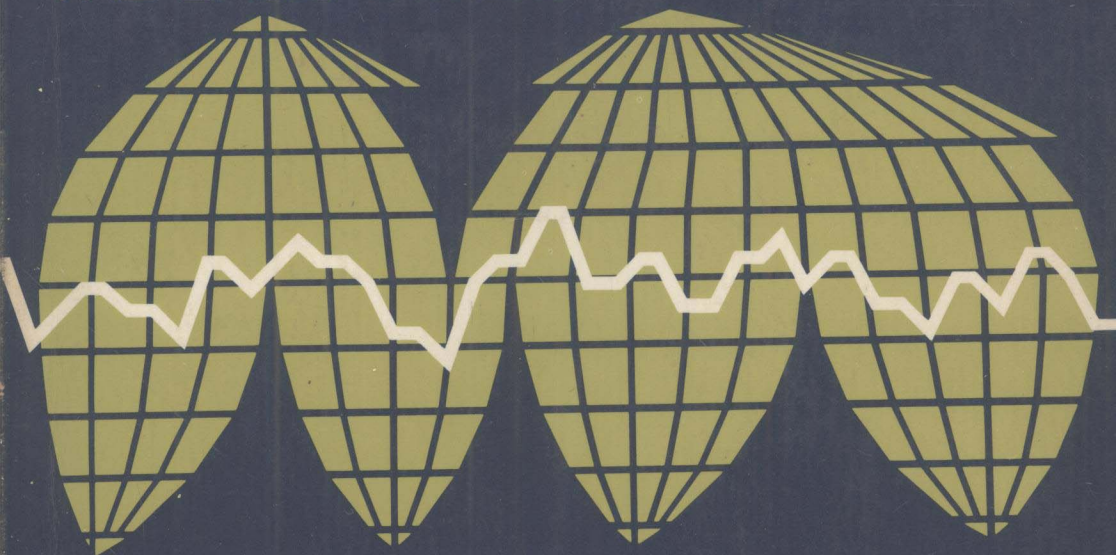


International Economics

A SELF-TEACHING INTRODUCTION TO
THE BASIC CONCEPTS

John Adams



SECOND EDITION

JOHN ADAMS

International Economics, Second Edition

A
SELF-TEACHING
INTRODUCTION TO
THE BASIC CONCEPTS

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International Economics

Second Edition

PREFACE

The gratifying reception accorded the first edition of this book has induced me to undertake a revision and extension. There is evidently a place for a book that concentrates on reducing the job of learning international economics to comparatively simple steps and thus permits more effective use of classroom time. In preparing this new edition I have benefited by useful suggestions from University of Maryland students and from instructors across the country. My thanks to all who have taken the trouble to criticize and encourage.

Those who have used the first edition will find that the changes here consist mainly of the addition of new materials. The chapter on the terms of trade has been moved to an appendix, and the section on modern trade theory now concludes with a discussion of a number of recent concepts, including the product cycle, the role of human skills, and the Linder theory of demand-based trade. Since the world economy has changed considerably in the last half decade,

particularly in the realm of international finance, it has been necessary to revise and expand the third section, which covers global monetary relations.

As before, I am grateful to E. Ray Canterbury, Florida State University, and Thomas Havrilesky, Duke University, for their interest and advice. Anthony Scaperlanda of Northern Illinois University also provided helpful guidance. Among my colleagues at the University of Maryland, Michael Pelcovits commented usefully on trial chapters; Kirt Toh, Wanda Tseng, and their students helped test the new portions of the program. Malathi Acharya assisted in editing. Edith Van Ness has been an admirable typist.

My wife, Suzanne, who has her own work, and my children, Jennifer, Lara, and Michael, who have their own school business to tend to, have again made possible the alternating quiet and noise essential to writing. This edition is therefore rededicated to them.

John Adams

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Classical Trade Theory

segment

ONE

INTRODUCTION AND INSTRUCTIONS

- 1.0 Objective** *This book provides a fresh approach for the student who wishes to master the basic language and diagrammatical tools of international economics. The materials are self-contained and self-teaching, but are designed to complement rather than replace ordinary textbooks and classroom discussion and lectures. Upon completion of the eighteen segments, the student will have gained a solid grounding in international trade theory and international finance and should be prepared for advanced discussions of international economic history, policy, theory, and institutions. In Segment One you will learn how to use the book and what kinds of questions you may expect to encounter as you read.*
- 1.1 Essay** We live in a world of specialists, and each group of specialists speaks a different language. Thus, when you chose to study international economics you essentially decided to de-

velop an understanding of the language and conceptual tools of the clan of international economists. As you work through this book you will learn how to read knowledgeably and speak intelligently about such subjects as international trade theory, tariffs and commercial policy, the balance of payments, and international currencies and finance. How you employ your new insights in reaching judgments about the major problems facing the contemporary world economy is, of course, then up to you.

The function of this book—and the chief advantage in using it—is to conserve valuable classroom time. If the student comes to class prepared by his study of one of these segments, and if the professor spends a relatively short time checking for comprehension and clearing up any lingering misunderstandings, both are then free to move on to more advanced and stimulating discussion. The “released” or newly regained time can be used to explore economists’ current understanding of the international economy and to raise some of the vital issues facing the world today: the growing income gap between rich and poor countries, the rising power and responsibility of multinational business corporations, the increasing obsolescence of the nation state as a political institution, and the failure of the world’s nations to live together in peace and to unite for the common good of mankind, without regard to nationality, color, religion, or ideology.

Most of the material in this book is presented in programmed form, although short essays are interspersed to provide historical or expository background. The entire book or *learning program* is a self-teaching educational device in which difficult subjects are broken down into their logical components, thus simplifying comprehension. The student works at his own pace but is constantly questioned to ensure his understanding at each step of the way. Often he can continue to advance only if, with the aid of what he has already learned, he can jump ahead in his own reasoning processes. Successful completion of a portion of the program thus virtually guarantees an understanding of the subject matter contained in that portion. A learning program is composed of a number of *segments*, each of which deals with a particular topic. Each segment begins with an *objective* which summarizes exactly what you are expected to learn. Within each segment are individual *frames*, or working units, which can consist of information, questions, or both.

- 1.2 Sample Questions** Questions on the material appear in a variety of forms. I have made a special effort to avoid dulling stereotypes or the same kinds of questions again and again. You should always work with extra paper so that you can do the required computations and sketch diagrams as you proceed. Answers to all questions are provided in the answer column of each page adjacent to each frame. You should keep each answer covered with a folded piece of paper or a 3 × 5 index card until you have mentally reacted to each question. This will provide you with an immediate reward for the correct answer or the shock of failure for the incorrect answer. Always repeat frames and segments that you find difficult.

The following questions are examples of the types you will encounter:

1.2
One

I am now working on frame number __ , which is part of Segment ____ .

Which of the following statements are true?

- (a) A segment is part of a frame.
- (b) A frame is part of a segment.
- (c) A learning program is a way of mastering a subject for oneself.
- (d) Specialists, such as international economists, speak their own languages.
- (e) One purpose of this program is to save classroom time.

b, c, d, e
beginning

An objective appears at the _____ (beginning/end) of each segment.

Introduction and
Instructions

The title of this segment is _____
[3W]. (Note: when more than one word is needed to complete an answer, an insert in brackets provides you with the exact number of words needed, in this case 3. The insert [MW] after a longer-than-average answer space means that a multiple-word phrase is needed. A multiplication sign, ×, indicates that two terms must be supplied, one on either side of the sign, as with $p \times q$.)

segment

TWO

THE MERCANTILISTS: NATION BUILDING

2.0 Objective *Why do nations trade together? How have different economists answered this question? Upon completion of Parts I and II, Classical Trade Theory and Modern Trade Theory, you will be able to answer these questions. In Segment Two you will begin by learning about a group of early economists called the mercantilists, who were active in the period 1500–1800. They believed that a country should always export more than it imports, thereby gaining what they called “treasure” –silver and gold—from other nations. An influx of treasure was supposed to stimulate economic activity and provide the revenue necessary to build a stronger nation. To achieve these ends foreign trade had to be carefully regulated by government.*

2.1 Essay The fundamental task of international trade theory is to explain why nations trade together. We know that people

will exchange their goods for those of another country only when they believe it is in their interest to do so. Yet not all economists agree on what a nation should expect to gain from its trade, nor do they all recommend the same trade policies. As you complete Parts I and II of this book you will become well versed in the language and arguments of leading economists and will then be able to discuss trade theory and policy issues in more subtle and sophisticated ways. You will also learn that modern thought is the product of a long evolution of ideas, and that many vital issues are currently far from settled, even among the experts. We begin by going back over 400 years to the mercantilists, the first economists, many of whose ideas and policy suggestions have weathered the passage of time surprisingly well—perhaps too well, according to a number of modern economists.

- 2.2 Essay By the end of the Middle Ages momentous political and economic forces were clearly observable in Europe. Loosely knit feudal kingdoms were becoming unified nation-states ruled by powerful kings, whose courts and administrations were centered in such cities as Paris and London. The age of exploration was under way and the seas had become highways to far-distant sources of valuable commodities—the legendary spices, silks, and other products of exotic lands. Within Europe, fast-growing overland trade bound together expanding cities, which housed the emerging middle classes—the craftsmen, merchants, and bankers. This parallel development of commerce and strong, centrally governed nations raised a novel question for intellectuals and statesmen: How was a nation to regulate its trade relations in its own best interests?

The central administration, centering on the king, faced two challenges—first, that of consolidating the power to rule within its own territory, and second, that of defending, or even extending, its national boundaries. Warfare was expensive, and so was the pomp and ceremony necessary to maintain the ruler's image. Revenue, in these days before the income tax, was hard to obtain, and the royal purse was subjected to many demands. The government's power to control foreign trade was recognized as one source of revenue, since trade could be taxed or even directly monopolized by the government. And, perhaps even more important, foreign trade was viewed as a part of an expansionist foreign policy, which advocated controlling the seas, claiming and defending new territories, and securing access to the wealth of the New World, Africa, and Asia.

During this period a number of men wrote short pamphlets and books on the subject of trade, its impact on the economy, and what government should do about it. Although these writers did not generate a unified body of theory or form a cohesive school, they have become known collectively as the “mercantilists” because of their interest in “mercantile” or commercial policy. Much of their work is of indifferent quality, and no single figure stands out as their spokesman. The mercantilists were active in England and on the Continent, particularly between about 1500 and 1800. They all agreed—and this is what binds them together—that government should closely regulate international trade. They did not advocate such control for its own sake, but as a means to several rather sensible ends. The cornerstone of their thinking was that a nation is better off when it exports, or sells abroad, more goods than it imports, or buys from abroad.

2.3 Do you agree or disagree with these statements?

agree

(a) A nation trades with other nations because it believes it will gain by such an exchange. _____

disagree

(b) All economists generally agree about the nature of trade benefits and the proper trade policy a nation should pursue. _____

disagree

(c) The mercantilists were a tightly knit group of economists who all said about the same thing. _____

agree

(d) Mercantilists urged governments to control foreign trade so that a nation's exports would exceed its imports. _____

2.4 The period of the greatest mercantilist influence on a governmental policy may be dated from about ____ to ____.

1500, 1800
their concern

Why are the “mercantilists” called that? _____

with “mercantile” policy

[MW]

Would it be accurate to say that, prior to the mercantile period, there existed neither centralized nations as we know them today nor large-scale international trade? ____ Explain.

yes, see frame 2.2

Why did the emerging centralized governments of this time seek revenue? What role did foreign trade play in their grand designs?

see frame 2.2

2.5 The economic analysis of the mercantilists centered on the balance of trade. The *balance of trade* is defined as the difference