Contents

	Preface		xiii
	Introduction		xix
1	**Intertemporal Trade and the Current Account Balance**		1
	1.1	A Small Two-Period Endowment Economy	1
		Application: Consumption Smoothing in the Second Millennium B.C.	8
	1.2	The Role of Investment	14
		Box 1.1 Nominal versus Real Current Accounts	18
	1.3	A Two-Region World Economy	23
		Application: War and the Current Account	25
		Application: Investment Productivity and World Real Interest Rates in the 1980s	35
	1.4	Taxation of Foreign Borrowing and Lending	42
	1.5	International Labor Movements	45
		Application: Energy Prices, Global Saving, and Real Interest Rates	51
	1A	Stability and the Marshall-Lerner Condition	53
		Exercises	54
2	**Dynamics of Small Open Economies**		59
	2.1	A Small Economy with Many Periods	60
		Application: When Is a Country Bankrupt?	66
	2.2	Dynamics of the Current Account	74
		Box 2.1 Japan's 1923 Earthquake	76
	2.3	A Stochastic Current Account Model	79
		Application: Deaton's Paradox	84
		Application: The Relative Impact of Productivity Shocks on Investment and the Current Account	87
	2.4	Consumer Durables and the Current Account	96
	2.5	Firms, the Labor Market, and Investment	99
	2A	Trend Productivity Growth, Saving, and Investment: A Detailed Example	116
	2B	Speculative Asset Price Bubbles, Ponzi Games, and Transversality Conditions	121
		Exercises	124
3	**The Life Cycle, Tax Policy, and the Current Account**		129
	3.1	Government Budget Policy in the Absence of Overlapping Generations	130
	3.2	Government Budget Deficits in an Overlapping Generations Model	133
		Box 3.1 Generational Accounting	142

		Application: Do Government Budget Deficits Cause Current Account Deficits?	144
		Application: Overlapping Generations and Econometric Tests of the Euler Equation	146
	3.3	Output Fluctuations, Demographics, and the Life Cycle	147
		Application: How Are Saving and Growth Related?	152
	3.4	Investment and Growth	156
		Application: Feldstein and Horioka's Saving-Investment Puzzle	161
	3.5	Aggregate and Intergenerational Gains from Trade	164
	3.6	Public Debt and the World Interest Rate	167
		Application: Government Debt and World Interest Rates since 1970	173
	3.7	Integrating the Overlapping Generations and Representative-Consumer Models	174
	3A	Dynamic Inefficiency	191
		Exercises	195
4		**The Real Exchange Rate and the Terms of Trade**	199
	4.1	International Price Levels and the Real Exchange Rate	200
	4.2	The Price of Nontraded Goods with Mobile Capital	202
		Box 4.1 Empirical Evidence on the Law of One Price	203
		Application: Sectoral Productivity Differentials and the Relative Prices of Nontradables in Industrial Countries	209
		Application: Productivity Growth and Real Exchange Rates	212
	4.3	Consumption and Production in the Long Run	216
	4.4	Consumption Dynamics, the Price Level, and the Real Interest Rate	225
	4.5	The Terms of Trade in a Dynamic Ricardian Model	235
		Box 4.2 The Transfer Effect for Industrial Countries	256
	4A	Endogenous Labor Supply, Revisited	258
	4B	Costly Capital Mobility and Short-Run Relative Price Adjustment	260
		Exercises	264
5		**Uncertainty and International Financial Markets**	269
	5.1	Trade across Random States of Nature: The Small-Country Case	270
		Box 5.1 Lloyd's of London and the Custom Market for Risks	274
	5.2	A Global Model	285
		Application: Comparing International Consumption and Output Correlations	290
		Box 5.2 Are Markets More Complete within than among Countries?	295
	5.3	International Portfolio Diversification	300

		Application: International Portfolio Diversification and the Home Bias Puzzle	304
	5.4	Asset Pricing	306
		Application: The Equity Premium Puzzle over the Very Long Run	314
		Application: GDP-Linked Securities and Estimates of V^m	317
	5.5	The Role of Nontradables	319
		Application: Nontradability and International Consumption Correlations	323
		Application: How Large Are the Gains from International Risk Sharing?	329
	5.6	A Model of Intragenerational Risk Sharing	332
		Box 5.3 A Test of Complete Markets Based on Consumption Divergence within Age Cohorts	335
	5A	Spanning and Completeness	335
	5B	Comparative Advantage, the Current Account, and Gross Asset Purchases: A Simple Example	337
	5C	An Infinite-Horizon Complete-Markets Model	340
	5D	Ongoing Securities Trade and Dynamic Consistency	343
		Exercises	345
6	**Imperfections in International Capital Markets**		349
	6.1	Sovereign Risk	349
		Box 6.1 Sovereign Immunity and Creditor Sanctions	352
		Application: How Costly Is Exclusion from World Insurance Markets?	366
		Application: How Have Prior Defaults Affected Countries' Borrowing Terms?	378
	6.2	Sovereign Risk and Investment	379
		Application: Debt Buybacks in Practice	399
	6.3	Risk Sharing with Hidden Information	401
	6.4	Moral Hazard in International Lending	407
		Application: Financing Constraints and Investment	417
	6A	Recontracting Sovereign Debt Repayments	419
	6B	Risk Sharing with Default Risk and Saving	422
		Exercises	425
7	**Global Linkages and Economic Growth**		429
	7.1	The Neoclassical Growth Model	430
		Box 7.1 Capital-Output Ratios since World War II	435
	7.2	International Convergence	454

		Application: Productivity Convergence, 1870–1979: The Baumol–De Long–Romer Debate	457
		Application: Public Capital Accumulation and Convergence	467
	7.3	Endogenous Growth	473
		Application: Can Capital Deepening Be an Engine of Sustained High Growth Rates: Evidence from Fast-Growing East Asia	481
		Application: Population Size and Growth	492
	7.4	Stochastic Neoclassical Growth Models	496
	7A	Continuous-Time Growth Models as Limits of Discrete-Time Models	508
	7B	A Simple Stochastic Overlapping Generations Model with Two-Period Lives	510
		Exercises	512
8		**Money and Exchange Rates under Flexible Prices**	513
	8.1	Assumptions on the Nature of Money	514
	8.2	The Cagan Model of Money and Prices	515
		Box 8.1 How Important Is Seignorage?	527
	8.3	Monetary Exchange Rate Models with Maximizing Individuals	530
		Application: Testing for Speculative Bubbles	546
	8.4	Nominal Exchange Rate Regimes	554
		Box 8.2 Growing Use of the Dollar Abroad	555
	8.5	Target Zones for Exchange Rates	569
	8.6	Speculative Attacks on a Target Zone	576
	8.7	A Stochastic Global General Equilibrium Model with Nominal Assets	579
	8A	A Two-Country Cash-in-Advance Model	595
	8B	The Mechanics of Foreign-Exchange Intervention	597
		Exercises	599
9		**Nominal Price Rigidities: Empirical Facts and Basic Open-Economy Models**	605
	9.1	Sticky Domestic Goods Prices and Exchange Rates	606
	9.2	The Mundell-Fleming-Dornbusch Model	609
	9.3	Empirical Evidence on Sticky-Price Exchange-Rate Models	621
	9.4	Choice of the Exchange-Rate Regime	631
	9.5	Models of Credibility in Monetary Policy	634
		Application: Central Bank Independence and Inflation	646
		Application: Openness and Inflation	653
		Exercises	657

10 Sticky-Price Models of Output, the Exchange Rate, and the Current Account 659

10.1 A Two-Country General Equilibrium Model of International Monetary Policy Transmission 660
Box 10.1 More Empirical Evidence on Sticky Prices 676
Box 10.2 The Role of Imperfect Competition in Business Cycles 689
10.2 Imperfect Competition and Preset Prices for Nontradables: Overshooting Revisited 689
Application: Wealth Effects and the Real Exchange Rate 694
10.3 Government Spending and Productivity Shocks 696
10.4 Nominal Wage Rigidities 706
Application: Pricing to Market and Exchange-Rate Pass-Through 711
Exercises 713

Supplements to Chapter 2 715
A Methods of Intertemporal Optimization 715
B A Model with Intertemporally Nonadditive Preferences 722
C Solving Systems of Linear Difference Equations 726
Supplement to Chapter 5 742
A Multiperiod Portfolio Selection 742
Supplement to Chapter 8 745
A Continuous-Time Maximization and the Maximum Principle 745
References 755
Notation Guide and Symbol Glossary 781
Author Index 789
Subject Index 795