

Dominick Salvatore

INTERNATIONAL ECONOMICS

EIGHTH EDITION



INTERNATIONAL ECONOMICS

Eighth Edition

Dominick Salvatore

Fordham University



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To Lucille

Preface

This is the eighth edition of a text that has enjoyed a flattering market success, having been adopted by more than 600 colleges and universities throughout the United States, Canada, and other English speaking countries. All of the features that have made the previous editions of this text one of the leading texts of International Economics in the United States and around the world have been retained in the eighth edition. However, the content has been thoroughly updated and expanded to include many new significant topics and important recent developments.

Significant International Developments

The main objective of the eighth edition of this text is to present a comprehensive, up-to-date, and clear exposition of the theory and principles of international economics that are essential for understanding, evaluating, and suggesting solutions to the important international economic problems and issues facing the United States and the world at the beginning of this new century. These are:

1. Despite the successful completion of the Uruguay Round in December 1993, trade protectionism remains high and the world is breaking up into several major trading blocks.
2. The globalization of capital markets has led to volatile and misaligned exchange rates, unstable financial conditions, and further erosion of governments' control over domestic monetary matters.
3. The frequent financial and economic crises in developing, emerging, and transition economies threaten the stability of the entire international monetary system.
4. The high structural unemployment and slow growth in Europe, as well as the decade-long economic crisis and deflation in Japan, dampen the growth of world trade and the world economy, and lead to more trade disputes.
5. Rapid technological change, globalization, and increased international competition are causing widespread downsizing and job insecurity in the United States, despite low unemployment rates.
6. The restructuring of the transition economies of Central/Eastern Europe and the former Soviet Republics is not proceeding as evenly and as rapidly as expected, and this presents a challenge for the entire world.
7. The deep poverty in many developing countries and the widening international inequalities pose serious moral, political, and developmental problems in the world today.

These events significantly affect United States well-being but are, to a large extent, beyond its control.

New to the Eighth Edition

Chapter 1 (Section 1.5) has been thoroughly revised to identify the major international economic (trade and financial) problems facing the United States and the world today, and so has the discussion in Chapter 21 (Section 21.6), which examines of how they can be resolved.

The physical introduction of the euro has been one crucial development since the previous edition. This topic is treated extensively in several new sections and case studies throughout the text to evaluate its effect on international trade and finance in Europe, the United States, and other countries around of the world.

The continuing globalization of the world economy and liberalization of international capital markets have further eroded governments' control over national economic and financial matters and discussed in several chapters and new sections in the trade and finance part of the text.

The continuing crisis in Japan, which represents a major challenge for Japan and the entire world, is examined in several new sections and case studies.

Other very important developments since the previous edition have been the financial and economic crises in Argentina, Turkey and Brazil, and these have exposed the fragility of the international monetary system and led to continued calls for reforms. This topic is fully explored in various new sections and case studies throughout the trade and finance parts of the text.

Case Studies have been increased to 120, of which more than one-third are new and the others have been thoroughly revised.

The INTERNET section has been updated and expanded and gives the most important Internet site addresses or links to data sources, information, and analyses for the topics presented in each chapter to show the student how to access and use the wealth of information available on the Internet.

The WEBSITE for the Text has also been thoroughly updated and expanded and presents for each chapter additional examples, cases, and theoretical points, as well as questions and problems that can be answered or solved using the Internet. The Website is continuously updated to reflect important new developments in the international economy as they unfold.

New sections and cases in trade theory and policy include: the changing pattern of comparative advantage in the U.S., the EU, and Japan; the changing comparative advantage of developing countries; the New Economy and productivity growth in the U.S. and in the other G-7 countries; the European Union's challenge of the Eastern enlargement; China as the next economic superpower? EU-US trade disputes and protectionism: from bananas, to beef, steel and subsidies; are strategic trade and industrial policies dead? International trade and wages in rich countries; globalization and poverty in developing countries; the anti-globalization movement is not going anywhere; has terrorism slowed the process of globalization? International trade, foreign aid and growth in developing countries; the new round of multilateral trade negotiations: prospects and expectations.

New sections and cases in international finance include: Fundamental forces and "news" in exchange rate forecasting; the super-dollar and rising U.S. trade deficits; is the U.S. trade deficit sustainable? The euro: expectations and performance; the

euro—not likely to overtake the dollar as the leading international currency any-time soon; structural imbalances in the U.S., the EU and Japan and exchange rate misalignments; the U.S. economy—was the new economy supposed to be recession proof? The Fed's and European Central Bank's response to the economic downturn; the EU is dragging its feet on economic restructuring and its growth is suffering; Japan's decade long economic crisis will continue until its banking sector is set right; the recent financial crisis in Brazil, Turkey, and Argentina; financial crises in emerging markets and reforms of the international monetary system.

More international trade and finance data are included throughout the text.

Audience and Level

The text presents all of the principles and theories essential for a thorough understanding of international economics. It does so on an intuitive level in the text itself, and more rigorously in the appendices at the end of most chapters. In addition, partial equilibrium analysis is presented before the more difficult general equilibrium analysis (which is optional). Thus, the book is designed for flexibility. It also overcomes the shortcomings of other international economics texts in which the level of analysis is either too complicated or too simplistic.

Organization of the Book

The book is organized into four parts. Part One (Chapters 2–7) deals with trade theory (i.e., the basis and the gains from trade). Part Two (Chapters 8–12) deals with trade policy (i.e., obstructions to the flow of trade). Part Three (Chapter 13–15) deals with the measurement of a nation's balance of payments, foreign exchange markets, and exchange rate determination. Part Four (Chapters 16–21) examines open-economy macroeconomics or the macro relationships between the domestic economy and the rest of the world, as well as the operation of the present international monetary system.

In the typical one-semester undergraduate course in international economics, instructors may wish to cover the 10 core chapters (2–3, 5, 9, 13–17, 21) as well as the few other asterisked sections in other chapters, and exclude the appendices. Undergraduate courses in international trade could cover Chapters 1 to 12 and 21 while in undergraduate courses in international finance could cover Chapters 1, and 13–21. The many examples and real world case studies presented also makes the text very suitable for international economics courses in business programs. In first-year graduate courses in international economics and business, instructors may want to cover the appendices also and assign readings from the extensive annotated bibliography at the end of each chapter.

For the Student

- *The same example is utilized in all the chapters dealing with the same basic concept.* This feature is unique to this text. For example, the same graphical and numerical

model is used in every chapter, from Chapters 2 through 10 (the chapters that deal with trade theory and policy). This greatly reduces the real burden on the student, who does not have to start afresh with a new example each time.

- *Actual numbers are used in the examples and the graphs are presented on scales.* This makes the various concepts and theories presented more concrete, accessible, and pertinent to the student, and the graphs easier to read and understand.
- *There are 120 case studies (from three to nine per chapter).* These real-world case studies are generally short and to the point and serve to reinforce understanding and highlight the most important topics presented in the chapter.
- *The sections of each chapter are numbered for easy reference.* Longer sections are broken into two or more numbered subsections. All of the graphs and diagrams are carefully explained in the text and then summarized briefly in the captions.
- *The judicious use of color and shading enhances the readability of the text and aids student understanding.*
- *Each chapter ends with the following teaching aids:*

Summary—A paragraph reviews each section of the text.

A Look Ahead—Describes what follows in the subsequent chapter.

Key Terms—Lists the important terms introduced in bold-face type in the chapter. A glossary of all these terms in is then provided at the end of the book.

Questions for Review—fourteen questions (two or more for each for each section in the chapter).

Problems—Fourteen to fifteen problems are provided for each chapter. These ask the student to calculate a specific measure or explain a particular event. Brief answers to selected problems (those marked by an asterisk) are provided at the end of the book for feedback.

Appendices—These develop in a more rigorous, but careful and clear fashion, material that is presented on an intuitive level in the chapter.

Selected Bibliography—The most important references are included along with specific notes indicating the topic they deal with. A separate authors index is included at the end of the book.

INTERNet—There is a section at the end of each chapter that provides Internet site addresses or links to data sources, information, and analyses on the topics presented in each chapter to show the student how to access and use the wealth of information available on the Internet.

- *Accompanying the text, there are also:*

A Website—This presents for each chapter additional examples, cases, and theoretical points and questions as well as problems that can be answered or solved using the Internet. The Website is continuously updated to reflect important new developments in the international economy as they unfold.

- **A Study Guide** prepared by Professor Arthur Raymond of Muhlenberg College is available for students. This provides extensive review of key concepts, numerous additional illustrative examples, and practice problems and exercise sets.

- A **Schaum Outline** on the *Theory and Problems of International Economics* (4th edition, 1996), prepared by the author, can be purchased in most bookstores. This provides a problem-solving approach to the topics presented in the traditional way in this and other international economics texts.

For the Instructor

- An **Instructor's Manual** prepared by the author is available which includes chapter objectives and lecture suggestions, answers to the end-of-chapter problems, a set of 15 to 20 multiple-choice questions, with answers, and additional problems and essays for each chapter.
- **Transparency masters** for all the figures and tables in the text are available in the *Instructor's Manual*.

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Brief Contents

CHAPTER 1: INTRODUCTION	1
-------------------------	---

PART ONE: INTERNATIONAL TRADE THEORY 27

CHAPTER 2: THE LAW OF COMPARATIVE ADVANTAGE	29
CHAPTER 3: THE STANDARD THEORY OF INTERNATIONAL TRADE	59
CHAPTER 4: DEMAND AND SUPPLY, OFFER CURVES, AND THE TERMS OF TRADE	89
CHAPTER 5: FACTOR ENDOWMENTS AND THE HECKSCHER-OHLIN THEORY	115
CHAPTER 6: ECONOMIES OF SCALE, IMPERFECT COMPETITION, AND INTERNATIONAL TRADE	165
CHAPTER 7: ECONOMIC GROWTH AND INTERNATIONAL TRADE	199

PART TWO: INTERNATIONAL TRADE POLICY 233

CHAPTER 8: TRADE RESTRICTIONS: TARIFFS	235
CHAPTER 9: NONTARIFF TRADE BARRIERS AND THE NEW PROTECTIONISM	273
CHAPTER 10: ECONOMIC INTEGRATION: CUSTOMS UNIONS AND FREE TRADE AREAS	321
CHAPTER 11: INTERNATIONAL TRADE AND ECONOMIC DEVELOPMENT	355
CHAPTER 12: INTERNATIONAL RESOURCE MOVEMENTS AND MULTINATIONAL CORPORATIONS	395

PART THREE: BALANCE OF PAYMENTS AND EXCHANGE RATES 427

CHAPTER 13: BALANCE OF PAYMENTS	429
CHAPTER 14: FOREIGN EXCHANGE MARKETS AND EXCHANGE RATES	455
CHAPTER 15: EXCHANGE RATE DETERMINATION	501

PART FOUR: OPEN-ECONOMY MACROECONOMICS AND THE INTERNATIONAL MONETARY SYSTEM 545

- CHAPTER 16: THE PRICE ADJUSTMENT MECHANISM WITH FLEXIBLE
AND FIXED EXCHANGE RATES 547**
- CHAPTER 17: THE INCOME ADJUSTMENT MECHANISM AND SYNTHESIS
OF AUTOMATIC ADJUSTMENTS 583**
- CHAPTER 18: OPEN-ECONOMY MACROECONOMICS: ADJUSTMENT
POLICIES 619**
- CHAPTER 19: PRICES AND OUTPUT IN AN OPEN ECONOMY: AGGREGATE
DEMAND AND AGGREGATE SUPPLY 663**
- CHAPTER 20: FLEXIBLE VERSUS FIXED EXCHANGE RATES, THE
EUROPEAN MONETARY SYSTEM, AND MACROECONOMIC
POLICY COORDINATION 695**
- CHAPTER 21: THE INTERNATIONAL MONETARY SYSTEM: PAST,
PRESENT, AND FUTURE 737**
- ANSWERS TO SELECTED PROBLEMS 781**
- GLOSSARY OF KEY TERMS 795**
- NAME INDEX 809**
- SUBJECT INDEX 815**

Contents

***Chapter 1: Introduction 1**

- 1.1 Importance of International Economics 1
 - Case Study 1-1 The Dell PC Is All But American 2*
 - Case Study 1-2 What Is an “American” Car? 3*
- 1.2 International Trade and the Nation’s Standard of Living 4
 - Case Study 1-3 Rising Importance of International Trade to the United States 6*
- 1.3 The Subject Matter of International Economics 7
- 1.4 Purpose of International Economic Theories and Policies 8
- 1.5 Current International Economic Problems 9
 - 1.5A Trade Protectionism in Industrial Countries 9
 - 1.5B Excessive Fluctuations and Large Disequilibria in Exchange Rates 10
 - 1.5C Financial Crises in Emerging Market Economies 10
 - 1.5D High Structural Unemployment and Slow Growth in Europe and Stagnation in Japan 10
 - 1.5E Job Insecurity from Restructuring and Downsizing in the United States 11
 - 1.5F Restructuring Problems of Transition Economies 11
 - 1.5G Deep Poverty in Many Developing Countries 11
- 1.6 Organization and Methodology of the Text 12
 - 1.6A Organization of the Text 12
 - 1.6B Methodology of the Text 13
- Summary 14 • A Look Ahead 15 • Key Terms 15 • Questions for Review 16 • Problems 16*
- Appendix: A1.1 Basic International Trade Data 17**
- Appendix: A1.2 Sources of Additional International Data and Information 21**
- Selected Bibliography 23**
- INTERNet 25**

PART ONE: INTERNATIONAL TRADE THEORY 27

***Chapter 2: The Law of Comparative Advantage 29**

- 2.1 Introduction 29
- 2.2 The Mercantilists’ Views on Trade 30
 - Case Study 2-1 Munn’s Mercantilistic Views on Trade 31*

Case Study 2-2 Mercantilism Is Alive and Well in the Twenty-First Century 32

- 2.3 Trade Based on Absolute Advantage: Adam Smith 33
 - 2.3A Absolute Advantage 33
 - 2.3B Illustration of Absolute Advantage 34
- 2.4 Trade Based on Comparative Advantage: David Ricardo 35
 - 2.4A The Law of Comparative Advantage 35
 - 2.4B The Gains from Trade 36
 - 2.4C Exception to the Law of Comparative Advantage 37
 - 2.4D Comparative Advantage with Money 38
- Case Study 2-3 The Petition of the Candlemakers* 40
- 2.5 Comparative Advantage and Opportunity Costs 40
 - 2.5A Comparative Advantage and the Labor Theory of Value 41
 - 2.5B The Opportunity Cost Theory 41
 - 2.5C The Production Possibility Frontier Under Constant Costs 42
 - 2.5D Opportunity Costs and Relative Commodity Prices 44
- 2.6 The Basis for and the Gains from Trade Under Constant Costs 44
 - 2.6A Illustration of the Gains from Trade 44
 - 2.6B Relative Commodity Prices with Trade 45
- 2.7 Empirical Tests of the Ricardian Model 47

Case Study 2-4 Relative Unit Labor Costs and Relative Exports—United States and Japan 49

Summary 50 • *A Look Ahead* 52 • *Key Terms* 52 • *Questions for Review* 52 • *Problems* 53

Appendix: A2.1 Comparative Advantage with More Than Two Commodities 54

Appendix: A2.2 Comparative Advantage with More Than Two Nations 56

Selected Bibliography 57

INTERNET 57

***Chapter 3: The Standard Theory of International Trade** 59

- 3.1 Introduction 59
- 3.2 The Production Frontier with Increasing Costs 60
 - 3.2A Illustration of Increasing Costs 60
 - 3.2B The Marginal Rate of Transformation 61
 - 3.2C Reasons for Increasing Opportunity Costs and Different Production Frontiers 62
- 3.3 Community Indifference Curves 62
 - 3.3A Illustration of Community Indifference Curves 63
 - 3.3B The Marginal Rate of Substitution 63
 - 3.3C Some Difficulties with Community Indifference Curves 64
- 3.4 Equilibrium in Isolation 65
 - 3.4A Illustration of Equilibrium Isolation 65
 - 3.4B Equilibrium Relative Commodity Prices and Comparative Advantage 65

3.5 The Basis for and the Gains from Trade with Increasing Costs	66
<i>Case Study 3-1 Comparative Advantage of the United States, the European Union, and Japan</i>	67
3.5A Illustrations of the Basis for and the Gains from Trade with Increasing Costs	68
3.5B Equilibrium-Relative Commodity Prices with Trade	69
3.5C Incomplete Specialization	70
<i>Case Study 3-2 Specialization and Export Concentration in Selected Countries</i>	71
3.5D Small-Country Case with Increasing Costs	71
3.5E The Gains from Exchange and from Specialization	72
3.6 Trade Based on Differences in Tastes	73
3.6A Illustration of Trade Based on Differences in Tastes	73
<i>Case Study 3-3 Job Losses in High U.S. Import-Competing Industries</i>	74
<i>Case Study 3-4 International Trade and Deindustrialization in the United States, the European Union, and Japan</i>	75
<i>Summary</i>	77
<i>• A Look Ahead</i>	78
<i>• Key Terms</i>	78
<i>• Questions for Review</i>	78
<i>• Problems</i>	79
Appendix: A3.1 Production Functions, Isoquants, Isocosts, and Equilibrium	80
Appendix: A3.2 Production Theory with Two Nations, Two Commodities, and Two Factors	82
Appendix: A3.3 Derivation of the Edgeworth Box Diagram and Production Frontiers	83
Appendix: A3.4 Some Important Conclusions	86
Selected Bibliography	87
INTERNet	88

Chapter 4: Demand and Supply, Offer Curves, and the Terms of Trade 89

*4.1 Introduction	89
*4.2 The Equilibrium Relative Commodity Price with Trade—Partial Equilibrium Analysis	90
4.3 Offer Curves	91
<i>Case Study 4-1 Demand, Supply, and the International Price of Petroleum</i>	92
4.3A Origin and Definition of Offer Curves	92
<i>Case Study 4-2 The Index of Export to Import Prices for the United States</i>	93
4.3B Derivation and Shape of the Offer Curve of Nation 1	94
4.3C Derivation and Shape of the Offer Curve of Nation 2	95
4.4 The Equilibrium-Relative Commodity Price with Trade—General Equilibrium Analysis	96
4.5 Relationship between General and Partial Equilibrium Analyses	97
4.6 The Terms of Trade	99
4.6A Definition and Measurement of the Terms of Trade	99
4.6B Illustration of the Terms of Trade	100

4.6C Usefulness of the Model	100
Case Study 4-3 <i>The Terms of Trade of the G-7 Countries</i>	101
Case Study 4-4 <i>The Terms of Trade of Industrial and Developing Countries</i>	102
Summary	103
A Look Ahead	104
Key Terms	104
Questions for Review	104
Problems	105
Appendix: A4.1 Derivation of a Trade Indifference Curve for Nation 1	106
Appendix: A4.2 Derivation of Nation 1's Trade Indifference Map	107
Appendix: A4.3 Formal Derivation of Nation 1's Offer Curve	107
Appendix: A4.4 Outline of the Formal Derivation of Nation 2's Offer Curve	110
Appendix: A4.5 General Equilibrium of Production, Consumption, and Trade	110
Appendix: A4.6 Multiple and Unstable Equilibria	113
Selected Bibliography	114
INTERNet	114
 *Chapter 5: Factor Endowments and the Heckscher-Ohlin Theory	 115
5.1 Introduction	115
5.2 Assumptions of the Theory	116
5.2A The Assumptions	116
5.2B Meaning of the Assumptions	117
5.3 Factor Intensity, Factor Abundance, and the Shape of the Production Frontier	118
5.3A Factor Intensity	118
5.3B Factor Abundance	120
5.3C Factor Abundance and the Shape of the Production Frontier	121
Case Study 5-1 <i>Relative Resource Endowments of Various Countries and Regions</i>	123
Case Study 5-2 <i>Capital-Labor Ratios of Selected Countries</i>	124
5.4 Factor Endowments and the Heckscher-Ohlin Theory	124
5.4A The Heckscher-Ohlin Theorem	125
5.4B General Equilibrium Framework of the Heckscher-Ohlin Theory	125
5.4C Illustration of the Heckscher-Ohlin Theory	127
5.5 Factor-Price Equalization and Income Distribution	129
5.5A The Factor-Price Equalization Theorem	129
Case Study 5-3 <i>Patterns of Comparative Advantage of Various Countries and Regions</i>	130
5.5B Relative and Absolute Factor-Price Equalization	131
5.5C Effect of Trade on the Distribution of Income	133
5.5D The Specific-Factors Model	134
Case Study 5-4 <i>Has International Trade Increased U.S. Wage Inequalities?</i>	135
5.5E Empirical Relevance	136