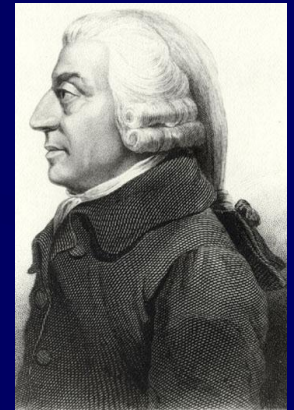


Y376 International Political Economy

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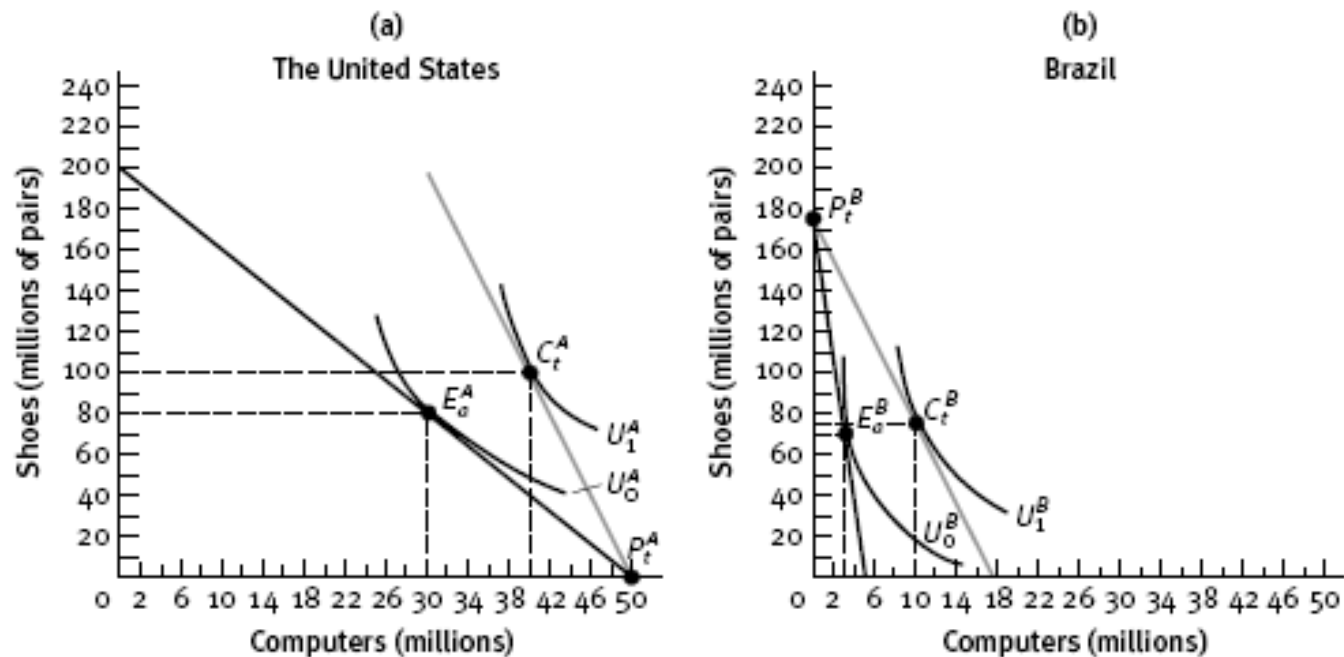
Pioneers of Trade Theory

- Adam Smith, *The Wealth of Nations* (1776) – first defense of free market policies
- David Ricardo, *Principals of Political Economy and Taxation* (1817) - introduced theory of comparative advantage



Graphical Version of Ricardian Theory

The Ricardian Model of Trade



Core Principle

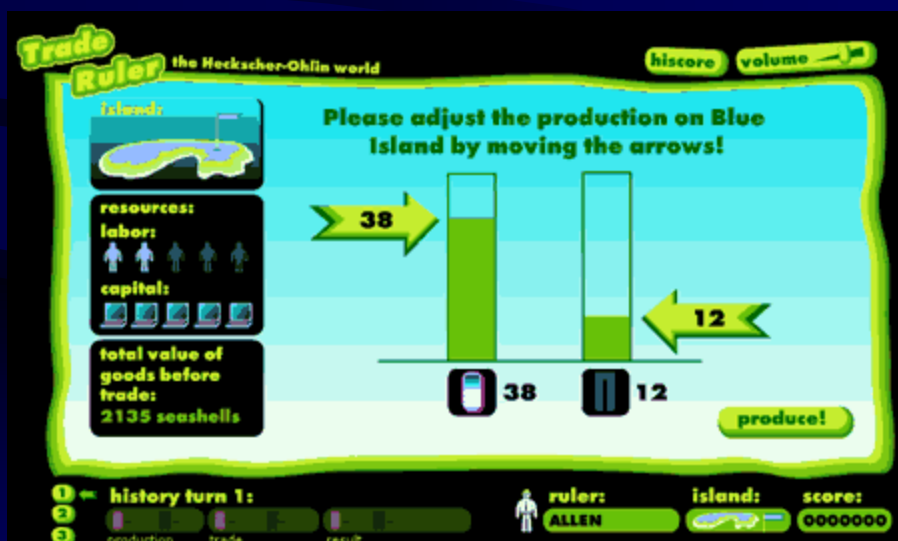
Trade between two countries allows each of them to specialize and increases each country's level of overall satisfaction.

Heckscher-Ohlin Model

- Basic model: two countries, two goods, two factors of production (Ricardo only had one)
- Differences in factor endowments lead to “gains from trade”
- Both countries will be better off if they specialize in producing goods which require a relatively abundant factor and then trade with another country
- For maximum benefit, the other country should have a very different factor endowment

Let's Play the Trade Ruler Game!

- http://nobelprize.org/educational_games/economics/trade/game/ruler.html



Types of Regional Integration

- Regional cooperation agreements
- Free trade areas
- Customs unions
- Common markets



Increasing
difficulty

Examples

- European Union (EU)
- North American Free Trade Agreement (NAFTA)
- Central American Free Trade Agreement (CAFTA)
- Southern African Development Community (SADC)

The European Union



- 1957 Treaty of Rome created the European Economic Community (6 members)
- Current number of members = 27
- Creation of the Unified Market under the Maastricht Treaty of 1992
- Creation of the Euro in 1999
- Passports abolished under the Schengen agreement

Members of the EU

1952 Belgium, France, Germany,
Italy, Luxembourg, Netherlands

1973 Denmark, Ireland, United
Kingdom

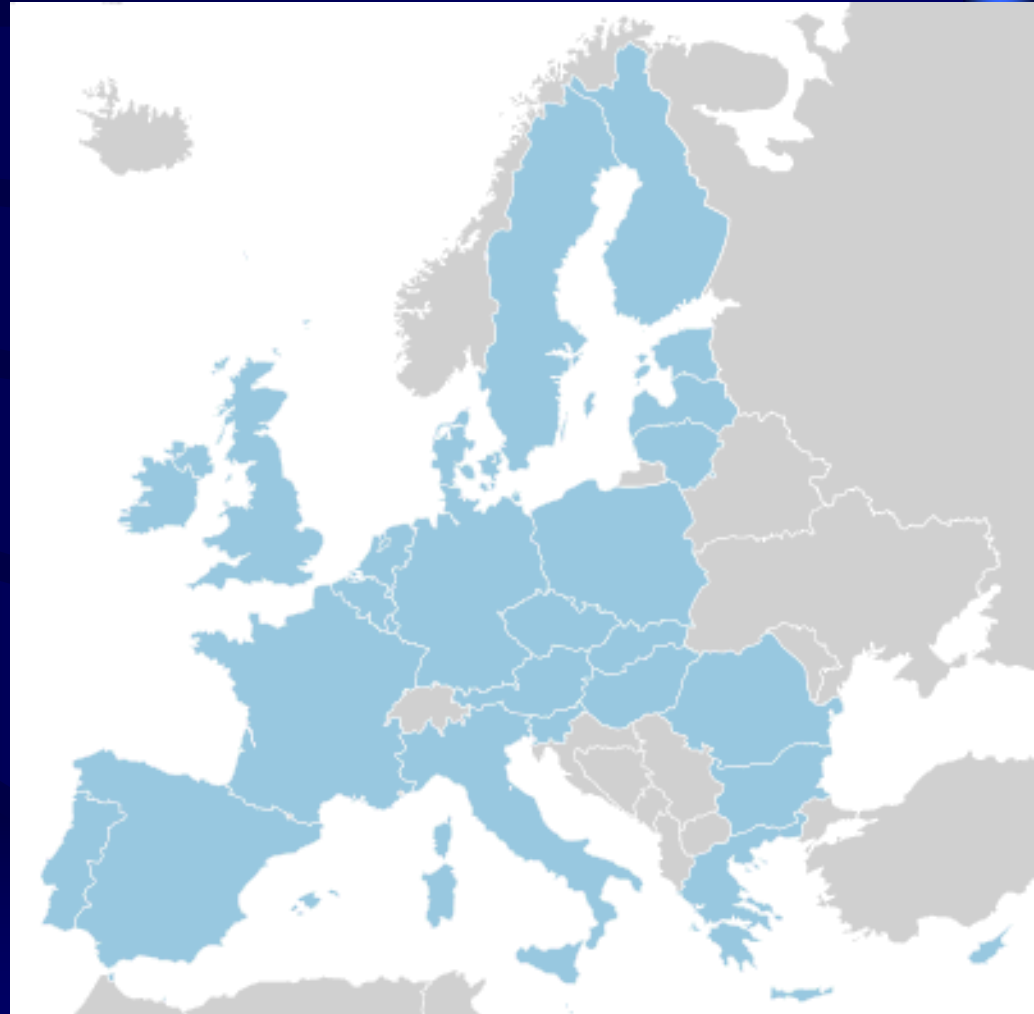
1981 Greece

1986 Portugal, Spain

1995 Austria, Finland, Sweden

2004 Cyprus, Czech Republic,
Estonia, Hungary, Latvia, Lithuania,
Malta, Poland, Slovakia, Slovenia

2007 Bulgaria, Romania



Trade Creation vs. Trade Diversion

- How compatible are regional and multilateral trade regimes?
- Economists study whether the regional arrangement creates or diverts trade
- If the agreement simply diverts trade from extraregional countries to intraregional trading partners, then it is trade diverting.

Fortress Europe vs. Fortress North America

- Consider the case of European antitrust enforcement (Does it favor EU firms against US firms?)
- Consider the NAFTA regional content rules for the auto industry (Do they discriminate against Japan and Europe?)

Why Hasn't Regional Integration Been Successful Outside Europe?

- Europe integrated mostly industrialized, wealthy countries.
- The EU insists that members must have democratic governments.
- Most other regions have considerably wider variations among potential members in size, wealth, degree of industrialization, and political systems (e.g. NAFTA).