Table of Contents

Preface	xi	Considering the Different Possibilities	33 34
Introduction	xv	Interpreting Relative Price Swings	
	24.4	Is a Commodity Relative Price Increase Bullish or Bearish? References	35 37
I			
ADDITO ACE AND MODILITY		4. The Terms of Trade	
ARBITRAGE AND MOBILITY		A Broader Estimate	39
		Policy Links	40
1. Arbitrage, Mobility, and Equilibrium Prices		The Adjustment Process: Investment Implications	41
		Does Our Theory Hold Water?	42
A 2X2X2X2 World	4	Does the Relationship Hold for Other Countries?	43
Equilibrium Under Autarky	4		
Global and National Equilibrium	4 7	5. Yields, Risk Premium, and Terms of Trade	
Global Equilibrium and the Trade Accounts		PPI 70.00 0 0 1 397 11	40
The Terms of Trade or Real Exchange Rate	8	The Different States of the World	48
Interest Rate Parity	8	Identifying the Different Environments	49
What Happens When the Terms of Trade Change	0	Summary	50 50
in Predictable Directions?	9	References	30
Adding the Final X2	9	6 The Communities Formania Environments	
Mobility, Trade, and the Equalization of Price	12	6. The Competitive Economic Environment:	
and Factor Returns Across Borders Transportation Costs and Overall Equilibrium	12 13	Lessons From the States	
Mobility and the Incidence of Taxes and	13	The States' Competitive Environment	52
Other Economic Shocks	15	The States' Income Tax Rates as a Proxy for	32
The Speed of Adjustment to a New Equilibrium	16	Their Competitive Environment	52
References	16	The Evidence: The Changing Competitive Environment	54
2. Practical Applications: The Investment		The Interaction Among States' Migration, State Income	
and Policy Insights and Implications Derived		Tax Rates, and Right to Work	56
		Brain Drain?	61
From Arbitrage and Mobility		Summary	64
Is the Law of One Price a Useful Concept?	20		
Convergence: The Implementation of the Euro	24	7. Economic Policy and Performance:	
The Convergence and Postconvergence Euro		The Small-Cap and Country Effect	
Environments	25		100
Divergence: The Dismantling of Bretton Woods	25	A Framework for Regional Economic Performance	66
The Local Inflation Results	26	The Ranking of the States	66
Does the Law of One Price Still Hold?	28	Application: The States' GDP Relative Performance	66
Are the Terms of Trade Constant?	29	Application: The States' Relative Stock Return	"
References	29	Performance and the Size Effect	66
		Investment Implications	68
3. Are Commodity Price Increases Equivalent		References	69
to Tax Increases?		8. Migration: A Political Problem,	
A O II DI I II II GE		9.	
Are Commodity Price Increases a Harbinger of Future	2.1	an Economic Problem, or Both?	
Inflation?	31 32	Migration: Europe and the Middle East	72
Solving the Signal Extraction Problem	32	Where Will the Migrants Go and What Will Be Their	1.7
Searching for the Equivalence between Price and Tax	32	Economic Impact on These Economies?	73
Increases Does the Price/Tax Equivalence Always Hold?	33	Politics or Economics?	73
Loco die Troc, tax Equivalence Triwayo From.	55	a succession of a	

Is Europe Unique or Are These Effects Universal? The Recent US Experience Immigration as an Economic Problem Who Should be Coming Into the Country?	74 74 75 75	12. The Degree of Global Integration and National Economies' Policy Options and Limitations	
How Would We Modify Immigration: What to Look for and How to Take Into Account		The Integrated Economy	102
the Policy Interactions?	75	The Price and Output Adjustment to a New Equilibrium	102
The Economic Determinants of Migration	77	The Demand and Supply Response	103
The Anchor Babies	78	Transportation Costs and the Degree of Integration	103
The Politics of Immigration	78	China and the Commodity Supercycle in the Context	104
The Burden of Adjustment	80	of an Integrated Global Economy The Commodity Supercycle	104
References	81	Policy Differences and the Degree of Integration in an Economy Output Level	105 106
II		China's Impact on the Global Economy's Equilibrium Output	100
THE TRADE BALANCE		Implications and Insights	108
		13. A Unified Theory: Terms of Trade, Real	
9. Global Investing: The Macro Prospective		GDP Growth Rate Differentials, the Trade	
Building Blocks		Balance, Capital Flows, and the Relative	
	- N	Stock Market Performance	
The Framework	85		
The Forders Person I de O	86	The Two Possibilities	111
The Exchange Rate and the Organization of the Monetary System	0/	The Terms of Trade	112
The Trade Balance and Capital Flows	86 87	The Global Economy's Adjustments to Economic	
What Happens When the Terms of Trade Change	07	Disturbances and the Correlation Among the Key	110
in Predictable Directions?	88	Economic Variables	112
Reference	88	What Does the Global Data Tell Us?	114
	00	A Unified Theory Reference	116 122
10. Diversity and Harmonization		Appendix	123
Autarkic Equilibrium	89	ži.	
Free Trade Equilibrium	89	III	
Some Generalizations	90		
The Link Between Consumption Harmonization		EXCHANGE RATE AND THE TER	MS
and Production Divergence	90	OF TRADE	
The Politics of Job Protection Policies	90	OI IMADE	
Diversity and Harmonization	91	1997 44 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1 1	
References	92	14. Protectionism, Devaluation, and the Terms	
11. The State Competitive Environment:		of Trade	
Integration and Convergence		The Nominal Exchange Rate	132
integration and Convergence		Floating Exchange Rates, Purchasing Power Parity,	152
A Framework for Regional Economic Performance	94	and the Terms of Trade	132
The Degree of Economic Integration	94	Currency Manipulation	133
Some Evidence	95	Terms of Trade Changes, the Wealth Effect,	100
States' Fiscal Policies Could Potentially Impact		and the Transfer Problem	134
the Degree of Integration	97	A Signal Extraction Problem	135
The Measurement of the Differences in Policies Across	68025	References	136
the States	98		110000
The States' Relative Marginal Tax Rates	98	15. Exchange Rates, Devaluations,	
Investment Strategy	99	and the Terms of Trade	
Limitations of the State Competitive Environment			
as an Investment Strategy	99	The Equivalence Between Currency Manipulation and	
Competitiveness, Integration, and Convergence	99	Countervailing Duties	138
References	100	Why Tariffs May Fail	138

T	TABLE OF CONTENTS		vii
The Protectionist Case for Exchange Rate Management	139	19. Self-Sufficiency, Nationalism,	
The Case Against Devaluation or Revaluation	139	and Protectionism: The Common Elements	
More on the Case Against the Nominal Exchange Rate	140	and riotectionism. The Common Bieneits	
Expanding the View	140	Self-Sufficiency Policies: Potential Pitfalls	183
The Big Mac Standard	141	The Narrow View	183
The Real Exchange Rate or Terms of Trade		Budget Constraints and Self-Sufficiency Policies	184
as an Indicator	142	Self-Sufficiency or Trade Restriction Policy Equivalences	185
The Better and Broader Measure	142	Winners and Losers and the Politics of Special Interest Groups	185
References	144	Intertemporal Considerations	186
		Is Self-Sufficiency and Protectionism the Answer?	188
16. The Nominal Exchange Rate, the Terms		22.2	
of Trade, and the Economy		20. Immigration and Protectionism	
Expanding the Framework to Include		Illegal Immigration	191
Transportation Costs	146	Security	192
What Drives the Nominal Exchange Rate?	146	Crime	192
Devaluation and Terms of Trade Effects	147	Legal Immigration: Economic Issues	193
A Signal Extraction or a Conceptual Problem?	147	The Case for a Skills-Based Immigration System	196
What Moves the Exchange Rates and	7 1.1	The Unintended Consequences of an Immigration System	196
Terms of Trade?	148	The Effect of Alternative Immigration Schemes	198
The Economic Performance During the Cycles	149	References	200
The Events	152	21 T 1 D 1: D 10	
Mexico and the Tequila Effect	152	21. Trade Policy, Protectionism, and Currency	
The Thai Blood Baht and the Asian Flu	154	Manipulation	
The Russian Crisis	156	CLITE CONTRACTOR MANAGEMENT	201
The Commodity Super Cycle	158	Global Implications of an AntiCurrency Manipulation Policy	201 202
China	160	Will Currency Manipulation Deliver the Goods?	202
References	162	China	205
11 TI LIGE . A L		22. Protectionism and Trade Policy	
17. The US Experience: An Interpretation		TI T 1 D 1 ID 10DDC 1	210
Trade Balance: Value or Growth Signal?	164	The Trade Balance and Real GDP Growth	210
The Trade Balance and the Economy's Price Earnings Ratio	165	The Trade Balance and the Capital Account	216 218
Trade, Employment, and Growth	166	The Conquest by Purchase	210
Do Exports Create Jobs? What About Imports?	168		
Economic Growth, the Trade Balance, and the Stock	100	IV	
Market Performance	168	71	
The Exchange Rate and Terms of Trade	170	THE BALANCE OF PAYMENTS	
19 Delegies Deies Changes Income Dedicteile tie		22 CLI II	
18. Relative Price Changes, Income Redistributio	11,	23. Global Investing: The Balance of Payments	
and the Politics of Envy		The Monetary System	222
Necessary Conditions	174	Extending the Framework to Account for Multiple	
Agricultural Commodities, the New Oil?	174	Economies and Currencies	224
Impact of Agricultural Price Support Programs	175	The Global and Individual Countries' Monetary	
Unintended Consequences: Economic Dependency	175	Equilibrium Under a Floating Exchange Rate	224
Economic Growth and Price Support Programs	176	Variations on a Theme: Alternative Assumption	
Unintended Consequences: Oil and Agricultural		Regarding the Money Demand Functions	224
Products	176	Scenario 1: The Textbook Scenario Where Each Country	
A Warning	176	Exclusively Uses Its Own Currency in All Domestic	
More Unintended Consequences: Starvation	177	Transactions	225
More Unintended Consequences: Trade Restrictions	177	Scenario 2: Each Country Uses Both Currencies	
A Generalization	178	in Domestic Transactions	227
Mercantilism Does Not Make For Good Economics	179	Implications and Insights	228
Protectionists Versus Free Trade Arguments	179	Scenario 3: One Country's Currency Circulates Both	
The Facts	180	at Home and Abroad, but the Second Country's	
References	180	Currency Only Circulates at Home	228

T/	BLE OF	CONTENTS	ix
35. Credit, the Carry Trade, Tax Rates, and the		Searching for Causes and Cures: The Homeowners	349
Residential Real Estate Market: A Retrospective		Searching for Causes and Cures: The Financing Mechanisms	350
The Democratization of Credit and Income Smoothing	312	Searching for Causes and Cures: Wealth Versus Income	351
The Role of Real Estate in the Credit Equation	314	Searching for Causes and Cures: Capital	
The Advantages of Owner-occupied Residential Real Estate	314	Adequacy Ratios	351
Financial Innovations and the Loss of Transparency	315	Searching for Causes and Cures: The Fed and Other	
The Credit Explosion	316	Government Agencies	352
Excessive Credit Creation and the Economy	316	Some Conclusions	352
The Fed's Role and the Carry Trade	317		
Did the Carry Trade Fuel the Market?	317	41. Realignment?	
The Making of a Storm	318	N 100 100 100 100 100 100 100 100 100 10	250
The Anatomy of a Crisis	318	A Government That Works?	355
References	319	Failure or Success, What Does the Data Say?	356
		Policy-Induced Moral Hazard and Substitution Effects	358
36. The Fed's Crisis Response		Multiplier Effects?	363 364
	221	The Politics of Special Interest Groups	304
The Greenspan Fed's Preemptive Strike	321	Class Warfare, the Politics of Redistribution, and the Slow	365
Two Wrongs Do Not Make a Right	322	Growth Trap	366
Some Money and Banking Mechanics	323	A Lasting Legacy?	367
Helicopter Ben's Crisis Response	323	Summary and Implications	36
Reference	325	References	50
37. Monetary Policy and the Interaction		42. Obamanomics: An Evaluation	
Between the Money and Credit Markets		W. D. 11 Ol. D. L. D. 111 12	369
beween the money and steam mande		Was President Obama Dealt a Bad Hand?	370
Money Market Disturbances, Uncertainty,		The Misery Index	37:
and the Demand for Cash	327	The Ranking of the Economic Performance	373
The Interaction Between Price Stability		Improvement Over the Initial Economic Conditions	373
and the Credit Markets	328	Transformational Change or Trickle up Economics Reference	376
Money Demand and Supply Shocks	329	Reference	3710
38. Is Central Banking an Art?		VI	
Low-Interest Rates and Keynesian Monetarism	333	CHINA—A CASE STUDY	
Yield: Documenting the Effects Induced			
by Low-Interest Rates	334		
What Does the Data Tell Us?	335	43. China in a Global Economy: An Interpretation	n
Keynesian Monetarism's Track Record	336	Weeding Out the Wrong Theories	379
Monetary Policy's Burden	336		31:
		The Possibilities Under a Floating Exchange	379
39. After the Deluge?		Rate System	380
		The Fixed Exchange Rate Scenarios Where Is China Today?	380
A Brief Description of the Problem and Economic		where is China Today:	300
Conditions as We Saw It	339	44. China's Wealth, Income, and the Savings	
The Monetary Base, Bank Credit, Money of Zero Maturity,	2.42		
and the Financial Crisis	340	Rate: The Complete Markets Case	
The Fed's Crisis Response	341	Wealth, Income, and the Savings Rate: The Incomplete	
The Monetary Aggregates After the Crisis	342	Markets Case	384
Inflation Rate, Interest Rates, the Slope of the Yield	242	Implications	384
Curve, and the Credit Spread	342	Appendix to Chapter 2: Consumption, Savings,	30
How Distorted Is the Fixed Income Market?	343	and Net Wealth	385
40. The Panic of 2008: Cause and Consequences		References	386
Bad Luck or Bad Policies	348	45. Examining China: Purchasing Power Parity,	
Lack of Regulation	348	Terms of Trade, and Real Exchange Rates	
Searching for Causes and Cures: The Carry Trade	348	Terms or Trade, and Near Exchange Nates	
Searching for Causes and Cures:	4, 1, 1, 1, 1, 1, 1, 1, 1, 1, 1, 1, 1, 1,	A Purchasing Power Parity World	38
The Government-Sponsored Enterprises	348	Nontraded Goods: A Violation of PPP?	388

Rates of Returns and Relative Price Differentials Across National Economies Purchasing Power Parity Versus the Terms of Trade Was China's Currency Overvalued?	388 389 390	48. Examining China: Monetary Policy, Inflation Potential, and the Organization of the Monetary System Under a Fixed Exchange Rate System	
46. Examining China: Economic Growth, Exchange Rates, and Relative		The RCC and NRCC Countries China's Monetary Policy and the Fixed-Rate Experience	401 402
Stock Performance		49. Examining China: China as a Nonreserve	
A Tale of Two Countries	393	Currency Country	
Are There More Than Two Tales?	394	The Fixed Exchange Rate Mechanism Link	
Which Tale is the Relevant One?	394	to the Domestic Money Supply	405
Can Currency Manipulation Affect the Trade Balance?	395	The Limits to the Central Bank's Money Creation Ability	406
What Do We Know	395	Domestic Credit Creation: Too Loose or Too Tight	406
		The Balance of Payments	406
47. Examining China: Monetary Policy, Inflation		Domestic Credit Creation and Hot Capital Flows	407
Potential, and the Organization of the Monetary		Grading China's Performance as a NRCC	408
System Under a Floating Exchange Rate System		Reference	410
China's Monetary Policy and the Floating Exchange Rate Experience	398	Index	411
The Central Bank Reaction to the Floating Exchange			
Rate Experience	399		