

Contents

Preface xiii

The Structure of the Book xiv

Acknowledgments xv

Introduction xvii

1 The Economics of Global Business: The Basics 1

1.1 Social Welfare 2

1.2 Mechanisms, Policies, and the Role of the Government 7

1.3 Assumptions and Equilibria 10

1.4 Shocks and Perturbations 13

1.5 Tradeoffs and the Free-Lunch Conundrum 14

1.6 Context-Dependent Economics 15

Part I: The Management of National Economies

2 Building Blocks: The Market for Goods and Services and Comparative Statics 19

2.1 The Market for Goods and Services 19

2.2 Comparative Statics 23

2.3 The Labor Market 25

Labor Laws, Structural Unemployment, and the Differences between France and the United States 28

2.4 Dynamics, Business Cycles, and Active or Passive Economic Policy 32

2.5 An Introduction to Economic Policy 36

3 Growth in the Long Run 39

3.1 Growth through the Centuries 40

3.2	The Solow Model and Growth in the Long Run	45
	Industrialization, China, and the Solow Model	47
	The United States: Escaping the Middle-Income Trap	49
	Human Capital and the Asian Success	51
3.3	Beyond the Solow Model	53
3.4	What Sustains Productivity and Long-Run Growth?	55
	Vietnam toward Development	57
	Guinea and the Plight of Poor Countries	59
3.5	Levels of Development	60
3.6	Financial Systems, Inequality, Climate Change, and Long-Run Growth	66
	Appendix 3.A: Endogenous Growth Theory	67
	Appendix 3.B: The Thirteenth Five-Year Chinese Plan	68
4	Growth in the Short Run: The Market of Goods and Services	71
4.1	The Commodities Supercycle and Economic Growth in Latin America and Australia in the 2000s	71
4.2	From Long- to Short-Run Growth	73
4.3	Aggregate Demand Shifts and Short-Run Dynamics	76
	The European Central Bank Interest Rate Hike of 2011	80
4.4	Stagflation and Aggregate Supply Shifts	82
4.5	The Components of Aggregate Demand: Consumption and Investment	86
	The New Development Bank: Investing in BRICS	89
4.6	On the Role of Expectations	92
	Rousseff's Impeachment: From Political Crisis to Economic Crisis	93
	The Faroe Islands, Croatia, and the Link between Expectations, Business Cycles, and Political Decisions	96
4.7	Summing Up and Preparing for Economic Policy	97
	Appendix 4.A: Phillips Curve, Okun's Law, Unemployment, and GDP Growth	98
5	The Financial Side of the Economy	101
5.1	Quantitative Easing and the Financial Crisis	101
5.2	Money and Its Role	102
5.3	The Money Market	104
5.4	A Simple Banking System	108
5.5	Bank Runs, "Too Big to Fail," and Financial Crises	111
	Japan, Argentina, and the Consequences of Financial Crises	114
	Systemic Risk and Losses in Commercial Banks: The Case of Sweden	117

- 5.6 The Instruments of Monetary Policy 118
- 5.7 The Transmission Mechanisms of Monetary Policy 122
 - Monetary Policy in Action: Required Reserves in Emerging Markets 123
 - The Independence of Central Banks 124
- 5.8 The Quantity Theory of Money 126
 - Quantitative Easing and the Quantity Theory of Money 128
- 6 The Loanable Funds (Credit) Market 133**
 - 6.1 The Main Concepts of the Loanable Funds Market 133
 - 6.2 The Link between the Money Market and the Credit Market 135
 - 6.3 The Basic Mechanics of the Loanable Funds Market 136
 - The World of Negative Interest Rates 142
 - 6.4 Public Debt and Its Effects on the Money Market and the Loanable Funds Market 145
 - 6.5 Connections between Money, Credit, and Real Markets 147
 - Simultaneous Clearing and the Central Bank's Reactions 148
 - The Paradox of Thrift 149
 - 6.6 The Investment-Saving Identity 152
 - Supply-Side and Trickle-Down Economics 156
- 7 Monetary and Fiscal Policies 159**
 - 7.1 Economic Policy and Time Lags 159
 - 7.2 Monetary Policy 160
 - Managing Monetary Policy during Stagflation: The US Disinflation of the 1980s 162
 - Expectations and Monetary Policy: The Fed Dilemma of 2017 164
 - 7.3 Fiscal Policy 164
 - Discretion versus Rules: Inflation Targeting and Balanced Budgets 165
 - The Maastricht Treaty and the European Unraveling 170
 - 7.4 Which Policy Is Better—Fiscal or Monetary? 171
 - Managing Fiscal Policy during a Deep Recession: Austerity in Europe 173
 - 7.5 Income Inequality and the Distributive Effects of Monetary and Fiscal Policies 177
 - Bolivia and the Tradeoffs between Growth, Income Inequality, and Basic Human Rights 177

8	The Government Budget and Its Economic Impacts	179
8.1	The Public Budget and Social Welfare	179
8.2	Public Debt and Credibility: Crowding Out and Crowding In	183
	Government Credibility and Financing Public Works	184
	Ricardian Equivalence	186
	Time Inconsistency	187
	Business Cycles and Public Debt	188
	The Fiscal Multiplier	189
8.3	Hyperinflation and Public Deficit	190
	The Missing Inflation of the 2010s	192
	Japan, Brazil, Credibility, and 250%	193
8.4	Who Sets the Interest Rate?	196
8.5	The Instruments of Fiscal Policy and Public Debt Management	197
	Indonesia and the Link between Credibility and Fiscal Policy	199
	Neutral Tax Reforms in the United States	200

Part II: Economic Policy in a Global Context

9	The Foreign Currency Market and Macroeconomic Repercussions	205
9.1	Exchange Rates and Their Economic Impacts	206
9.2	The Foreign Currency Market	208
	Brexit and the Weakening of the British Pound	211
9.3	Exchange Rate Determination and the Balance of Payments	213
9.4	The Mechanics of the Balance of Payments under Flexible Exchange Rates	218
9.5	Structural Deficits or Surpluses in the Balance of Payments Accounts	219
10	Exchange Rate Regimes	225
10.1	Foreign Currency Markets	225
10.2	Free Capital Flows and Exchange Rate Interventions	227
10.3	The Mechanics of Fixed Exchange Rate Regimes	229
	Denmark, Switzerland, and Capital Controls in Developed Countries	232
	Emerging Markets and Exchange Rate Regimes: The Case of India	235
10.4	Industrialization by Import Substitution versus Export-Oriented Growth	236
10.5	The Mechanics of Foreign Reserves	238
10.6	Balance of Payments Equilibrium in the United States	240

- 11 Economic Policies in a Globalized World 245**
 - 11.1 Interest Rate Parity and Monetary Policy in an Open World 245
 - South Africa and the Currency Crisis of 1998 248
 - 11.2 Monetary and Fiscal Policies in a Globalized World 250
 - 11.3 Currency Crises 252
 - The Asian Crisis of 1997 to 1998 254
 - Debt Crises, the Lost Decade, and Hyperinflation in Latin America 255
 - Reforms for Disinflation: The Case of Israel 256
 - Rescue Packages in Developed Countries 257
 - China, Sterilization, and the Holdings of US Debt 259
 - 11.4 The Trilemma of Economic Policy 260
 - The Chinese Trilemma and the Speculative Attack on the Yuan 261
 - 11.5 The Role of Foreign Saving: Sectoral Imbalances 264
 - Currency Crises and Stagflation 265
 - 11.6 Dimensions of Currency Policy 268
 - The Underperformance of the Malaysian Ringgit 270
 - Dirty Floating and a Costly Lunch in Mexico 271
 - Two-Money Systems 272
- 12 Income Inequality and Economic Policy 277**
 - 12.1 Income Inequality versus Wealth Inequality 277
 - 12.2 Multidimensional Inequality and Poverty around the World 282
 - Social Mobility and Development for All 286
 - 12.3 Distributional Effects of Monetary and Fiscal Policies 287
 - Bringing the Poor to the Table: Bolsa Família and the Law of Big Numbers 289
 - Demonetization in India 290
 - Carbon Taxes, Subsidies, Macroeconomics, and Income Inequality 291
 - 12.4 Trade, Inequality, and Politics 293
 - 12.5 Inequality and Macroeconomics Redux 296
- 13 Climate Change, the Environment, and Economic Policy 299**
 - 13.1 The Great London Smog and Life in Contemporary China 299
 - 13.2 Nature and Economic Shocks 301
 - Drought and Famine in Somalia 302
 - Water Management and the Economy 303
 - Water Conflicts and Economic Growth in Africa and Asia 304
 - Stagflation Due to Water Shortages: The Case of Brazil in 2001 306
 - California Drought and Economic Activity 306

13.3	Climate Change and Productivity	307
	Bolivia, Borneo, and the Growth/Deforestation Dilemma	308
13.4	The Environment and Economic Policy: Moving Forward	309
	Leading the Drive for Renewables: European Subsidies and Macroeconomic Repercussions	311
	The Oil Industry in Canada: Inequality, Growth, and the Environment	312
14	National Accounts: GDP, Inflation, Inequality, and Unemployment	315
14.1	Gross Domestic Product (GDP)	315
	Production (Supply of Domestic Goods)	316
	Income (Value Added)	317
	Expenditure (Demand)	318
	Bringing It All Together	322
	How Is GDP Actually Measured?	323
	Nominal versus Real GDP	325
	Potential versus Actual GDP	326
	Limits of GDP	327
14.2	Unemployment	329
	Unemployment Dynamics	331
	Labor Markets and Social Welfare	335
	Uber Drivers, Unemployment, and Informal Contracting	339
	Informal Workers in India	340
	Sclerotic Labor Markets	341
	Unemployment in South Africa	342
14.3	Inflation	344
	Core versus Noncore Goods and Services	345
	Technology, Quality, and Cost of Living	346
	Perceived versus Real Inflation	346
	Purchasing Power Parity	347
14.4	Income Inequality	348
15	Economics of Global Business: Integration, Limits, and Open Questions	351
15.1	Integrating All the Macroeconomic Markets	351
	Greece and Paths to Stability	361
	Shocks and Long-Run Growth: The Experience of Nigeria	363
	Mongolia, the IMF, Profligacy, and Austerity	367
	The Washington Consensus, Neoliberalism, and Keynesianism	370
15.2	How Policymakers Act	373

15.3	The Limits of Macroeconomics and Open Questions	375
	Should Economic Policy Be Active?	375
	Is Financial Globalization All the Rage?	377
	On the Role of a Public Deficit	379
	Demographics, Income Inequality, Sustainability, Secular Stagnation, and Other Contemporary Issues	380
	Index	385