

# International Economics

Twelfth Edition

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## INTERNATIONAL ECONOMICS

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# Preface

With this twelfth edition I am honored to take over the stewardship of the book. I joined Peter Lindert as co-author for the tenth edition, and he has now passed the book to my care, just as Charles Kindleberger, the original author of the book, did when Peter succeeded him as the book's author. We are all very happy that the book reaches its golden anniversary with this edition. I also enjoy the mirth of a literary improbability—I am the author of a book that was first published in the year I was born.

I maintain the characteristics and objectives of the book that have guided all its editions. The book

- combines rigorous economic analysis with attention to the issues of economic policy that are alive and important today
- is written to be concise and readable
- uses economic terminology when it enhances the economic logic of the analysis, but avoids jargon for jargon's sake.

I follow these principles when I teach international economics to undergraduates and masters students. I believe that the book benefits as I incorporate what I learn from the classroom into it.

The world is now deeply into the second great wave of globalization, in which product, capital, and labor markets are becoming more and more integrated across countries. This second wave, which began in about 1950, has now lasted about as long as the first, which began in about 1870 and ended with World War I (or perhaps with the onset of the Depression in 1930). As indicators of the current process of globalization, we see that international trade, foreign direct investments, cross-border lending, and international portfolio investments are growing faster than world production. Information and data now spread around the world instantly through the Internet and other global electronic media. As the world becomes more integrated, countries become more interdependent. Increasingly, events and policy changes in one country affect many other countries. Also increasingly, companies make decisions about production and product development based on global markets.

## CURRENT EVENTS AND NEW EXAMPLES

The global economy is an exciting place. It is a joy and a challenge for me to incorporate the events and policy changes that continue to transform it, and to find the new examples that show the effects of globalization (both its upside and

its downside). Here are some of the current and recent events that are included in this edition to provide new examples that show the practical use of our economic analysis:

- President Bush imposed new tariffs on steel imports into the United States in March 2002
- the euro completely replaced the separate national currencies of twelve member countries of the European Union in early 2002
- the rise of electronic brokering is changing how the foreign exchange markets work
- China and Taiwan joined the World Trade Organization in 2001
- the members of the World Trade Organization launched a new round of multilateral trade negotiations (the Doha round) in 2001
- the long recession in Argentina turned into a financial and economic meltdown in early 2002, with the Argentinean peso plummeting after the country's government abandoned the fixed exchange rate of one peso equal to one U.S. dollar
- Cemex, a multinational enterprise based in Mexico, has risen rapidly to become the third largest cement producer in the world
- the European Union is preparing to expand by adding up to a dozen countries as new members, perhaps as early as 2004
- Ecuador adopted the U.S. dollar as its own currency, in place of its sucre, in 2000
- the Japanese government has repeatedly intervened in the foreign exchange market to prevent the yen from appreciating against the U.S. dollar
- The International Monetary Fund provided a huge loan to Turkey in 2000, to try to prevent Turkey's financial crisis from deepening

## IMPROVING THE BOOK: ORGANIZATION AND TOPICS

In this edition I introduce a number of improvements to the pedagogical structure of the book.

- The shaded boxes that contain material separate from the text are now labeled by type: *Focus on Labor*, *Case Study*, and *Extension*. This will make it easier for instructors and students to see what kind of material is in the box, and how it relates to what is presented in the text of the chapter. In addition, I have added many new boxes, especially case studies.
- The order of Chapter 5 and 6 has been reversed from the eleventh edition. With this change all of the essentials of trade theories (productivity differences, factor endowments and factor proportions, product differentiation and

monopolistic competition, oligopoly, and agglomeration based on external economies) are presented in consecutive chapters. The new Chapter 6 then can use these concepts and tools to examine issues of sectoral changes, trade, innovation, and growth.

- Several key strengths of Part II (trade policy) are further enhanced. The discussion of nontariff barriers to trade in Chapter 8 has been sharpened. Chapter 10 now focuses completely on allegedly unfair trade (dumping and subsidies) and administered protection through antidumping and countervailing actions. A new box presents the examples of chicken, supercomputers and steel. In Chapter 12 the environmental effects of the Uruguay Round agreements are examined, adding strength to the book's unique and powerful treatment of trade and the environment.
- The discussion of the political economy of import barriers is now included in Chapter 9 as the capstone of the discussion of arguments for and against protection. A new box presents a case study of sugar as an example of the interplay between politics and economics.
- The twelfth edition has a single chapter that examines international resource movements, focusing on multinational enterprises and labor migration. This is now in Part II of the book, because of its link to government policy issues, rather than at the end of the book as it was in the previous edition.
- The book weaves discussion of labor issues into a number of chapters in Parts I and II. This topic is of great interest to students (and almost everybody else). The tour begins in Chapter 1, with a discussion of labor standards and conditions, issues prominent in the Seattle protests against the WTO and the ongoing protests against globalization. It continues through boxes that Focus on Labor in Chapters 3, 4, 6, and 9. Labor issues are also prominent in the discussion of the winners and losers from free trade in Chapters 4 and 5, trade adjustment assistance in Chapter 9, and labor migration in Chapter 14.
- The discussion of the determinants of exchange rates is now collected into a single chapter. Chapter 18 begins with an analysis of exchange rates in the short run, drawing on concepts like uncovered interest parity that were just presented in Chapter 17. Chapter 18 then examines exchange rates in the long run (purchasing power parity and the monetary approach). It concludes with a discussion of overshooting as a rather odd way that we may get from the short run to the long run.
- The chapter on international financial crises, which had been at the end of the book, is now included in Part III. This placement emphasizes the links of these crises to international financial flows and exchange rate policies.
- A new appendix presents the aggregate demand-aggregate supply framework as an approach to open-economy macroeconomics. This provides flexibility for instructors who would like to include this approach in their course.

## FORMAT AND STYLE

I have been careful to retain the goals of clarity and honesty that have made *International Economics* an extraordinary success in classrooms and courses around the world. There are plenty of quick road signs at the start of and within chapters. The summaries at the end of the chapters offer an integration of what has been discussed. Students get the signs, “Here’s where we are going, here’s where we have just been.” I have added more bullet-point and numbered lists, to add to the visual appeal of the text and to emphasize sets of determinants or effects.

I am candid about ranking some tools or facts ahead of others. The undeniable power of some of the economist’s tools is applied repeatedly to events and issues without apology. Theories and concepts that fail to improve on common sense are not oversold.

The format of the book is fine-tuned for better learning. Most exam-worthy **terms** appear in boldface in the text, with their definitions usually contiguous. Words and phrases that deserve *special emphasis* are in italics.

Each chapter (except for the short introductory chapter) has at least ten questions and problems. The answers to all odd-numbered questions and problems are included in the material at the end of the book. As a reminder, these odd-numbered questions are marked with a ♦.

### Box

Shaded boxes appear in different type with a different right-edge format and two columns per page, in contrast to the style of main text. As noted above,

the boxes provide discussions of labor issues, case studies, and extensions of the concepts presented in the text.

## SUPPLEMENTS

### Power Point Slides

New to this edition, the PowerPoint Slides will be available on the Instructor’s CD-ROM and via the course website. These presentations include slides with figures and graphs to make teaching and learning more accessible.

### Test Bank

For the first time ever, the twelfth edition of *International Economics* has an accompanying test bank. Prepared by Andrew Hill and Scott Klokis of the University of Delaware, the 500-question bank offers a plethora of testing options for the instructor, and will include such types of questions as multiple-choice, fill-in-the-blank, matching, true/false, and short-answer.

## Instructor's Manual

Written by the author, the Instructor's Manual contains chapter overviews, teaching tips, and suggested answers to the even-numbered questions and problems that are contained in the textbook.

## Study Guide

Written by Kerry Odell of Scripps College, the same author as the previous editions, the Study Guide is similar in format and quality to 11e. Each chapter is broken down into six sections—Objectives of the Chapter, Key Terms, Warm-Up Questions, Multiple-Choice Questions, Problems, and Discussion Topics—and is available to enhance student performance at minimal cost.

## Instructor's CD-ROM

New to this edition, electronic versions of all instructor supplements (including the PowerPoint presentation, Instructor's Manual, and 500-question Test Bank) may be conveniently accessed on an Instructor's CD. This makes it easy for instructors to use the various supplements designed to enhance the professor's teaching experience.

## COURSE WEBSITE

The website to accompany Pugel's twelfth edition provides the most complete content for any international text of its kind. Organized into separate sections for the instructor and the student, this much enhanced website provides a wide variety of learning devices geared specifically for either group.

For the student:

- interactive graphing exercises
- free study guide samples
- downloadable PowerPoints
- learning tips for students
- book-level glossary
- an outline
- a list of chapter-specific key terms
- a set of testing components including multiple choice, essay, fill-in-the-blank, true/false and matching questions

For the instructor:

- downloadable Instructor Manual
- downloadable PowerPoints
- group learning exercises
- online resource links for additional economic information
- links to professional resources

# Acknowledgments

I offer my deepest thanks to the many people whose advice helped me to improve *International Economics* in its twelfth edition. My first thanks are to Peter H. Lindert, my co-author on the previous several editions. I was most happy to join Peter as co-author, and I have learned much from him about the art of writing for the community of students who want to deepen their knowledge and understanding of the global economy.

I love teaching international economics, and I am grateful to my students for the many suggestions and insights that I have received from them. I especially thank my colleagues Richard Levich, Jianping Mei, Roy Smith, Paul Wachtel, and Harvey Ponichak for information and suggestions. I thank Professor Rachel McCulloch of Brandeis University and Professor Michel-Henry Bouchet of CERAM Sophia Antipolis (France) for comments on the previous edition. I am indebted to Professor Stephen S. Golub of Swarthmore College for providing an update of his results on productivity and wages (used in the box “Absolute Advantage Does Matter” in Chapter 3). I am grateful to Professor Li Kening of Beijing Materials College, who both translated the eleventh edition into Chinese, and pointed out passages in the book that could be improved or corrected. I also thank my brother, Michael Pugel, who shared with me his knowledge of technology issues from his perspective as an electrical engineer. In addition, I thank Gloria Asuncion and Janine Alberti, who provided help with the preparation of the manuscript.

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My final acknowledgment and thanks are to Charles P. Kindleberger, who was one of my teachers during my graduate studies. He started this book 50 years ago, and I strive to meet the standards of excellence and relevance that he set for the book.

*Thomas A. Pugel*

# Brief Contents

## **Preface** iii

## **About the Author** xx

- 1** International Economics Is Different 1

## **PART ONE**

### **The Theory of International Trade** 15

- 2** The Basic Theory Using Demand and Supply 17
- 3** Why Everybody Trades: Comparative Advantage and Factor Proportions 35
- 4** Who Gains and Who Loses from Trade? 69
- 5** Alternative Theories of Trade 91
- 6** Growth and Trade 111

## **PART TWO**

### **Trade Policy** 131

- 7** Analysis of a Tariff 133
- 8** Nontariff Barriers to Imports 153
- 9** Arguments for and against Protection 185
- 10** Pushing Exports 217
- 11** Trade Blocs and Trade Blocks 247
- 12** Trade and the Environment 273

- 13** Trade Policies for Developing and Transition Countries 309

- 14** Multinationals and Migration: International Factor Movements 339

## **PART THREE**

### **Understanding Foreign Exchange** 375

- 15** Payments among Nations 377
- 16** The Foreign Exchange Market 399
- 17** Forward Exchange and International Financial Investment 417
- 18** What Determines Exchange Rates? 445
- 19** Government Policies toward the Foreign Exchange Market 479
- 20** International Lending and Financial Crises 517

## **PART FOUR**

### **Macro Policies for Open Economies** 551

- 21** How Does the Open Macroeconomy Work? 553
- 22** Internal and External Balance with Fixed Exchange Rates 581
- 23** Floating Exchange Rates and Internal Balance 621
- 24** National and Global Choices: Floating Rates and the Alternatives 643

## **APPENDIX**

- A** The Web and the Library:  
International Numbers and Other  
Information 673
- B** Deriving Production-Possibility  
Curves 679
- C** Offer Curves 685
- D** The Nationally Optimal Tarriff 689
- E** Many Parities at Once 695
- F** Aggregate Demand and Aggregate  
Supply in the Open Economy 699
- G** Devaluation and the Current Account  
Balance 711

## **SUGGESTED ANSWERS— QUESTIONS AND PROBLEMS 717**

## **REFERENCES 747**

## **INDEX 761**

# Contents

## Preface iii

## About the Author xx

## Chapter One

### International Economics Is Different 1

#### Four Events 1

*Steel* 1

*Poor Workers in Poor Countries* 4

*The Euro* 7

*Argentina: From Darling to Delinquent* 8

#### Economics and the Nation-State 11

*Different Moneys* 11

*Different Fiscal Policies* 12

*Factor Mobility* 12

#### The Scheme of This Book 13

## PART ONE

### THE THEORY

### OF INTERNATIONAL TRADE 15

## Chapter Two

### The Basic Theory Using Demand and Supply 17

#### Four Questions about Trade 18

#### A Look Ahead 18

#### Demand and Supply 19

*Demand* 19

*Consumer Surplus* 21

*Supply* 22

*Producer Surplus* 23

*A National Market with No Trade* 24

#### Two National Markets and the Opening of Trade 24

*Free-Trade Equilibrium* 25

*Effects in the Importing Country* 27

*Effects in the Exporting Country* 30

*Which Country Gains More?* 30

#### Summary: Early Answers to the Four

Trade Questions 31

Suggested Reading 31

Questions and Problems 31

## Chapter Three

### Why Everybody Trades: Comparative Advantage and Factor Proportions 35

#### Adam Smith's Theory

of Absolute Advantage 36

*Case Study Mercantilism: Older than Smith—  
and Alive Today* 37

Ricardo's Theory of Comparative Advantage 39

Ricardo's Constant Costs and the  
Production-Possibility Curve 43

*Focus on Labor Absolute Advantage*

*Does Matter* 44

*Extension What If Trade Doesn't Balance?* 47

Increasing Marginal Costs 48

*What's Behind the Bowed-Out Production-  
Possibility Curve?* 50

*What Production Combination Is Actually  
Chosen?* 50

Community Indifference Curves 52

Production and Consumption Together 54

*Without Trade* 54

*With Trade* 54

*Demand and Supply Curves Again* 57

*Case Study The Opening of Trade and China's  
Shift Out of Agriculture* 58

The Gains from Trade 58

Trade Affects Production and Consumption 60

What Determines the Trade Pattern? 61

The Heckscher–Ohlin (H–O) Theory:

Factor Proportions Are Key 62

Summary 63  
 Suggested Reading 64  
 Questions and Problems 64

## Chapter Four

### Who Gains and Who Loses from Trade? 69

Who Gains and Who Loses Within a Country 69

*Short-Run Effects of Opening Trade* 70

*The Long-Run Factor-Price Response* 70

Three Implications of the H-O Theory 72

*Extension A Factor-Ratio Paradox* 73

*The Stolper-Samuelson Theorem* 74

*The Specialized-Factor Pattern* 75

*The Factor-Price Equalization Theorem* 76

Does Heckscher-Ohlin Explain Actual Trade Patterns? 77

*Factor Endowments* 77

*Case Study The Leontief Paradox* 78

*International Trade* 79

What Are the Export-Oriented and Import-Competing Factors? 82

*The U.S. Pattern* 82

*Focus on Labor U.S. Jobs and Foreign Trade* 83

*The Canadian Pattern* 84

*Patterns in Other Countries* 84

Do Factor Prices Equalize Internationally? 85

Summary: Fuller Answers to the Four

Trade Questions 86

Suggested Reading 87

Questions and Problems 87

## Chapter Five

### Alternative Theories of Trade 91

Trade Facts in Search of Better Theory 91

*The Rise of Intra-Industry Trade* 92

*Global Industries Dominated by a Few*

*Large Firms* 94

Economies of Scale 95

Monopolistic Competition and Trade 96

*Opening to Trade* 98

*Basis for Trade* 100

*Gains from Trade* 101

Oligopoly and International Trade 102

External Scale Economies and Trade 104

Summary: How Does Trade Really Work? 106

Suggested Reading 109

Questions and Problems 109

## Chapter Six

### Growth and Trade 111

Balanced Versus Biased Growth 112

Growth in Only One Factor 114

Changes in the Country's Willingness to Trade 115

*Case Study The Dutch Disease and Deindustrialization* 116

Effects on the Country's Terms of Trade 118

*Small Country* 118

*Large Country* 118

*Immiserizing Growth* 119

Technology and Trade 121

*Individual Products and the Product Cycle* 123

*Openness to Trade Affects Growth* 124

*Focus on Labor Trade, Technology, and U.S.*

*Wages* 125

Summary 126

Suggested Reading 127

Questions and Problems 128

## PART TWO

### TRADE POLICY 131

## Chapter Seven

### Analysis of a Tariff 133

A Preview of Conclusions 134

The Effect of a Tariff on Producers 134

The Effect of a Tariff on Consumers 137

The Tariff as Government Revenue 139

The Net National Loss from a Tariff 139

*Extension The Effective Rate of Protection* 142

The Terms-of-Trade Effect and a Nationally

Optimal Tariff 144

Summary 148

Suggested Reading 149

Questions and Problems 149

## xiv Contents

**Chapter Eight****Nontariff Barriers to Imports 153**

- Types of Nontariff Barriers to Imports 154
- The Import Quota 154
  - Quota versus Tariff for a Small Country* 156
  - Ways to Allocate Import Licenses* 157
  - Quota versus Tariff for a Large Country* 161
- Voluntary Export Restraints (VERs) 163
  - Case Study** *Auto VER: Protection with Integrity?* 164
- Other Nontariff Barriers 166
  - Case Study** *Carrots Are Fruit, Snails Are Fish, and Cows Need Passports* 167
  - Product Standards* 167
  - Domestic Content Requirements* 168
  - Government Procurement* 169
- How Big Are the Costs of Protection? 170
  - As a Percentage of GDP* 170
  - For Specific Products with High Protection* 172
- WTO: Tariff Success and New Challenges 173
  - Case Study** *China Joins the WTO* 176
- America's "Section 301": Unilateral Pressure 177
  - Case Study** *The Rocky Road to Doha* 178
- Summary 181
- Suggested Reading 182
- Questions and Problems 182

**Chapter Nine****Arguments for and against Protection 185**

- The Ideal World of First Best 186
- The Realistic World of Second Best 188
  - Government Policies toward Externalities* 189
  - The Specificity Rule* 190
- Promoting Domestic Production or Employment 191
- The Infant Industry Argument 195
  - How It Is Supposed to Work* 195
  - Focus on Labor** *How Much Does It Cost to Protect a Job?* 196
  - How Valid Is It?* 198

- The Dying Industry Argument and Adjustment Assistance 200
  - Should the Government Intervene?* 200
  - Trade Adjustment Assistance* 202
- The Developing Government (Public Revenue) Argument 203
- Other Arguments for Protection: Noneconomic Objectives 204
  - National Pride* 204
  - National Defense* 204
  - Income Redistribution* 205
- The Politics of Protection 206
  - The Basic Elements of the Political-Economic Analysis* 206
  - When Are Tariffs Unlikely?* 207
  - When Are Tariffs Likely?* 208
  - Case Study** *How Sweet It Is (or Isn't)* 210
  - Applications to Other Trade-Policy Patterns* 211
- Summary 213
- Suggested Reading 215
- Questions and Problems 215

**Chapter Ten****Pushing Exports 217**

- Dumping 217
- Reacting to Dumping: What Should a Dumpee Think? 220
- Actual Antidumping Policies: What Is Unfair? 221
- Proposals for Reform 225
  - Case Study** *Antidumping in Action* 226
- Export Subsidies 229
  - Exportable Product, Small Exporting Country* 230
  - Exportable Product, Large Exporting Country* 232
  - Switching an Importable Product into an Exportable Product* 233
- WTO Rules on Subsidies 234
- Should the Importing Country Impose Countervailing Duties? 235
  - Case Study** *Agriculture Is Amazing* 238
- Strategic Export Subsidies Could Be Good 240
- Summary 243
- Suggested Reading 244
- Questions and Problems 244

**Chapter Eleven****Trade Blocs and Trade Blocks 247**

- Types of Economic Blocs 247
- Is Trade Discrimination Good or Bad? 249
- The Basic Theory of Trade Blocs:
  - Trade Creation and Trade Diversion 250
  - Other Possible Gains from a Trade Bloc 253
- The EU Experience 254
  - Case Study Postwar Trade Integration in Western Europe* 256
- North America Becomes a Bloc 258
  - The Canada–U.S. Free-Trade Area* 258
  - Mexico’s Liberalization and NAFTA* 259
- Trade Blocs Among Developing Countries 262
- Trade Embargoes 264
- Summary 269
- Suggested Reading 270
- Questions and Problems 271

**Chapter Twelve****Trade and the Environment 273**

- Is Free Trade Anti-Environment? 273
- Is the WTO Anti-Environment? 278
  - Case Study Dolphins, Turtles, and the WTO* 280
- The Specificity Rule Again 282
- A Preview of Policy Prescriptions 283
- Trade and Domestic Pollution 285
- Transborder Pollution 289
  - The Right Solution* 289
  - A Next-Best Solution* 292
  - NAFTA and the Environment* 293
- Global Environmental Challenges 294
  - Global Problems Need Global Solutions* 294
  - Extinction of Species* 295
  - Overfishing* 297
  - CFCs and Ozone* 298
  - Greenhouse Gases and Global Warming* 299
- Summary 303
- Suggested Reading 305
- Questions and Problems 305

**Chapter Thirteen****Trade Policies for Developing and Transition Countries 309**

- Which Trade Policy for Developing Countries? 310
- Are the Long-Run Price Trends Against Primary Producers? 313
- International Cartels to Raise Primary-Product Prices 317
  - The OPEC Victories* 317
  - Classic Monopoly as an Extreme Model for Cartels* 318
  - The Limits to and Erosion of Cartel Power* 320
  - Other Primary Products* 322
- Import-Substituting Industrialization (ISI) 323
  - ISI at Its Best* 324
  - Experience with ISI* 325
- Exports of Manufactures to Industrial Countries 328
- The Special Challenges of Transition 329
  - Reforms for Transition* 330
  - Changing Trade Patterns* 332
  - Reforms, Recessions, and Renewed Growth* 333
- Summary 334
- Suggested Reading 336
- Questions and Problems 336

**Chapter Fourteen****Multinationals and Migration: International Factor Movements 339**

- Foreign Direct Investment 341
- Multinational Enterprises 342
- FDI: History and Current Patterns 343
- Why Do Multinational Enterprises Exist? 346
  - Inherent Disadvantages* 347
  - Firm-Specific Advantages* 347
  - Location Factors* 348
  - Internalization Advantages* 349
  - Oligopolistic Rivalry* 350
- Taxation of Multinational Enterprises’ Profits 350

**xvi** Contents

<i>Case Study</i> CEMEX A Model Multinational from an Unusual Place 351	
MNEs and International Trade 353	
Should the Home Country Restrict FDI Outflows? 355	
Should the Host Country Restrict FDI Inflows? 357	
Migration 359	
How Migration Affects Labor Markets 361	
Should the Sending Country Restrict Emigration? 364	
Should the Receiving Country Restrict Immigration? 365	
<i>Effects on the Government Budget</i> 365	
<i>Case Study</i> Are Immigrants a Fiscal Burden? 366	
<i>External Costs and Benefits</i> 368	
<i>What Policies to Select Immigrants?</i> 368	
Summary 369	
Suggested Reading 371	
Questions and Problems 372	

## **PART THREE**

### **UNDERSTANDING FOREIGN EXCHANGE 375**

#### **Chapter Fifteen**

##### **Payments among Nations 377**

Two Sides to Any International Exchange 378	
Putting the Accounts Together 381	
The Macro Meaning of the Current Account Balance 385	
<i>Case Study</i> Planet Earth's Balance of Payments 386	
The Macro Meaning of the Overall Balance 391	
The International Investment Position 392	
Summary 393	
Suggested Reading 395	
Questions and Problems 396	

#### **Chapter Sixteen**

##### **The Foreign Exchange Market 399**

The Basics of Currency Trading 400	
<i>Using the Foreign Exchange Market</i> 402	
<i>Case Study</i> Brussels Sprouts a New Currency: € 403	
<i>Case Study</i> Foreign Exchange Trading 404	
<i>Interbank Foreign Exchange Trading</i> 406	
Demand and Supply for Foreign Exchange 407	
<i>Floating Exchange Rates</i> 409	
<i>Fixed Exchange Rates</i> 410	
<i>Current Arrangements</i> 412	
Arbitrage within the Spot Exchange Market 412	
Summary 414	
Suggested Reading 414	
Questions and Problems 414	

#### **Chapter Seventeen**

##### **Forward Exchange and International Financial Investment 417**

Exchange Rate Risk 417	
The Market Basics of Forward Foreign Exchange 419	
<i>Hedging Using Forward Foreign Exchange</i> 420	
<i>Speculating Using Forward Foreign Exchange</i> 421	
<i>Extension</i> Futures, Options, and Swaps 422	
International Financial Investment 424	
International Investment with Cover 425	
<i>Covered Interest Arbitrage</i> 427	
<i>Covered Interest Parity</i> 428	
International Investment without Cover 430	
<i>Case Study</i> The World's Greatest Investor 432	
Does Interest Parity Really Hold?	
Empirical Evidence 435	
<i>Evidence on Covered Interest Parity</i> 435	
<i>Case Study</i> Eurocurrencies: Not (Just) Euros and Not Regulated 436	
<i>Evidence on Uncovered Interest Parity</i> 438	
<i>Evidence on Forward Exchange Rates and     Expected Future Spot Exchange Rates</i> 440	
Summary 440	
Suggested Reading 442	
Questions and Problems 442	

**Chapter Eighteen****What Determines Exchange Rates? 445**

A Road Map 447

Exchange Rates in the Short Run 448

*The Role of Interest Rates* 449*The Role of the Expected Future Spot**Exchange Rate* 451

The Long Run: Purchasing Power Parity (PPP) 453

*The Law of One Price* 453*Absolute Purchasing Power Parity* 454*Relative Purchasing Power Parity* 455**Case Study** *Price Gaps and International Income Comparisons* 456*Relative PPP: Recent Experience* 458**Case Study** *PPP from Time to Time* 461

The Long Run: The Monetary Approach 461

*Money, Price Levels, and Inflation* 462*Money and PPP Combined* 463*The Effect of Money Supplies on an Exchange Rate* 464*The Effect of Real Incomes on an Exchange Rate* 464

Exchange Rate Overshooting 465

**Extension** *Tracking the Exchange Rate Value of a Currency* 466**Case Study** *Forecasting Using a Modified Monetary Model* 470

How Well Can We Predict Exchange Rates? 472

Summary 473

Suggested Reading 475

Questions and Problems 475

**Chapter Nineteen****Government Policies toward the Foreign Exchange Market 479**

Two Aspects: Rate Flexibility and Restrictions on Use 480

Floating Exchange Rate 481

Fixed Exchange Rate 482

*What to Fix To?* 482*When to Change the Fixed Rate?* 483*Defending a Fixed Exchange Rate* 484

Defense through Official Intervention 485

*Defending against Depreciation* 485*Defending against Appreciation* 488*Temporary Disequilibrium* 490*Disequilibrium That Is Not Temporary* 491

Exchange Control 493

International Currency Experience 496

*The Gold Standard Era, 1870–1914 (One Version of Fixed Rates)* 497*Interwar Instability* 500*The Bretton Woods Era, 1944–1971 (Adjustable Pegged Rates)* 503*The Current System: Limited Anarchy* 507

Summary 512

Suggested Reading 514

Questions and Problems 515

**Chapter Twenty****International Lending and Financial Crises 517**

Gains and Losses from Well-Behaved

International Lending 518

Taxes on International Lending 521

International Lending to Developing Countries 522

*The Surge in International Lending, 1974–1982* 522*The Debt Crisis of 1982* 523*The Resurgence of Capital Flows in the 1990s* 524*The Mexican Crisis, 1994–1995* 525*The Asian Crisis, 1997* 527**Case Study** *Short of Reserves?**Call 1-800-IMF-LOAN* 528*The Russian Crisis, 1998* 530*The Brazilian Crisis, 1999* 531*The Turkish Crisis, 2001* 531*Argentina's Crisis, 2001–2002* 532

Financial Crises: What Can and Does Go Wrong 533

*Waves of Overlending and Overborrowing* 533**Extension** *The Special Case of Sovereign Debt* 534*Exogenous International Shocks* 536*Exchange Rate Risk* 536

## xviii Contents

<i>Fickle International Short-Term Lending</i>	537
<i>Global Contagion</i>	537
Resolving Financial Crises	538
<i>Rescue Packages</i>	538
<i>Debt Restructuring</i>	540
Reducing the Frequency of Financial Crises	541
<i>Bank Regulation and Supervision</i>	542
<i>Capital Controls</i>	543
<i>Case Study</i> <i>Mighty Joe Meets the Incredible</i>	
<i>Monetary Force</i>	544
Summary	546
Suggested Reading	548
Questions and Problems	548

## PART FOUR

### MACRO POLICIES FOR OPEN ECONOMIES 551

#### Chapter Twenty-One

##### How Does the Open Macroeconomy Work? 553

The Performance of a National Economy	553
A Framework for Macroeconomic Analysis	555
Domestic Production Depends on Aggregate Demand	555
Trade Depends on Income	557
Equilibrium GDP and Spending Multipliers	558
<i>Equilibrium GDP</i>	558
<i>The Spending Multiplier in a Small, Open Economy</i>	560
<i>Foreign-Income Repercussions</i>	561
A More Complete Framework:	
Three Markets	564
<i>The Domestic Product Market</i>	564
<i>The Money Market</i>	567
<i>The Foreign Exchange Market (or Balance of Payments)</i>	569
<i>Three Markets Together</i>	572
The Price Level Does Change	573
Trade Also Depends on Price Competitiveness	574
Summary	576
Suggested Reading	578
Questions and Problems	578

#### Chapter Twenty-Two

##### Internal and External Balance with Fixed Exchange Rates 581

From the Balance of Payments to the Money Supply	582
From the Money Supply Back to the Balance of Payments	586
Sterilization	589
Monetary Policy with Fixed Exchange Rates	590
Fiscal Policy with Fixed Exchange Rates	592
Perfect Capital Mobility	595
Shocks to the Economy	597
<i>Internal Shocks</i>	597
<i>International Capital-Flow Shocks</i>	598
<i>International Trade Shocks</i>	599
Imbalances and Policy Responses	601
<i>Internal and External Imbalances</i>	601
<i>Case Study</i> <i>A Tale of Three Countries</i>	603
<i>A Short-Run Solution: Monetary-Fiscal Mix</i>	606
Surrender: Changing the Exchange Rate	609
How Well Does the Trade Balance Respond to Changes in the Exchange Rate?	612
<i>How the Response Could Be Unstable</i>	613
<i>Why the Response Is Probably Stable</i>	613
<i>Timing: The J Curve</i>	615
Summary	616
Suggested Reading	618
Questions and Problems	618

#### Chapter Twenty-Three

##### Floating Exchange Rates and Internal Balance 621

Monetary Policy with Floating Exchange Rates	622
Fiscal Policy with Floating Exchange Rates	625
Shocks to the Economy	628
<i>Internal Shocks</i>	628
<i>International Capital-Flow Shocks</i>	628
<i>Case Study</i> <i>Why Are U.S. Trade Deficits So Big?</i>	630
<i>International Trade Shocks</i>	632
Internal Imbalance and Policy Responses	632
International Macroeconomic Policy Coordination	634

<i>Case Study</i> Can Governments Manage the Float? 636
Summary 638
Suggested Reading 640
Questions and Problems 641

## **Chapter Twenty-Four**

### **National and Global Choices: Floating Rates and the Alternatives 643**

Key Issues in the Choice of Exchange Rate Policy 644
<i>Effects of Macroeconomic Shocks</i> 644
<i>Case Study</i> What Role for Gold? 646
<i>The Effectiveness of Government Policies</i> 650
<i>Differences in Macroeconomic Goals, Priorities, and Policies</i> 651
<i>Controlling Inflation</i> 653
<i>Real Effects of Exchange Rate Variability</i> 655
National Choices 657
Extreme Fixes 659
<i>Currency Board</i> 659
<i>“Dollarization”</i> 660
The International Fix—Monetary Union 662
<i>Exchange Rate Mechanism</i> 662
<i>European Monetary Union</i> 665
Summary 669
Suggested Reading 671
Questions and Problems 671

## **APPENDIX**

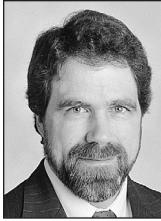
<b>A</b> The Web and the Library: International Numbers and Other Information 673
<b>B</b> Deriving Production-Possibility Curves 679
<b>C</b> Offer Curves 685
<b>D</b> The Nationally Optimal Tarriff 689
<b>E</b> Many Parities at Once 695
<b>F</b> Aggregate Demand and Aggregate Supply in the Open Economy 699
<b>G</b> Devaluation and the Current Account Balance 711

### **Suggested Answers— Questions and Problems 717**

### **References 747**

### **Index 761**

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