

International Economics

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Introduction

This chapter introduces the main questions of international economics. It asks what international economics is about, reviews the main topics in international trade, presents the core themes of international finance, and explains why the comparison between trade and finance is relevant.

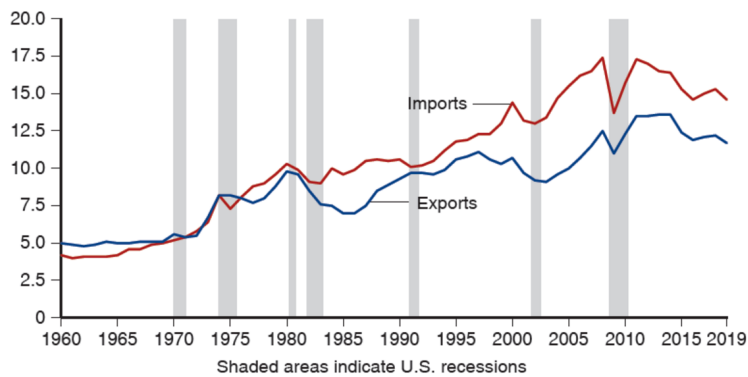
In particular, international trade focuses on gains from trade, the explanation of trade patterns and trade volumes, and the effects of government policies on trade. International finance, instead, deals with the balance of payments, exchange rate determination, international policy coordination, and capital markets.

What Is International Economics About?

International economics studies how nations interact through trade in goods and services, flows of money, and investment. It is an old subject, but it continues to grow in importance because countries are now more closely linked than ever before.

In the United States, exports and imports as shares of gross domestic product have followed an upward trend. International trade has roughly tripled in importance relative to the economy as a whole over the last sixty years. Both imports and exports fell substantially in 2009 because of the recession, and they fell again in 2020 because of the COVID-19 pandemic.

Figure 1.1.

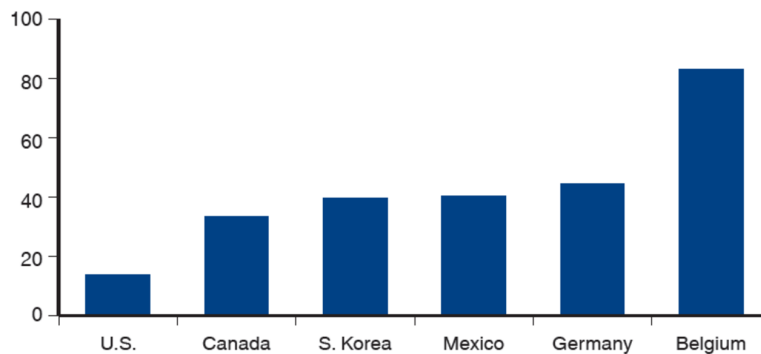


Exports and imports as a percentage of U.S. national income show that both have increased over time as a share of the U.S. economy, although imports have risen more than exports. The shaded areas in the figure indicate U.S. recessions. Source: U.S. Bureau of Economic Analysis, research.stlouisfed.org.

Compared with the United States, many other countries are even more dependent on international trade. Their imports and exports as shares of GDP are substantially higher. Because of its size and diversity of resources, the United States depends less on international trade than almost any other country.

Question. How do you think country size influences trade between countries?

Figure 1.2.



The average of exports and imports as percentages of national income in 2018 shows that international trade is more important to most other countries than it is to the United States. Source: World Bank.

1.1 The Gains from Trade

The most important insight in international economics is that there are gains from trade. When countries sell goods and services to one another, they almost always generate mutual benefits.

1. When a buyer and a seller engage in a voluntary transaction, both can be made better off. For example, Norwegian consumers import oranges that they would have great difficulty producing themselves.
2. Even a country that is the most efficient, or the least efficient, producer of everything can still gain from trade. Countries use their finite resources to produce what they are relatively most productive at, compared with their other production possibilities, and then trade those products for what they want to consume. In this way, countries can specialize in production while still consuming many different goods and services, although specialization also has its own risks.
3. Trade benefits countries by allowing them to export goods made with relatively abundant resources and import goods made with relatively scarce resources.
4. When countries specialize, they may also become more efficient because of large-scale production.
5. Countries may gain by exchanging current resources for future resources through international borrowing and lending, and they may also benefit from international migration.

Trade is predicted to benefit countries as a whole in several ways, but it may also harm particular groups within a country. In particular, international trade can harm the owners of resources that are used relatively intensively in industries that compete with imports. Trade may therefore affect the distribution of income within a country, creating winners and losers from globalisation.

1.2 The Pattern of Trade

The pattern of trade describes who sells what to whom. Differences in climate and natural resources help explain why Brazil exports coffee and Saudi Arabia exports oil. However, they do not fully explain why Japan exports automobiles while the United States exports aircraft.

A country's exports can depend on differences in labor productivity and on differences in the relative supplies of capital, labor, and land, as well as on how these resources are used in the production of different goods and services.

1.3 Effects of Government Policies on Trade

Governments influence the volume and composition of trade through a variety of policy instruments. These include tariffs, which are taxes on imports or exports; quotas, which are quantitative restrictions