The Economics of International Transfers

Since the famous debate between Keynes and Ohlin on German reparation payments after World War I, international transfers have attracted the attention of economists. Today the subject is of even greater importance with billions of dollars flowing between nations as unilateral transfers. However, the emphasis has shifted from balance-of-payments issues to the welfare consequences following a transfer, and in particular the welfare issues arising from aid to developing countries. In *The Economics of International Transfers* Professors Brakman and Van Marrewijk present a complete overview of transfers (including the history of transfers and current transfer flows), and their own unified framework in which they describe important and original research. Subjects considered include welfare effects, distortions, third parties, rent-seeking, the "trade or aid" discussion, multilateral agencies, tied aid and imperfect competition.

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More information

Contents

	List of figures	*page* vi
	List of tables	vii
	Preface	ix
1	General overview and stylized facts	1
2	The Keynes–Ohlin controversy	22
3	Welfare effects: Samuelson's theorem	32
4	Generalizations of Samuelson's theorem	54
5	Clouds on the horizon 1: distortions	71
6	Clouds on the horizon 2: third parties	96
7	The economics of multilateral transfers	119
8	The consequences of tied aid	133
9	Imperfect competition	152
10	Dynamics, money and the balance of payments	174
	Mathematical appendix	189
	References	208
	Index	216

Figures

2.1	Keynes and Ohlin compared	*page* 28
3.1	Leontief's example of a transfer paradox	35
3.2	Transfers and a change in numéraire	45
3.3	Market stability and the offer curve	50
6.1	Gale's example of a transfer paradox	98
8.1	Forced choice	148
9.1	Aid tied to food	162
9.2	Aid tied to manufactures in general	165
10.1	Neoclassical growth model	181
10.2	Neoclassical growth model and transfers	183
A.1	Special cases of the utility function	200

Tables

1.1	Net unilateral transfers	*page* 3
1.2	Britain's foreign trade 1796–1816, compared with unilateral foreign payments	7
1.3	French foreign trade 1872–5, compared with indemnity payments	12
1.4	German reparations payments 1925–32	14
1.5	German foreign trade 1925–32, compared with reparations payments	14
1.6	Eastern Germany relative to western Germany, and transfers	16
1.7	Historical examples of transfers	17
1.8	Ten largest donors of net official development assistance	19
1.9	Total net development assistance from DAC countries, including multilateral organizations	20
1.10	Payments in the European Union 1996	21
2.1	Production and consumption patterns	29
5.1	Sector-specific capital	82
5.2	Mobile capital	82
8.1	Tying of bilateral ODA by DAC members	134

Preface

Few economic problems have attracted as much of the attention of the world's leading economists and stirred up such lively debates between them as the transfer problem. Classical writers such as David Ricardo, David Hume and others, had heated debates with contemporaries on the consequences of balance-of-payments disequilibria (a temporary transfer). The most famous debate, however, was the discussion between John Maynard Keynes and Bertil Ohlin, which led to the first systematic treatment of the consequences of transfers as such. This debate was also primarily directed at the causes and consequences of possible balance-of-payments disequilibria. The early attention on balance-of-payments problems following a transfer is somewhat in contrast with today's interest in the transfer problem, which is mostly concerned with welfare effects. For example, the welfare effects associated with development assistance have been considered by Jan Tinbergen (1976), who regards development aid from the North to the South as a means of obtaining greater equality between nations. Moreover, he is convinced that development aid is necessary to increase welfare levels in the developing world. Needless to say, there is no general agreement between economists on the influence of development aid on welfare. Nor is there agreement on whether or not development assistance is necessary in the first place in order to put a country on a more rapid path to development. There are not only disagreements and discussions on the practical consequences of transfers, but also disagreements between modern theorists on the effects of transfers and how to model them. This is illustrated, for example, in the sometimes heated debate involving Graciela Chichilnisky, Jagdish Bhagwati and T. N. Srinivasan, Jan Willem Gunning and others.

Most textbooks on international trade theory contain a section on the transfer problem. It is often used to illustrate the fact that income adjustments in international economic relations are very important, or that terms-of-trade adjustments are only part of the adjustment process.

Furthermore, the transfer problem can easily be analyzed in Keynesian-type models, such as the Mundell–Fleming model. Textbooks use the 1929 debate between Keynes and Ohlin only to illustrate differences between the two main channels of adjustment: price adjustments and income adjustments. To summarize, however, this approach to the transfer problem, by simply restating the famous debate between Keynes and Ohlin in a "Keynesian" framework, ignores the fact that since the 1980s the literature on international transfers and international trade theory has witnessed a minor revolution. Not only have the analytical tools to analyze transfer problems changed, but the issues themselves have also changed.

Duality theory is a very powerful tool in reformulating various topics of importance in the literature on economic development and international economic theory. Most importantly, using duality theory it is possible to analyze the welfare consequences of various phenomena and economic policies in a systematic way. This enables us to make explicit welfare comparisons. The general equilibrium nature of duality theory also makes it very clear that the traditional partial equilibrium insights on the transfer problem can be misleading.

The "new" trade theory stresses the fact that the world is also characterized by increasing returns to scale and imperfect competition. It is by now well known that these developments in international trade theory imply that some of the traditional problems have to be reanalyzed. This also holds, as we will show, for the transfer problem. Economic welfare and economic development can be influenced in many ways; for example, by economic distortions, the wasting of valuable resources, rent-seeking, etc. The main focus of this book is how these aspects influence the welfare effects of transfers.

We do not expect the reader to have a thorough knowledge of international trade theory, but some knowledge of the basic results in international economics is recommended. Moreover, we expect the reader to know intermediate microeconomics, since we will frequently use microeconomics to explain our results. A short refresher course on the most important concepts is offered in the mathematical appendix. This appendix is also useful for becoming acquainted with our notation.

The plan of the book is as follows. Chapter 1 gives a brief overview of the history of the transfer problem and some information on transfer flows. It highlights the fact that it was traditionally considered to be a problem of balance-of-payments adjustments. Chapter 2 summarizes the debate on German war reparations payments between Keynes and Ohlin in 1929. It is important from an historical point of view, as the disagreement between Keynes and Ohlin paved the way for a systematic treatment of the transfer problem. One could argue that the modern literature on transfers takes this debate as a starting point. Chapter 3 presents the core material of this book. It not only illustrates that the transfer problem is not a problem in the Keynesian sense, but also introduces the main analytical tools of this book. Most chapters are relatively self-contained, but we advise the reader always to read chapter 3 before reading any of the other analytical chapters, because the conclusions serve as a benchmark for the results developed in other chapters. Chapter 4 generalizes the findings of chapter 3. The conclusions of chapters 3 and 4 change, in general, if distortions, such as tariffs or rent-seeking, are present. These are analyzed in chapter 5. In chapter 6 it is shown that, rather surprisingly and for reasons that may not be intuitively obvious, transfer paradoxes are possible in a perfectly competitive Walrasian-stable world if a third country (the bystander) is introduced. Chapters 7 and 8 generalize the results of the earlier chapters in a number of ways. Does it matter, for instance, if aid is given by multilateral agencies? Or does it matter that, in practice, aid is often given as tied aid? Note, that chapters 3 to 5 analyze a two-country world, whereas chapters 6 to 8 analyze a three (or more)-country world. Chapter 9 analyzes imperfect competition and economies of scale, alone and in combination with tied aid. It is shown that welfare is not only influenced by income and price effects, but also by a "love-of-variety" effect. Furthermore, and most importantly, it is shown that profits are possible in this context, even in equilibrium, if aid is tied to a specific sector or commodity. Finally, transfers are frequently given to alleviate balance-of-payments disequilibria (often by means of foreign exchange). In fact, this is a basic task of the International Monetary Fund. Moreover, aid is given to put developing countries on a higher path of development. Both issues require that a dynamic framework be introduced to analyze the consequences of aid. This is done in chapter 10.

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