

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
	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
	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