

Contents

List of Figures	xxi
List of Tables	xxx
List of Boxes	xxxiii
List of Technical Notes	xxxvi
Preface	xxxviii
Acknowledgements	xljii

PART I Introduction

- 1 The World Economy**
- 2 Global Economic Crisis**

PART II International Trade

PART II.A Comparative Advantage

- 3 Classical Trade: Technology**
- 4 Production Structure**
- 5 Factor Prices**
- 6 Production Volume**
- 7 Factor Abundance**
- 8 Trade Policy**

PART II.B Competitive Advantage

- 9 Imperfect Competition**
- 10 Intra-Industry Trade**
- 11 Strategic Trade Policy**
- 12 International Trade Organizations**
- 13 Economic Integration**

PART II.C Trade Interactions

14	Geographical Economics	341
15	Multinationals	371
16	Trade and Growth	548
17	Heterogeneous Firms	573

PART III International Money

18	Balance of Payments	403
19	Money Market	438
20	Foreign Exchange Markets	447
21	Purchasing Power Parity	460
22	Interest Rate Parity	476

PART III.A Money Basics

18	Balance of Payments	403
19	Money Market	438
20	Foreign Exchange Markets	447
21	Purchasing Power Parity	460
22	Interest Rate Parity	476

PART III.B Exchange Rates

23	Exchange Rate Regimes	515
24	The Monetary Approach	533
25	Short-Run Economic Policy	538
26	Expectations and Sticky Prices	557
27	New Macroeconomics	579

PART III.C Policy and Credibility

28	Credibility	584
29	Target Zones	594
30	Financial Crises	636
31	Optimal Currency Areas	644

PART IV Conclusion

32 Concluding Remarks	571
References	686
Index	699

Detailed Contents

List of Figures	xxi
List of Tables	xxx
List of Boxes	xxxiii
List of Technical Notes	xxxvi
Preface	xxxviii
Acknowledgements	xliii
PART I Introduction	1
1 The World Economy	3
1.1 Introduction	3
1.2 Land area and population	4
1.3 Income	7
1.4 Income per capita	11
1.5 International trade	12
1.6 Globalization	15
1.7 Trade connections in the world economy	20
1.8 Conclusions	21
Questions	21
Endnotes	23
2 Global Economic Crisis	24
2.1 Introduction	24
2.2 Collapsing trade flows	25
2.3 Seeds for the crisis: bubbles, innovation, and imbalance	31
2.4 From financial problems in the US to global output collapse	33
2.5 Government response, early victory, and new problems	36
2.6 European imbalances	39
2.7 Conclusions	45
Technical Note	46
Questions	46
Endnotes	48

PART II International Trade	49
PART II.A Comparative Advantage	51
3 Classical Trade: Technology	52
3.1 Historical introduction	52
3.2 Smith's argument for free trade	54
3.3 Ricardo's contribution	55
3.4 Technology as a basis for comparative advantage	56
3.5 Production possibility frontier and autarky	58
3.6 Terms of trade and gains from trade	61
3.7 Application: Kenya and the EU	63
3.8 More countries and world PPF	65
3.9 Measuring trade advantages: the Balassa index	66
3.10 Services	70
3.11 Conclusions	72
Questions	72
Endnotes	74
4 Production Structure	75
4.1 Introduction	75
4.2 Neoclassical economics	76
4.3 General structure of the neoclassical model	77
4.4 Production functions	78
4.5 Cost minimization	81
4.6 Impact of wage rate and rental rate	85
4.7 Constant returns to scale	86
4.8 Conclusions	90
Technical Notes	91
Questions	93
Endnotes	94
5 Factor Prices	96
5.1 Introduction	96
5.2 Factor price equalization	97
5.3 The Lerner diagram	98
5.4 From factor prices to final goods prices	101
5.5 From final goods prices to factor prices	101
5.6 Stolper–Samuelson	103
5.7 Graphical analysis	104
5.8 The magnification effect	105

5.9	Application: globalization, low wages, and unemployment	108
5.10	Conclusions	111
	Technical Notes	111
	Questions	113
	Endnotes	114
6	Production Volume	115
6.1	Introduction	115
6.2	Rybczynski	115
6.3	The Edgeworth Box	117
6.4	The contract curve	118
6.5	The distribution of labour and capital	119
6.6	Application: Russian immigrants in Israel	124
6.7	Conclusions	127
	Technical Notes	127
	Questions	128
	Endnotes	131
7	Factor Abundance	132
7.1	Introduction	132
7.2	Heckscher–Ohlin	134
7.3	Demand	134
7.4	The production possibility frontier	137
7.5	Structure of the equilibrium	141
7.6	Autarky equilibrium	142
7.7	International trade equilibrium	145
7.8	The case of the missing trade	149
7.9	Conclusions	150
	Technical Notes	151
	Questions	152
	Endnotes	153
8	Trade Policy	155
8.1	Introduction	155
8.2	Tariffs, quotas, and other trade restrictions	156
8.3	Tariffs and partial equilibrium	158
8.4	Tariffs and general equilibrium	162
8.5	General equilibrium with offer curves	166
8.6	The 'optimal' tariff?	167
8.7	Optimal tariffs and retaliation	170
8.8	Tariffs in the USA	173
8.9	Conclusions	174

Technical Note	174
Questions	175
Endnotes	176
PART II.B Competitive Advantage	177
9 Imperfect Competition	178
9.1 Introduction	178
9.2 Monopoly	180
9.3 Monopoly in general equilibrium: autarky	182
9.4 Oligopoly	183
9.5 The pro-competitive effect of international trade	186
9.6 ‘Reciprocal dumping’	188
9.7 Application: the Twaron takeover	191
9.8 Conclusions	191
Technical Notes	194
Questions	196
Endnotes	198
10 Intra-Industry Trade	199
10.1 Introduction	199
10.2 Measuring intra-industry trade	202
10.3 Dixit–Stiglitz demand	206
10.4 Demand effects; income, price elasticity, and the price index	207
10.5 Increasing returns to scale	210
10.6 Optimal pricing and zero profits	212
10.7 Explaining intra-industry trade	213
10.8 An alternative interpretation: intermediate goods	217
10.9 Conclusions	219
Technical Notes	219
Questions	221
Endnotes	222
11 Strategic Trade Policy	224
11.1 Introduction	224
11.2 Market power and tariffs	225
11.3 The non-equivalence of tariffs and quotas	227
11.4 Strategic trade policy	228
11.5 The nature of competition	230
11.6 Evaluation of strategic trade policy	232

11.7	Application: the aircraft industry	233
11.8	Conclusions	235
	Technical Notes	236
	Questions	237
	Endnotes	240
12	International Trade Organizations	241
12.1	Introduction	241
12.2	The World Trade Organization (WTO/GATT)	243
12.3	The United Nations (UN) and UNCTAD	250
12.4	Organization for Economic Cooperation and Development (OECD)	253
12.5	Case study: economic transition in Central and Eastern Europe	256
12.6	Conclusions	259
	Technical Notes	260
	Questions	265
	Endnotes	266
13	Economic Integration	267
13.1	Introduction	267
13.2	Types of regional economic integration	268
13.3	Neoclassical theory of economic integration	269
13.4	Regional trade agreements	273
13.5	Regionalism and the new trade theory	277
13.6	Europe and the European Union (EU)	280
13.7	Recent enlargement of the European Union (EU)	283
13.8	Conclusions	289
	Technical Note	289
	Questions	290
	Endnotes	292
PART II.C	Trade Interactions	293
14	Geographical Economics	294
14.1	Introduction	294
14.2	Zipf's Law and the gravity equation	295
14.3	The structure of the model	298
14.4	Multiple locations and equilibrium	301
14.5	Computer simulations: getting started	307
14.6	Alternative models: human capital and intermediate goods	311
14.7	Application: predicting the location of European cities	313

14.8	Conclusions	317
	Technical Notes	317
	Questions	319
	Endnotes	320
15	Multinationals	322
15.1	Introduction	322
15.2	The size and structure of multinationals	324
15.3	Foreign direct investment (FDI)	327
15.4	Explaining multinationals	331
15.5	Multinationals in general equilibrium	333
15.6	Characterization of equilibrium	337
15.7	Case study: hard-disk drives	341
15.8	Conclusions	342
	Questions	343
	Endnotes	344
16	Trade and Growth	346
16.1	Introduction	346
16.2	Modelling new goods	348
16.3	Kaldor's stylized facts of economic growth	351
16.4	The neoclassical model and the Solow residual	353
16.5	Empirical pictures	355
16.6	Endogenous growth	358
16.7	An experiment in geographical economics	362
16.8	Measuring what is not there: the Dupuit triangle	366
16.9	More on the dynamic costs of trade restrictions	368
16.10	China, a case study	370
16.11	Conclusions	373
	Technical Notes	374
	Questions	375
	Endnotes	377
17	Heterogeneous Firms	378
17.1	Introduction	378
17.2	Empirics of trade and firm heterogeneity	379
17.3	Heterogeneous firms in a closed economy	384
17.4	Firm heterogeneity, trade, and productivity	393
17.5	Heterogeneity and mode of entry	398
17.6	Conclusions	400
	Technical Notes	401
	Questions	403
	Endnotes	404

PART III International Money	405
PART III.A Money Basics	407
18 Balance of Payments	408
18.1 Introduction	408
18.2 National income accounting	408
18.3 The balance of payments	411
18.4 Capital flows	413
18.5 Nations and firms: a classic mistake	414
18.6 The benefits of international capital flows	419
18.7 Conclusions	422
Questions	423
Endnotes	425
19 Money Market	426
19.1 Introduction	426
19.2 The functions of money	426
19.3 Different types of money	428
19.4 The money market	430
19.5 The demand for money	431
19.6 The money supply process	433
19.7 Monetary equilibrium	438
19.8 Conclusions	440
Questions	440
Endnotes	442
20 Foreign Exchange Markets	443
20.1 Introduction	443
20.2 Spot exchange rates	444
20.3 Players and markets	448
20.4 Forward looking markets	449
20.5 Effective exchange rates	451
20.6 Trading volume	454
20.7 Conclusions	455
Technical Note	456
Questions	457
Endnotes	459
21 Purchasing Power Parity	460
21.1 Introduction	460

21.2	The Law of One Price and purchasing power parity	461
21.3	Prices and exchange rates	463
21.4	Real effective exchange rates	467
21.5	Causes of deviations from PPP	471
21.6	Testing for PPP	473
21.7	Structural deviations: PPP corrections	474
21.8	Conclusions	477
	Questions	477
	Endnotes	478
22	Interest Rate Parity	479
22.1	Introduction	479
22.2	Interest rates	480
22.3	Covered interest parity	483
22.4	The empirics of covered interest parity	484
22.5	Uncovered interest parity	488
22.6	Risk premium and transaction costs	490
22.7	The empirics of uncovered interest parity	491
22.8	Conclusions	494
	Technical Note	495
	Questions	496
	Endnotes	497
PART III.B Exchange Rates		499
23	Exchange Rate Regimes	500
23.1	Introduction	500
23.2	Exchange rate regimes	501
23.3	Exchange rate regimes and the policy trilemma	504
23.4	Gold standard (±1870–1914)	506
23.5	World wars and recession (1914–1945)	507
23.6	Bretton Woods (1945–1971)	509
23.7	Floating rates (1971–present)	509
23.8	International Monetary Fund (IMF)	513
23.9	World Bank	516
23.10	Bank for International Settlement (BIS)	519
23.11	Conclusions	519
	Technical Note	520
	Questions	520

	Endnotes	522
24	The Monetary Approach	523
	24.1 Introduction	523
	24.2 Money, price flexibility, and the modelling of exchange rates	523
	24.3 The monetary model and the price specie flow mechanism	525
	24.4 Flexible price monetary approach (floating exchange rates)	530
	24.5 Money, income, and exchange rates	532
	24.6 Conclusions	535
	Technical Notes	535
	Questions	536
	Endnotes	537
25	Short-Run Economic Policy	538
	25.1 Introduction	538
	25.2 Fixed exchange rates (small country, perfect capital mobility)	540
	25.3 Fixed exchange rates and large countries (perfect capital mobility)	542
	25.4 Imperfect substitutability (small country, fixed exchange rates)	544
	25.5 Flexible exchange rates (small country, perfect capital mobility)	546
	25.6 Flexible exchange rates, large countries, and imperfect substitutability	549
	25.7 Conclusions	553
	Technical Notes	554
	Questions	555
	Endnotes	556
26	Expectations and Sticky Prices	557
	26.1 Introduction	557
	26.2 Rational expectations and financial equilibrium	558
	26.3 Price stickiness and the phase diagram	560
	26.4 Equilibrium dynamics	562
	26.5 Exchange rate overshooting	565
	26.6 Expectations formation	567
	26.7 Fundamentals and bubbles	569
	26.8 Empirical evidence	572
	26.9 Conclusions	574
	Technical Notes	574
	Questions	576
	Endnotes	578

27	New Macroeconomics	579
27.1	Introduction	579
27.2	Exchange rates, terms-of-trade, and competition	580
27.3	Model structure and demand	582
27.4	Wage-setting and prices	586
27.5	Equilibrium	588
27.6	Monetary policy rules and exchange rate regimes	589
27.7	Conclusions	591
	Technical Note	591
	Questions	592
	Endnotes	593
PART III.C Policy and Credibility		595
28	Credibility	596
28.1	Introduction	596
28.2	Objectives: welfare and the loss function	597
28.3	From instruments to targets	599
28.4	From targets to objectives: expectations and the Phillips curve	601
28.5	The Barro–Gordon model	605
28.6	The Taylor rule	608
28.7	Conclusions	609
	Technical Notes	610
	Questions	611
	Endnotes	614
29	Target Zones	615
29.1	Introduction	615
29.2	Exchange rate regimes	616
29.3	Fixed exchange rates	617
29.4	Credibility of fixed exchange rate regimes I: preferences	619
29.5	Credibility of fixed exchange rate regimes II: shocks	622
29.6	The basic target zone model	624
29.7	Target zones and empirical tests	628
29.8	Conclusions	630
	Technical Notes	630
	Questions	631
	Endnotes	633
30	Financial Crises	634
30.1	Introduction	634

30.2	What is a currency crisis?	635
30.3	Characteristics of currency crises	637
30.4	First generation models	639
30.5	Second generation models	640
30.6	Frequency and measurement	643
30.7	The costs of financial crises and sequencing	645
30.8	Synthesis: third generation model	646
30.9	Conclusions	648
	Questions	648
	Endnotes	650
31	Optimal Currency Areas	651
31.1	Introduction	651
31.2	Optimal currency areas	652
31.3	Benefits of a common currency	655
31.4	The Maastricht Treaty	659
31.5	The Eurosystem	662
31.6	Monetary policy	664
31.7	Euro area problems during the Global Economic Crisis	667
31.8	Conclusions	669
	Technical Notes	669
	Questions	670
PART IV	CONCLUSION	673
32	Concluding Remarks	675
32.1	Introduction	675
32.2	International trade	675
32.3	Gains from trade	677
32.4	Trade policy	678
32.5	Applications	679
32.6	International money	679
32.7	Exchange rates	681
32.8	Policy framework	682
32.9	Economic policy	683
32.10	Conclusion	684
	References	686
	Index	699