Contents

To the Instructor xvii

1 AN INTRODUCTION TO INTERNATIONAL ECONOMICS 1

Comparative Advantage as a Basis for Trade: David Ricardo's Model ass

Aut Evaluation of the Classical Medel 81.

Characteristics of National Economies 3

Economic Growth 8

International Trade 9

The Direction of International Trade 12

What Goods Do Countries Trade? 16

Summary 25

Exercises 25

2 TOOLS OF ANALYSIS FOR INTERNATIONAL TRADE MODELS 27

Some Methodological Preliminaries 29

The Basic Model: Assumptions 31
The Basic Model: Solutions 41
Measuring National Welfare 44

ITEM 2.1 RELATIVE PRICES IN SAUDI ARABIA 45

ITEM 2.2 MEASUREMENT OF REAL INCOME 47

National Supply and Demand 49

Summary 52

Exercises 53

Appendix 2.1 An Advanced Tool of General Equilibrium Models 54

3 THE CLASSICAL MODEL OF INTERNATIONAL TRADE 59

Absolute Advantage as a Basis for Trade: Adam Smith's Model 61

ITEM 3.1 ON THE LIKELIHOOD OF BALANCED INTERNATIONAL TRADE 63

Comparative Advantage as a Basis for Trade: David Ricardo's Model 68

The General Equilibrium Solution of the Classical Model 69

The Gains from International Trade 75

ITEM 3.2 JAPAN'S GAINS FROM ENTRY INTO WORLD TRADE IN 1858 77

The Relationship Between Trade and Wages 78

An Evaluation of the Classical Model 81

Summary 82

Exercises 83

References 83

Appendix 3.1 The Classical Model with Many Goods 85

Appendix 3.2 Offer Curves and the International Terms of Trade 87

4 THE HECKSCHER-OHLIN THEORY 91

The HO Model: Basic Assumptions 93

ITEM 4.1 CAPITAL/LABOR RATIOS IN SELECTED U.S. INDUSTRIES 95

The HO Theorem 99

Equilibrium in the HO Model 101

Some New HO Theorems 107

Some Final Observations 111

Summary 112

Exercises 113

References 114

Appendix 4.1 Alternate Proofs of Selected HO Theorems 115

5 TESTS OF TRADE MODELS: THE LEONTIEF PARADOX AND ITS AFTERMATH 121

Tests of the Classical Model 122
Tests of the HO Model 125

ITEM 5.1 THE UNITED STATES INPUT-OUTPUT TABLE 126

Attempted Reconciliations of Leontief's Findings 128

Other Tests of the HO Model 131

Recent Tests of the HO Model 133

Alternative Theories of Comparative Advantage 135

Human Skills 135

Contents

TIN MINISTER THE THE PROPERTY OF THE PARTY O

Product Cycle Model 136

Similarity of Preferences 137

Intraindustry Trade 138

Increasing Returns and Imperfect Competition 140

Conclusions 143

Summary 144

Exercises 145

References 145

Appendix 5.1 Using an Input-Output Table 147

6 TARIFFS 151

The Gains from Free Trade 153

Tariffs: An Introduction 155

Tariffs: An Economic Analysis 157

The Gains from Free Trade: One More Time 159

The Welfare Cost of Tariffs 162

ITEM 6.1 THE WELFARE COSTS OF TARIFFS: SOME RECENT ESTIMATES

FROM CERTAIN U.S. INDUSTRIES 166

Some Complications 167

The Optimal Tariff 167

ITEM 6.2 THE SMOOT-HAWLEY TARIFF AND ITS AFTERMATH 172

How High Are Tariffs? 174

Effective Rates of Protection 176

Summary 180

Exercises 181

Feferences 182

Expendix 6.1 The Imperfect Substitutes Model 183

NONTARIFF BARRIERS AND ARGUMENTS FOR PROTECTION 187

THE RESIDENCE OF THE REAL ASSAULT FOR THE RESERVE AND ASSAULT FOR THE RESERVE ASSAULT FOR THE RESERVE

THE RESIDENCE OF THE PROPERTY OF THE RESIDENCE OF THE PROPERTY OF THE PARTY OF THE

Quotas 189

Welfare Effects of Quotas 191

TEM 7.1 SHOULD THE UNITED STATES AUCTION QUOTA RIGHTS? 193

ITEM 7.2 EFFECTS OF THE U.S.-JAPAN AUTO VERS 195

The Equivalence or Nonequivalence Between Tariffs and Quotas 200

Other Nontariff Barriers 201

Export Subsidies 202

Government Procurement Policies 203

Health and Safety Standards 204

Failure to Protect Intellectual Propety Rights 205

How Important Are Nontariff Barriers? 205

Invalid Arguments for Protection 209

Patriotism 209

Employment 209

Fallacy of Composition 210

Fair Play for Domestic Industry 210

Preservation of the Home Market 211

Valid Arguments for Protection 211

Government Revenue 211

Income Redistribution 212

Noneconomic Goals 215

Infant Industry Protection 218

Second-Best Arguments 219

Strategic Trade Policies 220

Summary 222

Exercises 223

References 224

8 COMMERCIAL POLICY: HISTORY AND PRACTICE 225

U.S. Commercial Policy: History 227

ITEM 8.1 THE GATT 233

ITEM 8.2 THE URUGUAY ROUND 236

The Conduct of U.S. Commercial Policy 237

Dumping 238

Antidumping Law 240

Countervailing Duty Law 242

Unfair Foreign Practices: Section 301 243

TRADE POLICY CASE STUDY 1: CANADA SOFTWOOD LUMBER 244

THE RESIDENCE STORES

TRADE POLICY CASE STUDY 2: SEMICONDUCTORS 246

The Escape Clause: Section 201 248

Other Measures 249

TRADE POLICY CASE STUDY 3: MOTORCYCLES 250

ITEM 8.3 THE OMNIBUS TRADE ACT OF 1988 251

Comparisons with Policies in Other Countries 252

Preferential Trading Arrangements 253

Introduction 253

Economic Analysis 255

Summary 259

Exercises 260

References 260

I'dle threat fowers prisectors and and seed

420 APE APPLICATION OF APPLICATIONS OF THE PERSON OF THE P

WHICH TOWOR DURSELLING DURSELLING

9 INTERNATIONAL TRADE AND ECONOMIC GROWTH 263

Trade and Growth: Less Than Full Employment 265

Trade and Growth: Full Employment 272

ITEM 9.1 EXPORT PROMOTION VS. IMPORT SUBSTITUTION GROWTH POLICIES 273

Trade and Growth: Some Additional Comments 281

Technological Change 282

Growth, Prices, and Welfare 283

International Flows of Factors 284

Labor 284

ITEM 9.2 THE DUTCH DISEASE 285

Capital 288

Economic Analysis 292

Summary 295

Exercises 295

References 296

10 THE FOREIGN EXCHANGE MARKET 297

Spot Rates 298

ITEM 10.1 BID-ASK SPREADS AND POLITICS:

THE SOUTH AFRICAN RAND 301

Arbitrage 303

Forward Rates 307

Swaps 309

The Futures Market 311

Foreign Currency Options 314

Central Bank Intervention 316

Black Markets and Parallel Markets 318

ITEM 10.2 FEDERAL RESERVE FOREIGN EXCHANGE MARKET INTERVENTION 320

Summary 322

Exercises 323

References 323

Appendix 10.1 Exchange Rate Indexes 325

11 THE BALANCE OF PAYMENTS 329

Current Account 331

Financing the Current Account 335

Additional Summary Measures 337

ITEM 11.1 THE WORLD'S LARGEST DEBTOR 338

Transactions Classification 341
Balance of Payments Equilibrium and Adjustment 343
Summary 346
Exercises 347
References 347

12 PRICES AND EXCHANGE RATES: PURCHASING POWER PARITY 349

MARKET SON BUT AT BEEN SONGE OF THE SONE SONE SONE

Absolute Purchasing Power Parity 351

ITEM 12.1 THE U.S. CONSUMER PRICE INDEX 352

Relative Purchasing Power Parity 356

Time, Inflation, and PPP 357

ITEM 12.2 HYPERINFLATION IN BOLIVIA 358

Deviations from PPP 359

"Overvalued" and "Undervalued" Currencies 367

Summary 370

Exercises 371

References 371

13 EXCHANGE RATES, INTEREST RATES, AND INTEREST PARITY 373

Interest Parity 374

Interest Rates and Inflation 378

ITEM 13.1 LENDERS AND BORROWERS, LOSERS AND WINNERS 380

Exchange Rates, Interest Rates, and Inflation 382

Expected Exchange Rates and the Term Structure of Interest Rates 383

Summary 386

Exercises 386

References 387

Appendix 13.1 Taxation and Interest Rate Parity 388

14 FOREIGN EXCHANGE RISK, FORECASTING, AND INTERNATIONAL INVESTMENT 391

Types of Foreign Exchange Risk 392
Foreign Exchange Risk Premium 396
Market Efficiency 399
Foreign Exchange Forecasting 400

ITEM 14.1 FOREIGN EXCHANGE ADVISORY SERVICES 402

International Investment and Portfolio Diversification 404

PARKET OTHER OF A LOUIS TO BE TO THE OWN THE O

. Bit selectorum evident tenolismesm

SIR OVERLIBER

SOURCE SELECTIONS OF BRIDE SECTION OF SECTIO

Direct Foreign Investment 407
Capital Flight 409
Summary 411
Exercises 411
References 412

15 BASIC THEORIES OF THE BALANCE OF PAYMENTS AND EXCHANGE RATES 413

Elasticities Approach to the Balance of Trade 414

Elasticities and J Curves 417

Currency Contract Period 418

Pass-Through Analysis 420

The Evidence from Devaluations 423

ITEM 15.1 THE PASS-THROUGH EFFECT AND PROFITS 424

Absorption Approach to the Balance of Trade 427

Monetary Approach to the Balance of Payments 429

Summary 436

Exercises 436

References 437

Appendix 15.1 Stable Foreign Exchange Markets and the Marshall–Lerner Condition 438

16 RECENT EXCHANGE RATE THEORIES 443

The Asset Approach 444

Sterilization 448

Exchange Rates and the Trade Balance 451

Overshooting Exchange Rates 453

Currency Substitution 456

The Role of News 458

ITEM 16.1 DOLLARS, ZLOTYS, AND VODKA IN POLAND 459

Summary 461

Exercises 461

References 462

17 ALTERNATIVE INTERNATIONAL MONETARY STANDARDS 463

The Gold Standard: 1880 to 1914 464
The Interwar Period: 1918 to 1939 467