

USC Marshall

School of Business

FBE 462

INTERNATIONAL TRADE, FINANCE AND COMMERCIAL POLICIES

Spring 2017

FACULTY AND CONTACT INFORMATION

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Office hours:	Tuesday 12:50-1:50 and by appointment
Class hours:	Tuesday-Thursday 2:00-3:50
Classroom:	JFF 236

COURSE DESCRIPTION

This course provides a systematic understanding of critical aspects of international trade and finance. The course is divided in three sections. The first and second sections deal with international trade. The third section deals with international finance.

International trade is one of the important forces driving toward globalization, that is, the integration of national business activities into globally competitive markets. The first section of the course examines the role of comparative advantage as a determinant of the location of production and reviews several theories that explain why countries trade with each other. The second section examines the effects of government policies toward international trade with special attention to trade tariffs, quotas, voluntary export restrictions and subsidies. Another goal of this section is to study the economic and political forces underlying the creation of trade blocs such as free trade areas, custom unions and common markets.

The third section of the course deals with international finance which is another important force driving toward globalization. This section examines how international financial markets operate and the forces that make these markets global. Central to the analysis is the role of money in an international context and the role of exchange rates as relative prices of national currencies. The course develops some key principles of international financial investment and examines how the foreign exchange can be used to hedge and speculate in financial markets. It also studies the role of government policies toward the foreign exchange market, including the choice between fixed and floating exchange rates, and the use of exchange controls to create impediments to excessive

currency volatility. The section also deals with the dynamics of financial and currency crises.

LEARNIG OJECTIVES

The primary objective of this course is to enable you to make informed judgments about the consequences of increasing worldwide integration in trade and finance. Knowing the consequence of trade and financial integration is important for making informed business decisions. Achieving this goal involves several steps. First, we must become familiar with the main empirical facts and trends about the process of trade and financial integration. Second, we must learn why we observe these trends (explanations). An understanding of trade and international finance theory is necessary for interpreting the empirical dynamics of trade and financial variables. Third, we must learn how the institutional environment of the countries participating in the globalization process and their government policies affect the process of trade and financial integration and, ultimately, the wellbeing of the participating countries. Students are expected to learn:

- How international commodity markets operate.
- How currency markets operate.
- How financial asset markets operate.
- The aggregate economic gains (or losses) from trading commodities, currencies and financial assets in international markets.
- How the gains (and losses) are distributed among various groups in society.
- The gains and losses from restricting international trades in commodities, currencies and financial assets.
- The politics that drive the actual trade policies.
- The causes of currency crises?
- The role of international institutions such as the World Trade Organization, the International Monetary Funds, and the European Union.

COURSE MATERIALS

- **Textbook:** Thomas Pugel, *International Economics*, Sixteenth Edition, McGraw-Hill Irwin.
- **Slides:** I will post in Blackboard the slides for each topic before the first class session dealing with the particular topic.
- **Additional readings:** Later in the course I will post some readings in Blackboard.

I strongly recommend reading (perhaps quickly) the book sections indicated in the list of topics below before the class meets. In class I will cover the concepts and issues that are most challenging, reinforcing and extending what is in the required reading. I also suggest that after the class session you review the reading to solidify your understanding.

It is important that you develop the ability to use and apply the concepts and tools developed in the course. The best way to do this is by practicing actively. Questions and problems in the textbooks at the end of each chapter are good for practice.

COURSE REQUIREMENTS AND GRADING

The course grade will be based on the following weighted requirements:

1. First mid-term examination	24%
2. Second mid-term examination	24%
3. Final examination	30%
4. Six problem sets	12%
5. One group assignment	7%
6. Class attendance, participation and presentation	3%

Important dates for course requirements

<u>Requirement</u>	<u>Date</u>
<i>Problem set 1</i>	<i>January 19</i>
<i>Problem set 2</i>	<i>February 2</i>
<i>Midterm exam 1</i>	<i>February 7</i>
<i>Group assignment</i>	<i>February 21</i>
<i>Problem set 3</i>	<i>February 23</i>
<i>Problem set 4</i>	<i>March 7</i>
<i>Midterm exam 2</i>	<i>March 9</i>
<i>Problem set 5</i>	<i>April 4</i>
<i>Problem set 6</i>	<i>April 27</i>
<i>Final Exam</i>	<i>May 4 (2:00-4:00)</i>

The two midterm exams and the final exam are **not cumulative** and will address the subject matter that precedes them. For all the exams, you are responsible for the assigned textbook chapters, the assigned problem sets and any material covered in class. The exams are intended to assess how well you understand the basic ideas and principles. All exams are closed-book, closed notes. You may use a calculator but not a cell phone, laptop, or any other electronic device.

The group assignment will be posted in Blackboard one month before the project is due. A group can contain between 2 and 4 students. It cannot contain more than 4 members. Students are encouraged to form their own group. Those who do not form a group themselves will be assigned to groups that are randomly formed.

It is highly recommended to keep up with current developments in the international environment, both for class purposes and for your own benefit. You can do this by reading the relevant articles in newspapers (e.g., *Financial Times*, *Wall Street Journal*, *New York Times*) or weekly magazine (e.g., the *Economist*). To encourage the readings of news and the applications of the theory to the real world, students are encouraged to make in-class presentations of issues recently covered in the news that are related to the topics of the course. We will use the last 15 minutes of class for these presentations. The presentation can be done in groups of 2, 3 or 4 students and they can be the same as those formed for the group assignment described above.

Each individual course requirement receives a numerical score but not a letter grade. The overall numerical score in the course is converted into a letter grade at the end of the semester in accordance with the Marshall School guidelines. There is no official quota for the number of A's, B's, etc., although the average grade for elective undergraduate courses can be expected to be close to 3.3 out of 4.0 (corresponding to a B+).

EXPECTATIONS AND CLASSROOM ETIQUETTE

It is very important that you contribute to the interactive nature of the classroom environment. Although all class sessions will be conducted in lecture format, classroom interaction is highly encouraged. I especially encourage active participation in the discussion through observations and questions. I expect many questions from students.

TECHNOLOGY POLICY

Laptop and Internet usage is not permitted during academic or professional sessions unless otherwise stated by the respective professor and/or staff. Use of other personal communication devices, such as cell phones, is considered unprofessional and is not permitted during academic or professional sessions. ANY e-devices (cell phones, iPads, other texting devices, laptops, I-pods) must be completely turned off during class time. Upon request, you must comply and put your device on the table in off mode and FACE DOWN. You might also be asked to deposit your devices in a designated area in the classroom. Videotaping faculty lectures is not permitted due to copyright infringement regulations. Audiotaping may be permitted if approved by the professor. Use of any recorded or distributed material is reserved exclusively for the USC students registered in this class.

ACADEMIC INTEGRITY AND CONDUCT

USC seeks to maintain an optimal learning environment. General principles of academic honesty include the concept of respect for the intellectual property of others, the expectation that individual work will be submitted unless otherwise allowed by an instructor, and the obligations both to protect one's own academic work from misuse by others as well as to avoid using another's work as one's own (plagiarism). Plagiarism – presenting someone else's ideas as your own, either verbatim or recast in your own words – is a serious academic offense with serious consequences. All students are expected to understand and abide by the principles discussed in the *SCampus*, the Student Guidebook (www.usc.edu/scampus or <http://scampus.usc.edu>). A discussion of plagiarism appears in the University Student Conduct Code (section 11.00 and Appendix A).

Students will be referred to the Office of Student Judicial Affairs and Community Standards for further review, should there be any suspicion of academic dishonesty. The Review process can be found at: <http://www.usc.edu/student-affairs/SJACS/>. Failure to adhere to the academic conduct standards set forth by these guidelines and our programs will not be tolerated by the USC Marshall community and can lead to dismissal.

Discrimination, sexual assault, and harassment are not tolerated by the university. You are encouraged to report any incidents to the *Office of Equity and Diversity* <http://equity.usc.edu/> or to the *Department of Public Safety* <http://dps.usc.edu/contact/report/>. This is important for the

safety of the whole USC community. Another member of the university community – such as a friend, classmate, advisor, or faculty member – can help initiate the report or can initiate the report on behalf of another person. *Relationship and Sexual Violence Prevention and Services* (RSVP) <https://engemannshc.usc.edu/rsvp/> provides 24/7 confidential support, and the sexual assault resource center webpage <https://sarc.usc.edu/reporting-options/> describes reporting options and other resources.

SUPPORT SYSTEMS

Students whose primary language is not English should check with the *American Language Institute* <http://dornsife.usc.edu/ali>, which sponsors courses and workshops specifically for international graduate students. *The Office of Disability Services and Programs* (www.usc.edu/disability) provides certification for students with disabilities and helps arrange the relevant accommodations. If an officially declared emergency makes travel to campus infeasible, *USC Emergency Information* (<http://emergency.usc.edu>) will provide safety and other updates, including ways in which instruction will be continued by means of blackboard, teleconferencing, and other technology.

COURSE SCHEDULE (Tentative)

PART I: THEORIES OF INTERNATIONAL TRADE

1. January 10 - Introduction: International Linkages and Globalization

2. January 12 - Basic Theory Using Demand and Supply

Industry demand and consumer surplus.

Industry supply and producer surplus.

Free trade equilibrium and the net national gains from trade.

Required reading: Pugel, Chapter 2.

Practice Questions and Problems 1-14 (Chapter 2).

3. January 17, 19, 24 - Why Countries Trade

Adam Smith's theory of absolute advantage.

Ricardo's theory of comparative advantage.

Heckscher-Ohlin theory of factor proportions.

Required reading: Pugel, Chapters 3 and 4.

Practice Questions and Problems: 1-12 (Chapter 3).

Practice Questions and Problems: 1-8 (Chapter 4).

4. **January 26 - Who Gains and Who Loses from Trade and Test of the H-O Theory**

Short-term welfare consequences.

Long-term welfare consequences.

Are the predictions of the H-O theory supported by the trade data?

Required reading: Pugel, Chapter 5.

Practice Questions and Problems: 1-12 (Chapter 5).

5. **January 31 - Alternative Theories of Trade**

Increasing intra-industry trade and the limits of the Heckscher-Ohlin's theory.

Economies of scale.

Monopolistic competition.

Oligopoly and international trade.

Required reading: Pugel, Chapter 6.

Practice Questions and Problems: 1-10 (Chapter 6).

February 2 - Review in preparation for the midterm exam

February 7 - First midterm exam covering Part I only

PART II: TRADE POLICIES

1. **February 9, 14 - The Analysis of Tariffs**

The effects of tariffs on producers, consumers and government revenues.

The net national consequences of tariffs.

The nationally optimal tariff.

Required reading: Pugel, Chapter 8.

Practice Questions and Problems: 1-12 (Chapter 8).

2. **February 16, 21 - Nontariff Barriers to Imports arguments for protection**

Import quota

Import quotas versus tariffs

Voluntary export restraints (VERs)

Other nontariff barriers

The real world is not first best.

Required reading: Pugel, Chapter 9, 10.

Practice Questions and Problems: 1-13 (Chapter 9).

3. February 23 - Pushing Exports

Dumping and antidumping policies.
Exports subsidies.
Countervailing duties.

Required reading: Pugel, Chapter 11.
Practice Questions and Problems: 1-12 (Chapter 11).

4. February 28 - Trade Blocs and Trade Blocks

Free-Trade Area, Customs Unions, Common Market, Economic Union.
The theory of trade blocks: trade creation and trade diversion.
North American Free Trade Agreement (NAFTA)
Trade blocks among developing countries.
Trade embargoes.

Required reading: Pugel, Chapter 12.
Practice Questions and Problems: 1-12.

5. March 2 – Migration

Migration, the labor market and policies toward immigration.

Required reading: Pugel, Chapter 15 (Pages 354-365).
Practice Questions and Problems: 11-19 (Chapter 15).

March 7 - Review in preparation for the midterm exam

March 9 - Second midterm exam covering Part II only

PART III: International Finance

6. March 21, 23 - Payments among nations and foreign exchange market

Balance of payment.
Current account, capital account, foreign reserves.
The basic currency trading.
Demand and supply for foreign exchange.
Floating and fixed exchange rates.
Arbitrage in the spot exchange market.

Required reading: Pugel, Chapter 16, 17
Practice Questions and Problems: 1-12 (Chapter 16).
Practice Questions and Problems: 1-12 (Chapter 17).

7. March 28, 30 - Forward exchange and international financial investment

Hedging the risk using the foreign exchange market.
Speculating using the foreign exchange market.
Other currency contracts: futures, options and swaps.
International investment with and without cover.
Covered interest arbitrage and covered interest parity.
Does the interest rate parity hold?

Required reading: Pugel, Chapter 18.
Practice Questions and Problems: 1-12.

8. Apr. 4, 6 - What determine exchange rates?

Exchange rates in the short and long run.
Purchasing Power Parity (PPP): absolute and relative PPP.
Exchange rate overshooting.

Required reading: Pugel, Chapter 19, Chapter 23 (pages 594-598).
Practice Questions and Problems: 1-16.

9. April 11 - Government policies towards the foreign exchange

Defending a fixed exchange rate.
Market interventions by the central bank.
Exchange controls.
Some historical experience: Gold Standard, Bretton Woods and recent days.

Required reading: Pugel, Chapter 20, Chapter 25.
Practice Questions and Problems: 1-12

10. Apr. 13, 18 - Trade in capital and financial crises

Gains and losses from international lending.
Lending to developing countries.
Financial crisis and their causes.
Resolving financial crisis and preventing them.

Required reading: Pugel, Chapter 21.
Practice Questions and Problems: 1-12.

11. Apr. 20, 25 – Currency options and exchange exposure

American options.

European options.

Using currency options for speculation.

Using currency options for hedging.

. Assessing the exposure to exchange risks and hedging tools.

Required reading: Notes provided by the instructor.

April 27 - Review in preparation for the final exam

May 4 - Final exam covering only Part III (2:00-4:00)