
Contents

1	Growth and International Trade: Introduction and Stylized Facts	1
1.1	Introduction and Motivation	1
1.2	Definition of Growth Magnitudes	3
1.2.1	Growth Rates of Products and Quotients	6
1.3	Kaldor's "Stylized Facts"	7
1.4	Kuznets' Facts	13
1.5	Internationalization Facts	14
1.5.1	World Trade Is Growing Faster Than World Output	17
1.5.2	Export and Import Ratios Increase Over Time	17
1.5.3	Two-Thirds of Foreign Trade Takes Place Between Developed Countries	18
1.5.4	Neighboring Countries Trade More With Each Other Than Countries That Are Further Apart	19
1.6	Globalization Facts	21
1.6.1	Foreign Direct Investment and Financial Investment	22
1.6.2	Asia Since the 1970s: "The" Dynamic Export Region	22
1.7	Summary and Conclusions	23
1.8	Exercises	25
	References	26

Part I Growth

2	Modeling the Growth of the World Economy: The Basic Overlapping Generations Model	29
2.1	Introduction and Motivation	29
2.2	The Set-Up of the Model Economy	30
2.3	The Macroeconomic Production Function and Its Per Capita Version	32
2.4	Structure of the Intertemporal Equilibrium	35
2.4.1	Intertemporal Utility Maximization of Younger Households	35
2.4.2	Old Households	39

2.4.3	A-Temporal Profit Maximization of Producers	39
2.4.4	Market Equilibrium in All Periods	40
2.5	The Fundamental Equation of Motion of the Intertemporal Equilibrium	41
2.6	Maximal Consumption and the “Golden Rule” of Capital Accumulation	44
2.7	Summary and Conclusion	46
2.8	Exercises	47
	Appendix	48
	References	52
3	Steady State, Factor Income, and Technological Progress	55
3.1	Introduction and Motivation	55
3.2	The GDP Growth Rate in Intertemporal Equilibrium and in Steady State	57
3.3	Existence and Stability of the Long-Run Growth Equilibrium	58
3.4	Efficiency of the Steady State	62
3.5	Comparative Dynamics in the Basic OLG Model	64
3.5.1	Increase in the Time Discount Factor	64
3.5.2	Reduction of the Population Growth Rate	66
3.5.3	Increase in the Rate of Technological Progress	66
3.6	Real Wage, Real Interest Rate and Income Shares	66
3.6.1	Income Distribution along the Equilibrium Growth Path	67
3.7	Technological Progress in Neoclassical Growth Theory	70
3.7.1	Hicks-Neutral Technological Progress	71
3.7.2	Harrod-Neutral Technological Progress	73
3.7.3	Solow-Neutral Technological Progress	74
3.7.4	Resumé	75
3.8	Growth Accounting	75
3.9	Summary and Conclusion	77
3.10	Exercises	79
	References	79
4	Economic Growth and Public Debt in the World Economy	81
4.1	Introduction and Motivation	81
4.2	European Debt Statistics	82
4.3	First-Order Conditions and Market Clearing	84
4.3.1	Market Equilibrium in All Periods	87
4.4	Intertemporal Equilibrium Dynamics	87
4.5	Existence and Stability of Steady States	90
4.5.1	Existence of a Long-Term Growth Equilibrium	90
4.5.2	Stability of the Steady States	93
4.5.3	Analytical Investigation of Dynamic Stability	96
4.6	Reducing Public Debt Under Dynamic Efficiency	100
4.7	Summary and Conclusions	106
4.8	Exercises	108
	References	108

5 “New” Growth Theory and Knowledge Externalities	
in Capital Accumulation	111
5.1 Introduction and Motivation	111
5.1.1 Empirical Shortcomings of the “Old” Growth Theory	111
5.1.2 Theoretical Shortcomings of the “Old” Growth Theory	113
5.1.3 Main Approaches of “New” Growth Theory	114
5.1.4 Aims of Explanation and Preview	116
5.2 Public-Good Characteristics of Knowledge Externalities	116
5.3 Knowledge Externalities in the Basic OLG Model	117
5.3.1 The Production Technology With Knowledge Externalities	118
5.3.2 Intertemporal Utility Maximization of Active Households	120
5.3.3 Profit Maximization of Firms	120
5.3.4 Market Clearing Conditions	121
5.3.5 Structure of the Inter-Temporal Equilibrium	121
5.4 The Shortcomings of the Old Growth Theory from the Perspective of Romer’s New Growth Model	124
5.5 Public Debt and Net Deficit in Romer’s New Growth Model	126
5.5.1 Government Budget Constraint, FOCs and Market Clearing	126
5.5.2 Intertemporal Equilibrium Dynamics	127
5.5.3 Existence and Dynamic Stability of Balanced Growth	128
5.6 Business Cycles and Endogenous Growth	130
5.7 Summary and Conclusion	132
5.8 Exercises	133
Appendix	133
References	135
6 Endogenous Technological Progress and Infinite Economic Growth	137
6.1 Introduction and Motivation	137
6.2 Monopolistic Competition and Product Innovation in Intertemporal Equilibrium	138
6.2.1 Production Technologies and Innovation	138
6.2.2 Choice Problems and Market Clearing Conditions	139
6.2.3 Structure of the Intertemporal Equilibrium	141
6.3 Unbounded Economic Growth and Increasing Growth Rates	145
6.4 One-Period Versus Long-Duration Patents	147
6.5 Summary and Conclusion	149
6.6 Exercises	150
References	150
7 Human Capital, Religion, and Economic Growth	151
7.1 Introduction and Motivation	151
7.2 Human Capital Formation in the Basic OLG Model	154
7.2.1 FOCs for Profit and Intertemporal Utility Maximization	155

7.2.2	Market Clearing Conditions	157
7.2.3	The Structure of Intertemporal Equilibrium	158
7.3	Intertemporal Equilibrium Dynamics and Steady State	158
7.3.1	Intertemporal Equilibrium Dynamics	159
7.3.2	Steady State	160
7.3.3	Predictions of the Basic Human Capital Model	161
7.4	An OLG Model of Religion and Human Capital Formation	162
7.4.1	The OLG Set-Up	162
7.4.2	Religious Participation and Children's Education	163
7.4.3	Religion as a Steady-State Phenomenon	165
7.5	Summary and Conclusion	165
7.6	Exercises	166
	References	167
8	Economic Growth With Bubbles	169
8.1	Introduction and Motivation	169
8.2	Stylized Bubble Facts	170
8.3	Bubbles in the Basic OLG Growth Model	175
8.3.1	Equilibrium with Bubbles and Without Financial Frictions	176
8.3.2	Equilibrium With Bubbles and Financial Frictions	179
8.3.3	Where Is the Market for Bubbles?	184
8.4	Summary	186
8.5	Exercises	187
	References	188

Part II International Trade

9	International Parity Conditions in a Two-Country OLG Model Under Free Trade	191
9.1	Introduction and Motivation	191
9.2	The General OLG Model of International Trade in Goods, Financial Assets and Money	192
9.3	Young Household's Choice and International Parity Conditions	193
9.3.1	Domestic and Foreign Households in the International Equilibrium	193
9.3.2	Choice-Based Consumer Price Indices ("Ideal" Deflators) and Real Consumption Expenditures	195
9.3.3	Purchasing Power Parity in Its Absolute and Relative Version	197
9.3.4	The Household's Choice Problem Using the Deflator and Real Consumption Expenditure	200
9.4	The Neoclassical Model of International Commodity Trade	203
9.4.1	Domestic and Foreign Producers in the Intertemporal World Market Equilibrium	203

9.4.2	Domestic and Foreign Households in the Intertemporal World Market Equilibrium	203
9.4.3	Terms of Trade (TOT) in the Neoclassical Basic Model	204
9.4.4	Market-Clearing Conditions and Current Account Balance	205
9.5	Summary	209
9.6	Exercises	210
	Mathematical Appendix	210
	References	213
10	Factor Proportion, Inter-Sectoral Trade, and Product Life Cycle	215
10.1	Introduction and Motivation	215
10.2	Production-Based Equilibrium Conditions in Autarky	216
10.3	Equalization of Factor Prices in the World Market Equilibrium	220
10.4	Factor Proportions of Inter-Industrial Trade in the World Market Equilibrium	223
10.5	The Leontief Paradox and the Neo-factor-proportion Theory	227
10.6	The “Product Life Cycle” and the Dynamics of Comparative Advantages	229
10.7	Summary	231
10.8	Exercises	232
	References	233
11	Product Differentiation, Decreasing Costs, and Intra-sectoral Trade	235
11.1	Introduction and Motivation	235
11.2	Linder’s Demand-Based Trade Theory	239
11.3	Monopolistic Competition and Product Differentiation in a Closed Economy	240
11.3.1	Utility Maximization of Households and the Demand for Differentiated Goods	241
11.3.2	Profit Maximization of Producers and Short-Term Equilibrium	244
11.3.3	The Long-Term Market Equilibrium	246
11.4	Intra-industry Trade under Monopolistic Competition	247
11.4.1	Price Elasticity of Demand Is Independent of the Number of Variants	248
11.4.2	Price Elasticity of Demand Depending on the Number of Variants	251
11.5	Summary	253
11.6	Exercises	254
	Mathematical Appendix	254
	References	256

12	Globalization, Capital Accumulation, and Terms of Trade	259
12.1	Introduction and Motivation	259
12.2	Causes and Consequences of the Globalization of Commodity Markets	261
12.3	Globalization of Commodity Markets: A Comparative-Static Analysis	262
12.4	Dynamics of the Region-Specific Capital Intensities and of the Terms of Trade	265
12.5	Globalization and Inequality Between Nations	269
12.6	Summary	275
12.7	Exercises	276
	References	276
13	Innovation, Growth and Trade in a Two-Country OLG Model	279
13.1	Introduction and Motivation	279
13.2	Intermediate Products in the Two-Country OLG Model	281
13.3	Agents' Choice Problems and Market-Clearing Conditions with Intra-sectoral Trade in Intermediates	281
13.4	Producers' First-Order Conditions	285
13.5	The Structure of Intermediate Product Prices and Quantities	287
13.6	Cost Minimization of Final Good Producers and the Prices of Final Goods in the Industry Equilibrium	289
13.7	The Growth Rate of Intermediate Product Innovations in the International Equilibrium Versus in Autarky	292
13.8	Integration, Efficiency and Economic Growth: Some Comments	295
13.9	Summary	297
13.10	Exercises	298
	References	298
14	Real Exchange Rate and Public Debt in a Two-Advanced-Country OLG Model	301
14.1	Introduction and Motivation	301
14.2	Literature Review and Preview	302
14.3	The Two-Good, Two-Country OLG Model	305
14.4	Intertemporal Equilibrium Dynamics and Existence of Steady States	309
14.5	Stability of Steady States and Steady-State Effects of Public Debt Shocks	314
14.6	Transitional Impacts of Shocks in Home's Sustainable Public Debt	317
14.7	Summary and Conclusions	321
14.8	Exercises	323
	Mathematical Appendix	324
	References	330

15	Public Debt Reduction in Advanced Countries and Its Impacts on Emerging Countries	333
15.1	Introduction and Motivation	333
15.2	Literature Review	334
15.3	Firm FOCs and Intertemporal Equilibrium in a Two-Country OLG Model with Unequal Technologies	336
15.4	Existence, Dynamic Stability and Comparative Statics of Steady States	337
15.5	Steady State Welfare Effects of a Unilateral Reduction of Public Debt in Home	343
15.5.1	Steady-State Welfare Effects of Unilateral Debt Reduction in Home	344
15.5.2	Numerical Illustrations of Welfare Effects for the Leading US-China Case	348
15.6	Summary and Conclusions	350
15.7	Exercises	352
	Mathematical Appendix	353
	References	359
16	External Balance, Dynamic Efficiency and Welfare Effects of National Climate Policies	361
16.1	Introduction and Motivation	361
16.2	Literature Review and Preview	362
16.3	The Two-Good, Two-Country OLG Model with Nationally Tradable Emission Permits	364
16.3.1	Firms	364
16.3.2	Households and Governments	366
16.3.3	Market Clearing and International Trade	368
16.4	The Steady State and Unilateral Permit Policy	369
16.4.1	Intertemporal Equilibrium Dynamics	369
16.4.2	Characterization of Steady States	370
16.4.3	Steady State Effects of Unilateral Permit Policies	371
16.5	The Steady-State Welfare Effects of Different Permit Policies	373
16.5.1	Derivation of Welfare Effects	373
16.5.2	Comparison of Global Welfare Effects of Unilateral Permit Policies in Home and in Foreign	376
16.5.3	Comparison of Welfare Effects of a Unilateral Domestic and a Multilateral Permit Policy	377
16.5.4	Comparison of Welfare Effects of a Unilateral Foreign and a Multilateral Permit Policy	378
16.6	Summary and Conclusions	379
16.7	Exercises	381
	Mathematical Appendix	381
	References	389

17	Nationally and Internationally Optimal Climate Policies	391
17.1	Introduction and Literature Review	391
17.2	Internationally Differing Environmental Preferences in the Basic Model	394
17.3	Nationally Optimal Permit Levels	396
17.4	Internationally Optimal Permit Policies	400
17.5	Summary and Conclusion	407
17.6	Exercises	408
	Appendix	408
	References	410
18	Modeling the Debt Mechanics of the Euro Zone	413
18.1	Introduction and Motivation	413
18.2	Stylized Macroeconomic Facts: Financial Autarky Versus EMU	414
18.3	The Basic Model	418
18.3.1	Financial Autarky	420
18.3.2	International Equilibrium Under Financial Integration	423
18.3.3	Financially Integrated Versus Financially Autarkic Steady State	427
18.4	Beyond the Basic Model: From Debt Mechanics Towards Debt Trap for South	429
18.5	Conclusion	434
18.6	Exercises	435
	References	435
	Index	437