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Book Reviews

Cross-over in International Economics

Real-Financial Linkages Among Open Economies.
Edited by Sven W Arndt and J David Richardson
Cambridge, MA MIT Press, 1987, 215 pp, \$27.50

Reviewed by Maureen Kilkenny

There are two camps in international economics. Both are concerned with relative prices. The international trade theorists are interested in the relative prices of goods among countries at one point in time. They try to explain patterns of trade by differences in factor endowments, technology, tastes, and other structural parameters. The international macroeconomists study the relative prices of assets over time. They try to explain currency exchange rates by international differences in interest rates, money supplies, and other financial variables. The first camp has relied largely on theoretical propositions, while the latter is rife with stylized facts estimated from semi-reduced-form models.

Arndt and Richardson present eight papers by representatives from both camps who have crossed over to the other side. The trade theorists search for stylized facts from aggregate data, and the international macroeconomists base their reduced forms on structural, sectorally disaggregated models. The results are informative, innovative, and inspiring.

About two-thirds of the collection will directly interest the agricultural economist studying the relationship between international agricultural prices and the dollar exchange rate. What do exchange rates have to do with competitiveness? What caused exchange rates to appreciate? Is there a way to short-circuit the negative impact of currency appreciation on export demand? Is the volume of trade adversely affected by exchange rate volatility? These are some of the questions addressed.

The introductory overview contains concise explanations of the Law of One Price, Purchasing Power Parity, basic measures of competitiveness, and the nontradeable/tradeable price-relative version of the real exchange rate. Some knowledge of the literature is presumed, but the explanations are simple and clear. Just the right

The reviewer is an economist, formerly with the National Aggregate Analysis Section, Agriculture and Rural Economy Division, ERS, and now a visiting assistant professor in the Department of Economics at The Pennsylvania State University.

number of equations and graphs are used. The overview provides a unifying framework, relating all the models to the same basic structural assumptions. The papers on intertemporal and asset market linkages are also related to the papers on goods markets through the relative price theme.

Krugman and Marston provide two particularly interesting contributions. Krugman presents a study relating international price formation to market structure. An exporter with market power can avoid passing exchange rate increases to the export market by reducing nominal prices (in terms of their own currency). Marston asks how different rates of productivity growth among sectors can affect measures of international competitiveness. He shows that the real exchange rate in the United States reflected the relative rates of productivity growth between traded and nontraded sectors of the U.S. economy relative to those of Japan, but not the other way around. One consequence is the persistent trade deficit with Japan. Since the U.S. agricultural sector is both important in trade and shows high productivity growth, these types of linkages may be critical to agricultural economists.

Hutchinson and Pigott present a clear story of how a government deficit (not accompanied by monetary accommodation) puts pressure on domestic aggregate demand, worsens the current account balance, increases the interest rate, and causes exchange rate appreciation. Sound familiar? They study 10 industrialized economies and show that the United States is a textbook case where goods-market effects dominate.

The papers include (1) "Real-Financial Linkages among Open Economies: An Overview" by Sven W. Arndt and J. David Richardson, (2) "Some Interactions between Goods Markets and Asset Markets in Open Economies" by Alan C. Stockman, (3) "Pricing to Market When the Exchange Rate Changes" by Paul Krugman, (4) "Real Exchange Rates and Productivity Growth in the United States and Japan" by Richard C. Marston, (5) "The Assessment of National Price Levels" by Irving B. Kravis and Robert E. Lipsey, (6) "Real and Financial Linkages in the Macroeconomic Response to Budget Deficits: An Empirical Investigation" by Michael M. Hutchinson and Charles A. Pigott, (7) "Monetary, Financial, and Real Effects of Yen Internationalization" by Koichi Hamada and Akiyoshi Horiuchi, (8) "Long-Run Exchange Rate Variability and International Trade" by Paul De Grauwe and Bernard de Bellefroid.

De Grauwe and de Bellefroid show that the decline in the longrun rate of growth in bilateral international trade since 1973 is positively related to exchange rate variability, slower growth in gross national product, and less trade integration. Thus, not only do the levels of relative prices matter, but so do the variances

The collection covers only a subset of the many linkages between real and financial markets both within and

among open economies. The fundamental relationships between exchange rates, budget deficits, and international competitiveness are posited as testable hypotheses and are successfully analyzed. An obvious omission, of interest to agricultural economists, is an analysis of the asset characteristics of commodity futures markets. The editors suggest that their book is a first step toward filling an analytical and empirical gap. Agricultural economists who read this book should be inspired to contribute to the next steps.

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