunerated reserve requirement
US	United States
USITC	United States International Trade Commission
VDR	variable deposit requirement
VEAM	Vietnam Engine and Agricultural Machinery Corporation
VER	voluntary export restraint
VNM	value of non-originating materials
WAMU	West African Monetary Union
WTO	World Trade Organization

# Symbols

$a$	labor input coefficient
$A$	technology factor
$B$	Grubel–Lloyd index
$BI$	Belassa index of revealed comparative advantage
$C$	household consumption or IMF conditions
$d$	firm-level demand
$D$	demand or distance
$DD$	demand diagonal
$\Delta$	change in
$e$	nominal exchange rate or exports as a percentage of GDP
$E$	exports or emigration
$ES$	emigration supply
$F$	Fixed costs or flow of trade/FDI
$G$	government expenditures or gain
$h$	ratio of total human capital to total labor (human capital-labor ratio)
$H$	Total human capital
$I$	Investment
$ID$	Immigration demand
$k$	ratio of total physical capital to total labor (capital–labor ratio)
$K$	physical capital
$L$	labor, liquidity, loans or loss
$M$	money (both supply and demand) or mass
$n$	natural rate of population growth
$p$	price or price level
$q$	firm-level quantity
$Q$	quantity
$r$	interest rate
$re$	real exchange rate
$rw$	relative wage
$R$	total return on asset
$S$	supply
$S_F$	foreign savings
$S_G$	government savings

xxiv      List of Symbols

$S_H$	household savings
$t$	ad valorem tariff
$T$	specific tariff or taxes
$\theta$	constant
$V$	variable costs or velocity of money
$W$	wage
$\omega$	relative low-skilled to high-skilled wage
$y$	real gross domestic product
$Y$	nominal gross domestic product, gross national income or factor income
$Z$	imports