

## Fulbright School of Public Policy and Management

Summer Semester – Y2021-2022

### TRADE POLICY

#### Teaching team

|                        |                     |  |
|------------------------|---------------------|--|
| <i>Instructor</i>      | Ari Kokko           | <a href="mailto:ako.egb@cbs.dk">ako.egb@cbs.dk</a>                         |
| <i>Teaching Fellow</i> | Doan Thi Thanh Thuy | <a href="mailto:thuy.doan@fulbright.edu.vn">thuy.doan@fulbright.edu.vn</a> |
| <i>Tutor</i>           | Bui Manh Tien       | <a href="mailto:tien.bui@fulbright.edu.vn">tien.bui@fulbright.edu.vn</a>   |

#### Class meetings

Two class meetings each day, from October 02 to October 09, 2022:

08:30 – 10:00 AM

10:15 – 11:45 AM

#### Office hours

|                     | Mon            | Tue           | Wed | Thurs         | Fri           |
|---------------------|----------------|---------------|-----|---------------|---------------|
| Ari Kokko           | By appointment |               |     |               |               |
| Doan Thi Thanh Thuy |                | 16:45 – 18:00 |     | 16:45 – 18:00 |               |
| Bui Manh Tien       |                | 16:30 – 18:00 |     |               | 16:30 – 18:00 |

Meeting can also be arranged by appointment upon teaching members' availability. The office hours are officially enforced from September 26 to October 23, 2022.

#### Course descriptions

The course provides students with a theoretical background on international trade, including classical, neoclassical, and “new” trade theories. The theories will help students to understand complex economic phenomena and explain trade patterns between countries. The course emphasizes understanding the institutional environment of international trade as well as the benefits and challenges of regional integration and bilateral trade agreements. Also, the course discusses how domestic firms in Vietnam and other small economies can improve their international competitiveness and benefit from international trade.

The course will consist of two parts. Part 1, International Trade Theories, discusses the main concepts and approaches in international trade with real-life applications: the comparative

model of David Ricardo and Eli Heckscher, Bertil Ohlin, and new trade model with increasing returns to scale. Part 2, International Trade Policy, presents motives for regional integration and bilateral trade agreement; trade intermediaries; factor mobility and effects of foreign direct investment; and international competitiveness of domestic firms.

## Assignments

There will be one in-class problem set and one take-home assignment that help students review and apply basic concepts and analytical tools acquired from the course into real world. The take-home assignment will be uploaded on Teams.

There might be short quizzes, about 5-10 minutes at the beginning of a class to check on the students' reading and understanding of materials.

## Final term paper: Policy application

This is a 7000-word research paper. Students will work in groups of 2-3 to apply concepts, models, and knowledge acquired during the course into analyzing a policy issue related to *Vietnam in Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)*. Group members will be randomly assigned. Every member must contribute equally to the group term paper.

## Course Assessment

| Activities           | Percentage  |
|----------------------|---|
| Class participation  | 30%<br>(Class attendance 50%,<br>Participation in class discussion 50%) |
| In-class problem     | 15%   |
| Take-home assignment | 25%   |
| Final term paper     | 30%   |

Students must complete the assignments and term paper on their own and submit them before 8:20 on the due dates. Copying of other's work is not allowed. Students need to refer to Student's Handbook regarding Guidelines on class attendance, assignment submission, complaining, plagiarism, and special needs.

*\* Students are allowed to be absent from two (02) class meetings. Exceed the absence allowance, students will receive a zero (0) attendance score. Other administrative policy regarding class attendance will strictly apply.*

## Important dates (subject to change)

- Sunday, 02/10/2022 In-class problem set due
- Thursday, 06/10/2022 Term paper proposal due
- Sunday, 09/10/2022 Take-home assignment due
- Sunday, 23/10/2022 Final term paper due

## Course sessions and readings

### Sunday (02/10/2022)

#### *Session 1. Introduction*

The first lecture will discuss the role of theory in understanding complex economic phenomena and provide a brief overview of the main themes of the course. It will then turn to a discussion of classical and neoclassical trade theories, with emphasis on models introduced by David Ricardo and Eli Heckscher, and Bertil Ohlin. Some of the highlights of the discussion are a) the theory of comparative advantage, b) the observation that simple trade models are based on very restrictive assumptions, and c) the insight that trade is caused by differences in technologies and factor endowments.

*Readings:* Krugman, Obstfeld & Melitz, International Economics. Chapters 2-3, 5.

#### **In-class problem (distributed and due)**

### Monday (03/10/2022)

#### *Session 2. Trade policy in the neoclassical model*

The classical and neoclassical models of trade suggest that everyone will benefit from free trade, even if some countries are much stronger in all industries. The rational policy conclusion from this theoretical insight is that trade policy should aim to facilitate free trade. The lecture will discuss the role of the GATT and the WTO for global trade liberalization and touch on the political economy of trade policy.

*Readings:* Krugman, Obstfeld & Melitz, International Economics, Chapter 10.

### Tuesday (04/10/2022)

#### *Session 3. “New” trade theory*

One of the basic assumptions in classical and neoclassical trade theory is that there are constant returns to scale. However, in reality, many industries and production processes are characterized by large fixed costs of production, which means that there are increasing returns to scale. This applies in particular to those industries that seem to be of strategic importance because they contribute to technological progress and productivity growth across many sectors. Bigger is better (or at least stronger). The presence of economies of scale means that large players will have important advantages. This lecture discusses competition strategies under increasing returns to scale and the consequences for gains from trade and trade policy.

*Readings:* Krugman, Obstfeld & Melitz, International Economics, Chapter 7.

## Wednesday (05/10/2022)

### Session 4. Regional integration and bilateral trade agreements

Although it may be tempting to implement various strategic trade policies in markets characterized by economies of scale and imperfect competition, it is difficult in practice. Trade partners will not always appreciate such policy interventions and may therefore retaliate. But bigger is still stronger. Many small countries have therefore decided that it would be better to be big. A country cannot grow very fast, but it can become part of a larger market as a result of regional integration. The lecture identifies some reasons why regional integration in the “new trade theory world” is much more interesting than it was in the “neoclassical theory world”. We will also discuss some of the challenges of regional integration. How far should it go? Some of the motives for bilateral trade agreements are also discussed.

#### *Readings:*

- Krugman, Obstfeld & Melitz, International Economics, Chapter 10.
- Patrik Gustavsson and Ari Kokko (2004). Regional Integration, FDI, and Regional Development. EIB Papers, Vol. 9, No.1, pp. 110-135.

## Thursday (06/10/2022)

### Session 5. *New themes: trade costs, trade intermediaries, and preference utilization*

Trade theories are simplifications of reality and often based on very restrictive assumptions. One such assumption is that it is the country that engages in international trade. Neither classical nor neoclassical trade theory was concerned about firms. The development of firm-level trade models has brought us a bit closer to reality. Melitz (2003) introduced the idea of heterogeneous firms and argued that only the most productive firms are able to become exporters since they are the only ones that can still make profits after covering the higher transaction costs for international trade. However, even this was a simplification. Reality is even more complex. This lecture starts with Melitz (2003) and turns to a discussion of the role of trade intermediaries – firms specialized in handling international trade. We will also discuss how well bilateral trade agreements work, and why not all firms engage in tariff-free trade when there is a free trade agreement.

#### *Readings:*

- Mark J. Melitz (2003). The impact of trade on intra-industry reallocations and aggregate industry productivity. *Econometrica*, 71(6), 1695-1725.
- Sven-Olov Daunfeldt, Erik Engberg, Daniel Halvarsson, Ari Kokko, and Patrik Tingvall (2019). Wholesale firms: A catalyst for Swedish exports? Ratio Working Paper 328, Ratio, Stockholm. Chapters 1-2.
- Jonas Kasteng, Ari Kokko, Nils Norell, and Patrik Tingvall (2022). Learning to Use Trade Preferences: A Firm and Transaction Level Analysis of the EU-South Korea FTA. Mimeo, Copenhagen Business School, September.

**One-page term paper proposal due**

## Friday (07/10/2022)

### *Session 6. Factor mobility and foreign direct investment*

Most theories of international trade assume that it is only goods that move between countries and that factors of production stay put where they originally were born. This lecture discusses factor mobility, with a particular emphasis on capital mobility and foreign direct investment. How are host countries affected by inflows of FDI? What happens in the home country when domestic enterprises decide to start investing abroad?

#### *Readings:*

- Krugman, Obstfeld & Melitz, International Economics, Chapter 9.
- Magnus Blomström and Ari Kokko (1997). How Foreign Investment Affects Host Countries. Policy Research Working Paper No. 1745, The World Bank, Washington, D.C., March.

## Saturday (08/10/2022)

### *Session 7. International competitiveness*

In the distant past, countries were able to affect the relative competitiveness of their enterprises in many ways. Many trade policy instruments – such as import quotas, tariffs, and subsidies – were used to protect domestic firms from foreign competition or to help them win market shares in foreign markets. These policy measures are difficult to implement today, mainly because they are contrary to the commitments made in the WTO. This does not stop national governments from thinking about what is good for domestic enterprises. This lecture will examine some of the policy lessons from the Asian miracle economies and also discuss the current Vietnamese situation. Vietnam differs from some of the earlier Asian success stories because such a large share of Vietnam's exports is generated by foreign-invested enterprises. What policies could Vietnam use to ensure that the export success of foreign-invested enterprises also benefits domestic firms?

#### *Readings:*

- Ari Kokko (2002). Export-Led Growth in East Asia: Lessons for Europe's Transition Economies. Stockholm School of Economics EIAS Working Paper No. 142, February. (Published as "Export-Led Growth in East Asia: Lessons for Europe's Transition Economies" in S. Söderman, ed, Emerging Multiplicity—Integration and Responsiveness in Asian Business Development, Palgrave Macmillan, Basingstoke, 2006, pp 33-52.)
- Ari Kokko, Curt Nestor, and Le Hai Van (2022). FDI in Vietnam Policies, Effects, and Linkages to the Local Economy. Forthcoming in Vietnam: Navigating a Rapidly Changing Economy, Society, and Political Order, edited by Börje Ljunggren and Dwight H. Perkins, Harvard University Asia Center, 2023.

**Sunday (09/10/2022)**

***Session 8. Industrial upgrading and development in Northern Europe***

Sweden and Finland are two examples of small countries that have managed to develop strong competitiveness in several knowledge-intensive industries with substantial economies of scale. The standard assumption would be that small economies are at a disadvantage when economies of scale are important. Yet, both Sweden and Finland have been successful in these industries and managed to shift from a position as raw material suppliers to knowledge producers. This lecture focuses on some of the explanations for the long-term competitiveness of the Nordic economic model.

*Readings:* Ari Kokko (2005). Excess Capacity in Swedish Industrial Development. International Journal of Learning and Change, Vol. 1, No. 1, pp 122-140.

**Take-home assignment due**

**Sunday (23/10/2022)**

**Final term paper due**