

Fall 2006

Course Outline  
ARE 201 (Half of semester)  
Introduction to Trade Theory and Policy

Instructor: Larry Karp

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Office hours, Wed 12.30 – 2 and by appointment.

Course Objective: Introduce students to the basic models and theorems of international trade. Develop intuition about trade, and especially general equilibrium models.

Approach: I will emphasize geometric arguments because I think that these are particularly useful for developing intuition. In some cases I'll show the algebraic treatment. In 20 hours of lectures I want to go through a large amount of basic trade theory, and illustrate its importance using several policy applications. I will not attempt to discuss the empirical trade literature, or the "new trade theory". This course should prepare students to begin reading the frontier work in trade. It is not, however, intended to be a course about the frontier.

Readings: Lecture notes and problem sets (and later, the solution keys) are available on webpage <http://are.berkeley.edu/courses/ARE201>. These notes should make it unnecessary for students to worry about copying diagrams or algebra during lectures, enabling them to concentrate on the ideas rather than the technical details. The lecture notes are a supplement to rather than a replacement for the texts.

Problem sets: There are five problem sets, available on the webpage for this class. The first problem set is due September 11. The second problem set is due September 13.

Solution keys from previous years are easy to obtain. I consider it dishonest to use these keys. Please work through the problems on your own and use the keys after you have turned in the problem set.

1. The first problem set consists of exercises based on the Ricardian model. This material is a small part of the lectures, but is essential for understanding the basic ideas of international trade theory.
2. The second problem set requires that you use linear supply and demand curves and graphical methods to analyze the welfare effects a certain policy under autarky and free trade. Since this problem set uses undergraduate-level tools, you can begin this set at any time. (You don't need to wait for a particular lecture.)

3. The third problem set also uses a partial equilibrium model and graphical methods - undergraduate-level tools. The problem is an application of the “theory of the second best”. You are asked to compare different policies for correcting a distortion, under free trade and autarky.

4. The fourth problem set is an application of the Principle of Targeting and of the possibility of immiserizing growth, in general and partial equilibrium settings.

5. The fifth problem set requires a bit of calculation. Its purpose is to show how the equilibrium in a simple political economy model depends on whether the economy is open or closed.

Grading and time of final exam: Problem sets count for 10% of the final grade. The final exam (1.5 hours) counts for 90% of the final grade. The final exam will be held within two weeks after the last lecture. If there is a consensus and an available room, students can choose the exam time.

The grades for the two modules will be averaged, to obtain the course grade.

Texts:

(NV) Neil Vousden "The Economics of Trade Protection", Cambridge University Press, 1990. [This is the basic text. The first chapters give a good overview of the HOS and specific factors models, and subsequent chapters give a clear and concise treatment of a variety of policy problems.]

(BS) Jagdish Bhagwati and TN Srinivasan "Lectures on International Trade" MIT Press 1992.

(BPS) Jagdish Bhagwati, Arvind Panagariya and TN Srinivasan "Lectures on International Trade" MIT Press 1998 (second edition). This book is a revision of Bhagwati and Srinivasan, and covers much of the same material. I will give page numbers for both books so that you can use either book.

(E) Wilfred Ethier, Modern International Economics 3rd ed. WW Norton 1995 [This is an undergraduate book in trade. The algebra is consigned to appendices, and the text contains the geometric and intuitive arguments.]

Supplementary Reading: “Free Trade Under Fire” by Douglas Irwin, Princeton University Press 2002. I would like everyone to read the first four chapters of this book before the end of the module. I will not discuss the book in class, but to encourage you to read the first four chapters, I will include an exam question on the material; this exam question will be no more than 10% of the exam grade. (Just read the book, don’t feel that you have to study it.)

## List of Topics and Readings

Section 1, Topics: Ricardian Model, comparative advantage, real wage and welfare.

Section 1 Readings, E Chapter 1, BS Chapters 1 – 2 (pages 9-15, 30-33) or BPS (pages 9-15, 29-30), Chapter 1 of online notes.

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Section 2, Topics,. Graphical analysis of basic trade model, introduction to comparative statics, stability, Theory of Second Best, Principal of Targeting, immiserizing growth.

Section 2, Readings . E Chapter 4 (for excess S&D curves); BS Chapter 12 pages 134 - 138 or BPS pages 247 – 250 (for Transfer Problem), Chapter 2 of online notes.

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Section 3, Topics. The Ricardo-Viner (Specific Factors) model, and applications to imperfect property rights and minimum wage economies.

Section 3, Readings. E 176 - 185; BS Chapters 21 – 23, BPS Chapter 7 (for comparative statics) and Chapter 27 (for sticky wage application) or BS: Chapter 8 (for comparative statics) and chapter 23 (for sticky wage application), Chapter 3 of online notes.

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Section 4, Topics. The Heckscher-Ohlin-Samuelson model, and applications to environmental questions, and immiserizing growth.

Section 4, Readings. ; NV Chapters 1 - 2, BS or BPS Chapters 5 - 6, E Chapter 5, Chapter 4 of online notes .

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Section 5, Topics. Environmental policy and comparative advantage.

Section 5, Reading. Copeland and Taylor's JEL article and Chau's paper. (Links are available online) Chapter 5 of online notes.