BOOK REVIEWS


The Handbook of International Economics, Volume II, edited by Ronald W. Jones and Peter B. Kenen, covers the theory of international monetary relations and the macroeconomics of open economies. Like the other volumes in the North-Holland Handbook series, this one contains several well-written survey articles by leading economists in the field. It will no doubt prove useful for classroom use, and as a bibliographic source. On the other hand, the volume is troubling in several respects. It offers a vast proliferation of models and special cases, but it is surprisingly short on general principles. Moreover, the Handbook fails to address many of the most central policy issues in the area of international economics, and thus will prove of little direct help to policymakers grappling with the debt crisis, alternative exchange rate regimes, capital controls, black markets, non-convertible currencies, etc. Finally, and inevitably, the Handbook is a bit out of date in parts of the field in which rapid progress is being made, and so it gives an incomplete view as to the state of the art.

The eleven chapters of this volume are divided roughly between theoretical and empirical topics (the chapters are numbered to follow from Volume I, and so run from Chapter 13 to 23). Chapter 13 opens the volume with an insightful essay by Peter Kenen on the theoretical developments in open economy macroeconomics during the twenty-five years following World War II. Chapter 14, by Jacob Frenkel and Michael Mussa, carries the story forward by another decade, to the early 1980s. Chapters 15–18 survey a selection of major theoretical models in international monetary economics. Here the editors have chosen to divide the theoretical landscape into analytical pieces of a complete model, with separate chapters reserved for asset markets, goods and factor markets, stabilization policies, and exchange rate determination. Chapters 19–22 then focus on empirical studies of various topics in international monetary economics: exchange rate determination, aggregate trade equations, multi-country macroeconomic modelling, and the demand and supply of international reserve assets. The final chapter, by
Richard Cooper, offers a theoretical survey of issues in international policy coordination.

The division of the theoretical topics has both strengths and weaknesses. The main strength is simply that the resulting chapters are very good. Chapter 15, on asset markets, by William Branson and Dale Henderson, and Chapter 18, on exchange rate determination, by Maurice Obstfeld and Alan Stockman, are particularly outstanding. Both of these chapters take the reader through the modern dynamic theory of asset pricing with forward-looking agents, in presentations that are clear, well-motivated, and mathematically rigorous. Both of these chapters will show up on many graduate-level reading lists.

On the other hand, the chapter divisions lead to considerable overlap and sometimes to inconsistencies across chapters. In international economics, most of the interesting results are of a general equilibrium character, so that it is very difficult to focus exclusively on asset markets, or goods markets, or exchange markets alone. Thus, each of the authors in Chapters 14–18 is compelled to lay out a full model, even though their particular assignment is only a small piece of the full model. The result is a massive duplication of effort, that is made especially troubling by the fact that the various 'complete' models set forth by the authors often bear little resemblance to one another. In one chapter, for example, consumption is determined by disposable income; in another, by wealth; in yet another, by intertemporal optimization subject to a dynamic budget constraint. These swings in assumptions are made almost without comment.

What is missing from the Handbook, and to some extent from the field itself, is a 'standard' model against which others can be compared. A simple international version of an Arrow–Debreu economy, in the first theoretical chapter, would have provided an enormously useful touchstone for the rest of the theorizing. Such a general model might have included the following elements: a competitive economy, with agents trading in world commodity and asset markets; a representative household making dynamic consumption allocations subject to an intertemporal budget constraint; a government pursuing a path of spending, taxing, and borrowing, subject to an intertemporal budget constraint; and firms pursuing an optimal production and investment program in order to maximize the value of the firm. As a starting point, this economy could be studied with infinitely lived households operating in an environment of no uncertainty, and with perfect foresight. Extensions in the chapter could include a treatment of finite-lived households (for example, in an overlapping generations context), and dynamic equilibrium in an environment with uncertainty.

The need for such a chapter is obvious when the following facts are considered. First, very few of the models in the Handbook carefully describe the dynamic budget constraints facing households, governments, and firms,
even though the entire volume is concerned with the intertemporal choices that are facilitated by internationally traded financial assets. Bruce and Purvis offer a few valuable pages (pp. 847–854) on this topic, as do Obstfeld and Stockman in their chapter devoted to exchange rate determination. However, given the centrality of the issues involved, it is disappointing that the entire discussion is limited to a few pages scattered throughout the volume. Second, no chapter spells out the aggregate budget constraint facing a country that has access to international capital markets. How much can the residents of one country borrow from the rest of the world, and on what terms? Under what conditions will an external debt crisis arise? Third, no model discusses the crucial issue as to how alternative monetary arrangements affect a country’s dynamic budget constraint. Classic questions in the field thus remain unaddressed. For example, does the international role of the dollar give the United States an ‘exorbitant privilege’, as Charles de Gaulle maintained, by permitting it seignorage gains not available to other countries? No model in the Handbook comes close to telling us.

So much time is spent specifying and respecifying partial models that little time is left over for discussion of key policy issues in international monetary economics. Consider the list of topics barely or not at all mentioned in the Handbook:

(1) limitations on convertibility of currencies: exchange controls, capital controls, multiple exchange rates, black markets;
(2) alternative global monetary arrangements: functioning and mechanics of the gold standard or alternative fixed exchange rate systems, target zones, monetary unions, the European Monetary System;
(3) foreign borrowing: the LDC debt crisis, policy responses to a cutoff of foreign lending, IMF conditionality, historical experiences with foreign borrowing;
(4) linkages between trade and international financial policies: timing of liberalization, macroeconomics of tariffs, exchange rate instability and trade flows.

At a time of considerable consternation about the current international monetary system, Black’s Chapter 22 on international money and international monetary arrangements devotes about 18 pages to the supply and demand of international reserve assets, and only two pages to the issue of optimal design of the international monetary system. The essay is characteristically well argued and well written, but the emphasis surely reverses the relative importance of topics.

The field is making great strides in many of the areas neglected by the Handbook. The recent proliferation of dynamic models of international lending and borrowing, of the current account, and of macroeconomic adjustment, is helping the field to move to a richer ‘benchmark’ case. Moreover, the major policy issues missing from the Handbook are not
suffering from any shortage of attention. There has recently been a vast outpouring of writing on alternative exchange rate systems, international policy coordination, strategies for trade and financial liberalization, and so on. In the end, this Handbook will probably prove to be a useful stepping stone to a new collection of richer and more comprehensive papers in the not-too-distant future.

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John Whalley is the consummate practitioner of computable-general-equilibrium (CGE) analysis applied to international trade. This book establishes him further as a consummate purveyor of CGE insights to professional economists and to others with practical and policy interests in international economic affairs. These are the audiences for whom he writes. Well under half of the contents will be familiar from Whalley’s past publications.

Whalley’s objective for his professional audience is to bridge ‘theory and application in the analysis of global trade policy…, to preserve the spirit of much of the theoretic work on trade policy, but to give particular numerical specifications of policies and economic environments reflecting both the data and the institutional settings…’. His objective for his practical and policy audience springs from his belief that ‘policy is driven by perceptions, which in turn can be influenced by the best attempts to deal with questions… Whether we like it or not, some form of model underlies each and every decision on trade policy… Raising the level of the debate by providing fresh insights into the policy issues at stake is the objective of this book.’

Consistent with these objectives, most of the chapters summarize Whalley’s extensive applications of CGE analysis. The analysis itself is explained, but in summary fashion. Only one chapter goes into any detail on CGE methodology. Likewise only one goes into any detail on the theory of international trade policy. Three chapters are devoted to the empirical calibration of the CGE model. Eight chapters then employ it to estimate the impacts of policy changes and other exogenous shocks.

The book’s title is sadly confining. Whalley estimates the impacts of a lot more than just ‘trade liberalization’: factor income taxes, factor mobility across sectors, relative national growth rates, and foreign aid are all altered to estimate their impacts. The impacts themselves are estimated for a lot more than just ‘major’ trading areas: in a four-region version of the model,