

Foders, Federico

**Book Review — Digitized Version**

[Book Review of] Bowen, Harry P., ..., :Applied international trade analysis: Ann Arbor, Univ. of Michigan Press, 1998

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ture after the Asian crisis, just as this failed to happen after earlier crises. He believes that this failure together with the IMF's inability to function properly as a lender of last resort makes a market solution the only viable option. Phillip Turner puts forward some concrete proposals to strengthen the regulatory environment. He also emphasizes the difficulties of transparency arising from rapid financial development, such as the growth of derivatives. Finally, Charles Goodhart argues that current financial crises share some features with those of the 19<sup>th</sup> century. He stresses the importance of orderly debt work-outs in resolving crises.

In conclusion, the book makes an important contribution not only to a better understanding of the underlying causes of the Asian crisis but also to the debate on the prevention and resolution of future crises. The different chapters of the book nicely illustrate the controversy that is still surrounding the causes of the Asian crisis. Part One argues forcefully that East Asia's economies exhibited some fundamental weaknesses. However, the fundamentals-based arguments brought forward fail to explain some important aspects of the crisis, in particular its timing, simultaneous occurrence and its irreconcilability with East Asia's past success. Due to these failures, the authors of the contagion papers in Part Three seem to win the debate by arguing that a full explanation of the Asian crisis can only be found by also analyzing how crises can spread contagiously across countries.

The chapters also reveal the significant difference in opinion among the authors in terms of what policies should be adopted to prevent and resolve future crises. Work on contagion is still rare. But if the importance of contagion can be confirmed, it will have highly relevant policy implications as it would require a fundamental change in our thinking about crisis prevention and resolution. As argued by chapters 11 and 12, the importance of contagion means that improving domestic fundamentals is clearly insufficient. The increasingly international nature of crises requires that we create international institutions that are capable of dealing with the issues of crisis prevention and in particular crisis resolution. Many of the proposals in the book focus on the need and the feasibility for the creation of a lender of last resort, an international bankruptcy court, debt contracts and orderly debt work-outs and standstill procedures. Such policies won't prevent the occurrence of future crises, but they should make them far less likely and much less severe than the Asian crisis.

Marcel Fratzscher

**Bowen, Harry P., Abraham Hollander, and Jean-Marie Viaene, *Applied International Trade Analysis*. Ann Arbor 1998. University of Michigan Press. XXVI, 654 pp.**

The failed attempt at launching the Millennium Round of trade negotiations in December 1999 has been interpreted by some as a major blow to the World Trade Organization (WTO) and the existing trading order. For others, including this reviewer, the Seattle meeting was something different: In retrospect, it stands out as a historical opportunity to restate the challenges currently faced by the international trading system. One of these challenges, a legacy of the Uruguay Round, is the conflict between the EU and the US concerning agriculture. It occupied center stage in Seattle and left the world with the prospect of a trade war. The irony of Seattle is that we might get the next round of multilateral negotiations not in spite, but precisely because of the strong pressure exerted by the prospect of a trade war on both trade powers. In other words, the Seattle debacle produced an unexpected message: trade policy still matters. In this spirit, Seattle turns out to have been a timely wake-up call to remind the world that the future trade system should primarily be shaped in multilateral negotiations. In fact, the 21<sup>st</sup> cen-

ture calls for a new trading order that effectively addresses both the weaknesses of the current system as well as the emerging issues. Hitherto unresolved issues such as agriculture and services and new issues such as e-commerce, competition policy and investment should be put high on the agenda.

With a favorable, albeit not relaxed, environment for global and regional trade policy discussions in place, books like the one written by Harry P. Bowen, Abraham Hollander and Jean-Marie Viaene are highly welcome. It gives an overview of traditional approaches and recent advances in trade theory, applied analysis and formal tests of theory. In doing so it offers a number of tools that will prove useful in the upcoming trade policy debate. Since the presentation of the tools is accompanied by qualifications concerning the actual reach of each tool, the reader gets much more than a mere technical guide: a realistic feeling for what economics can do to upgrade the skills of those playing or considering to play active roles in the debate. Divided into four parts, the book includes a description of the pattern of world trade and factor flows (Part I), traditional pure trade theory (Ricardo, Heckscher-Ohlin) (Part II), imperfect competition (the so-called "new" trade theory) and multinational production (the OLI framework) (Part III), regional integration, exchange rates and growth (Part IV).

What makes this book different from other textbooks in international economics? The blend of theory, policy and empirical tests. While the authors brilliantly merge theory with applications, in some cases the reader is left to find out for herself whether and to what extent a theory is empirically valid. Some readers, particularly undergraduate students, might have a problem in finding the right answers. However, the difficulty is not with the book per se but rather with the field of enquiry. Even widely accepted theories of international trade are only seldom and almost never automatically reflected in the data. More often than not experienced researchers have to confess that they are unable to clearly discriminate between competing theories and to determine their relative explanatory power. While data supply problems do play a role, empirical verification of trade theories remains a tough business even in those cases in which data are available in acceptable quality. This uncertainty constitutes a distinct characteristic of the field of international trade. Thus the careful reader of *Applied International Trade Analysis* has a real chance to learn not only about the great potential of trade theory, in the analysis of traditional issues as well as in the analysis of imperfect competition and multinational production, but also about its limitations. This seems to be one of the extremely valuable (though hidden) goals of the book.

The last part (Part IV: Special Topics), the shortest in the book, introduces the reader to regional integration, exchange rates and growth theory. The chapter on regional integration is a must at a time when the coexistence or, more precisely, the "cohabitation" of regionalism and multilateralism sets the stage for trade policy. The authors manage to summarize the key arguments for and against regional integration schemes and to report the main results from the empirical literature on 33 pages. They include results such as the estimated welfare effect of Britain's accession to the EC and the estimated income effect of Spain's accession to the EC, both of which carry a negative sign. The authors add that this 'conclusion is shared by most models of integration that were constructed in the late 1970s and 1980s under the paradigm of perfect competition' (p. 516). By moving on to models featuring scale economies and imperfect competition, the authors are able to show that, at least with respect to NAFTA, increasing returns and factor mobility seem to have had a positive impact on the Mexican economy. On the other hand, in the case of the US and Canada the measured gains from integration turn out to be rather small, if not negligible, and thus in line with estimates obtained under the assumption of perfect competition. In their final remarks to this chapter Bowen, Hollander and Viaene ask the fundamental question: "How much is a country willing to pay in order to enjoy free trade with a specified group of countries?" Instead of providing

a clear-cut answer they have to admit that the current state of research in the field of regional integration is, to say the least, unsatisfactory, and that “there is a clear need for improved links between theory and data and for renewed empirical investigations of the questions raised by regional integration.”

The chapter on exchange rates (Chapter 13) focuses on the currency risk faced by, and the pricing policies of, international firms, thereby touching upon the topic of exchange rate pass-through under oligopoly. While the exposition is clear and quite comprehensive, after having worked through most of the pure theory of international trade, the reader would probably have expected something different at this stage. Perhaps a dose of open economy macroeconomics (OEM) as established by Mundell, Dornbusch and Obstfeld? Well, why not? It is always an asset to understand the way monetary, exchange rate and trade policies interact. Fortunately for the authors, it is virtually impossible to present the very basics of OEM on 24 pages. I therefore believe that it would not make much sense to ask for OEM in a book that has already 654 pages. Indeed, the authors should be protected from such a claim.

As concerns the theory of economic growth presented in Chapter 14, the reader might notice that an elaborate discussion of the link between growth and international trade is missing. The omission of this link in the derivation of the neoclassical model of growth is not a problem. It is, however, in the discussion of models of endogenous growth. In the same vein, the comments on the relevant empirical work (on pp. 590 and 592) are much too brief. The reader does not get the flavor of the current controversy in the literature regarding the existence of such a link. The next edition of the book should improve on that.

All in all the excellent book written by Bowen, Hollander and Viaene can be recommended to graduate students as a textbook and to academics and practitioners as a valuable reference book. The many readings listed at the end of each chapter, classified by topic, the extensive bibliography in the back of the book, covering the literature up to 1997, the appendix on trade and factor data (including Internet sources) and the very useful index all add to the intrinsic value of the book.

Federico Foders

**Diebold, Francis X., and Glenn D. Rudebusch, *Business Cycles— Durations, Dynamics, and Forecasting*. Princeton, New Jersey 1999, Princeton University Press, XIX, 420 pp.**

This book is a collection of papers published between 1989 and 1998, giving a comprehensive, modern perspective on the business cycle and the research techniques currently employed in analyzing it. The collection is structured along five central questions with the very readable introductory chapter serving as a guide.

The first question is whether business cycles have become more moderate in the postwar era. This could be expected, since there have been important changes in the economy that may have paved the way in that direction such as the higher share of the less cyclical services in aggregate production and employment, significant improvements in inventory control technology and a much more active role of governments in stabilizing aggregate activity. Francis X. Diebold and Glenn D. Rudebusch contribute to the discussion by shifting its focus from measuring the relative volatility of output growth in the prewar and in the postwar era to the relative duration of expansions and contractions. On the basis of the NBER's business cycle chronology, they find that expansions have been longer and contractions shorter in the period after World War II. Their results have been shown to be qualitatively robust to