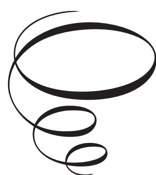
Advances on International Economics

Advances on International Economics

Edited by

Carmen Díaz-Roldán and Javier Perote

Cambridge Scholars Publishing



Advances on International Economics

Edited by Carmen Díaz-Roldán and Javier Perote

This book first published 2015

Cambridge Scholars Publishing

Lady Stephenson Library, Newcastle upon Tyne, NE6 2PA, UK

British Library Cataloguing in Publication Data
A catalogue record for this book is available from the British Library

Copyright © 2015 by Carmen Díaz-Roldán, Javier Perote
and contributors

All rights for this book reserved. No part of this book may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior permission of the copyright owner.

ISBN (10): 1-4438-7828-6
ISBN (13): 978-1-4438-7828-9

CONTENTS

List of Tables ... xi

List of Figures ... xiii

Part I: Introduction

Chapter One ... 3
Recent Developments on International Economics
Carmen Díaz-Roldán and Javier Perote
1.1. Introduction
1.2. Modelling International Economics
1.3. International Trade
1.4. Macroeconomic Aspects of International Trade and Finance
1.5. International Factor Movements and International Business

Part II: Modelling International Economics

Chapter Two ... 21
Recent Episodes on a Globalized Economy: An Historical Approach
Nieves Carmona-González
2.1. Introduction
2.2. Globalization of the Economy in an Historical Perspective
2.3. Globalization: The Result of Integration and Internationalization Processes
2.4. Economic Integration as the Engine of Globalization: Some Examples
2.5. Economic Crises: Lessons from the Past
2.6. Conclusions

Chapter Three ... 39
Monetary Unions under Financial Shocks: Do Fiscal Rules Matter?
Carmen Díaz-Roldán and Alberto Montero
3.1. Introduction
3.2. The Fiscal Rules in Monetary Unions
3.3. The Macroeconomic Model

3.4. The Costs and Benefits of Following a Fiscal Rule
3.5. Summary and Conclusions

Chapter Four 63
A Generalized NEG Wage-Type Equation
Fernando Bruna
4.1. Introduction
4.2. The Demand Side of the NEG Basic Model
4.3. Supply Side and Generalized Wage-Type Equation
4.4. Inclusion of Human and Physical Capital
4.5. Conclusions

Chapter Five 83
The Stationarity of the Inflation in Latin-American Countries Reviewed when Additive Outliers are Detected
Dionisio Ramírez-Carrera and Gabriel Rodríguez
5.1. Introduction
5.2. The Issue of Outlier Detection and Testing for Unit Roots with Additive Outliers
5.3. Monte Carlo Results
5.4. Empirical Application
5.5. Conclusions

Part III: International Trade

Chapter Six 117
The Effectiveness of Development Aid in Promoting Economic Growth
Laura Gómez-Wingley
6.1. Introduction
6.2. Theoretical Background and Current Situation
6.3. Methodology
6.4. Results
6.5. Conclusions

Chapter Seven.. 139
Offshoring and Productivity from a Time-Series Perspective
Pablo Agnese
7.1. Introduction
7.2. A Simple Model
7.3. Empirical Analysis
7.4. Effects on Labor Productivity
7.5. Final Remarks

Chapter Eight 159
Sectorial Differences in Export Performance: The Role of the Decision-Maker's Gender
Helena Marques
8.1. Introduction
8.2. Explaining Differences in Export Propensity and Intensity
8.3. What Can be Learned from Worldwide Data
8.4. Gender Effects across Sectors and Firm Sizes
8.5. Conclusions

Chapter Nine 183
Tariff Reform and Reduction of Regulatory Barriers: An Analysis for Female and Male Workers
María C. Latorre
9.1. Introduction
9.2. Data on Gender and Tanzanian Economic Structure
9.3. The Model
9.4. Results
9.5. Conclusions

Part IV: Macroeconomic aspects of International Trade and Finance

Chapter Ten 209
Detecting *De Facto* Exchange Rate Regimes
María del Carmen Ramos-Herrera and Simón Sosvilla
10.1. Introduction
10.2. *De Iure* and *De Facto* Exchange Rate Regimes Classifications
10.3. Implicit Fluctuation Bands
10.4. Credibility Tests of Fluctuation Bands
10.5. Concluding Remarks

Chapter Eleven 225
How Do International Economic Conditions Affect Household Economic Expectations? An Analysis for the Peripheral Countries
Cristina Vilaplana Prieto
11.1. Introduction
11.2. Econometric Model
11.3. Data and Descriptive Statistics
11.4. Results
11.5. Conclusions

Chapter Twelve 247
Assessing the Evolution of Economic Integration in Latin America:
Is Mercosur *passé*?
Alejandro Jacobo and Ileana Jalile
12.1. Introduction
12.2. On MERCOSUR Trade Dynamism
12.3. Disentangling the Determinants of Tariff AD Barriers in MERCOSUR
12.4. Concluding Comments

Chapter Thirteen 271
Normative *vs*. Positive Fiscal Policies: An International Analysis on Their Contribution to Economic Growth
Fernando Callejas, Isabel Martínez and Miguel A. Tarancón
13.1. Positive Economics *versus* Normative Economics
13.2. Importance of Fiscal Policy to the Economy of a Country and Its Impact on Economic Growth
13.3. Procyclical Fiscal Policy
13.4. Analysis of the Implementation of Fiscal Policies in the Economies of Different Geographical Areas

Part V: International Factor Movements and International Business

Chapter Fourteen 299
Financial Market Risk Before and After the Subprime Crisis
Isabel A. Palomero, Javier Perote and Andrés Mora-Valencia
14.1. Introduction
14.2. Empirical Characteristics of Financial Time Series
14.3. Non-Normality and the Frequency of Log-Returns
14.4. Estimating Value-at-Risk of Financial Series
14.5. Value-at-Risk in Highly Volatile Scenarios
14.6. Conclusions

Chapter Fifteen 321
Financialization of the Economy and Changes in Industrial Relations
Santos Ruesga and Manuel Trujillo
15.1. Introduction: The Beginning of Financial Globalization
15.2. The Concept of Financialization
15.3. The Effect of Financialization on the Labour Market
15.4. Empirical Evidences
15.5. Summary and Conclusions

Chapter Sixteen 343
The China Effect on Foreign Reinvestment in Asia
Salvador Gil-Pareja, Rafael Llorca and Jordi Paniagua
16.1. Introduction
16.2. Background
16.3. Empirical Methodology and Data
16.4. Results and Discussion
16.5. Conclusions

LIST OF TABLES

Table 3-1: Government Deficit (-)/Surplus (+) and Debt in the EU-27 (% of GDP)
Table 3-2: Losses after a Common Contractive Demand Shock
Table 4-1: The Generalized Wage Equation in Several NEG Models
Table 5-1: Size of the ADF Test: ARFIMA (0, d, 0) Errors
Table 5-2: Size of the ADF Test: ARFIMA (0, d, 1)
Table 5-3: Size of the ADF Test: ARFIMA (1, d, 0)
Table 5-4: Size of the ADF Test: ARFIMA (0, d, 0)
Table 5-5: Size of the ADF Test: ARFIMA (0, d, 1)
Table 5-6: Size of the ADF Test: ARFIMA (1, d, 0)
Table 5-7: Standard and New Unit root Tests
Table 5-8: ADF Test corrected for Additive Outliers using τ_d
Table 6-1: Description of the Variables and Data Sources
Table 6-2: Models for Testing the Impact of ODA on Economic Growth
Table 7-1: Labor Productivity Growth Rate, Broad Sector Averages (%)
Table 7-2: Summary Statistics, 1976-2008
Table 7-3: Two Equation Models for Different Industries
Table 7-4: Offshoring Contribution to Productivity
Table 8-1: Survey Countries and Sectors
Table 8-2: Description of Variables
Table 8-3: Mean Differences by Top Manager and Sole Owner Gender
Table 8-4: Gender, Exporting and Firm Size by Sector (Sample %)
Table 8-5: Export Propensity by Sectors
Table 8-6: Export Intensity by Sectors
Table 8-7: Summary of Gender Effects
Table 9-1: Factors' Remuneration with Respect to Total Value Added in the New and Previous Datasets (in percentage)
Table 9-2: Tariff Levels, Market Shares and Regulatory Barriers (in Percentage)
Table 9-3: Aggregate Results (% Change from Initial Equilibrium)
Table 9-4: Production (Percentage Change from Initial Equilibrium)
Table 9-5: Factor Remunerations (Percentage Change from Initial Equilibrium)
Table 9-6: Sectoral Composition of Factors' Remunerations Across Main Sectoral Classifications (in Percentage)

Table 9-7: Factor Intensities Across Sectors (in Percentage)
Table 9-8: Sensitivity Analysis
Table 11-1: Description of the Special Eurobarometer Surveys Used
Table 11-2. Descriptive Statistics for Macroeconomic Variables
Table 11-3: Estimation of the Bivariate Ordered Model with and without Mixed Effects
Table 11-4: Predicted Probabilities from the Bivariate Ordered Model with Mixed Effects
Table 11-5: Simulation of the Effect over Expectations as a Consequence of a Change in Macroeconomic Conditions
Table 12-1: Applied Bilateral Tariffs Baseline Model
Table 12-2: Bilateral Tariff Baseline Model Before/After 2009
Table 12-3: Bilateral Tariff Baseline Model with Product Fixed Effect
Table 12-4: Antidumping Initiations Incidence Before/After 2009
Table 12-5: Antidumping Initiations Incidence Model: Fixed Effects
Table 13-1: Summary of Contributions Concerning the Impact of Fiscal Policy on Economic Growth
Table 13-2: Germany. Positive Economic – Normative Economic Adjust
Table 13-3: France. Positive Economic – Normative Economic Adjust
Table 13-4: Italy. Positive Economic – Normative Economic Adjust
Table 13-5: Spain. Positive Economic – Normative Economic Adjust
Table 13-6: European Union. Positive Economic – Normative Economic Adjust
Table 13-7: United Kingdom. Positive Economic – Normative Economic Adjust
Table 13-8: Japan. Positive Economic – Normative Economic Adjust
Table 13-9: Brasil. Positive Economic – Normative Economic Adjust
Table 13-10: Relationship 2002-2012
Table 14-1: Log-Likelihood of ARMA-GARCH Models
Table 14-2: Fitted Density Parameters for the IBEX35
Table 14-3: Descriptive Statistics for Log-Returns of Different Indices
Table 14-4: AR(1)-GARCH(1,1) Estimates in the Pre-Crisis Period
Table 14-5: AR(1)-GARCH(1,1) Estimates in the Crisis Period
Table 15-1: Empirical Outcomes
Table 16-1: World's Largest Companies
Table 16-1: Main contributions on the China Effect
Table 16-2: Variable Description
Table 16-3: List of Countries
Table 16-4: Results

LIST OF FIGURES

Figure 5-1: Quarterly Latin-American Inflation Series
Figure 7-1: Labor Productivity Growth Rate, Broad Sector Averages (%)
Figure 7-2. Offshoring intensity and IT-Manufacturing (%)
Figure 7-3: Semiconductors: Offshoring Contribution to Productivity
Figure 7-4: Electronic Parts: Offshoring Contribution to Productivity
Figure 7-5: Industry Machinery: Offshoring Contribution to Productivity
Figure 7-6: Electronic Equipment: Offshoring Contribution to Productivity
Figure 11-1: Household Expectations (EH) and General Economic Expectations (EE) Differences and Real GDP Growth Rate
Figure 11-2: Difference between Optimistic and Pessimistic Household Expectations (EH) and General Economic Expectations (EE) and GDP Growth Rate
Figure 11-3: Effect of General Economic Expectations over Household Expectations
Figure 12-1: Trade Openness: MERCOSUR Countries 1991-2011
Figure 12-2: Growth Rates of TO and GDP: Argentina 1991-2011
Figure 12-3: Growth Rates of TO and GDP: Brazil 1991-2011
Figure 12-4: Growth Rates of TO and GDP: Uruguay 1991-2011
Figure 12-5: Growth Rates of TO and GDP: Uruguay 1991-2011
Figure 12-6: Intraregional Trade Index for MERCOSUR 1994-2009
Figure 12-7: Herfindahl-Hirschmann Index: MERCOSUR 1991-2012
Figure 13-1: Positive Economics *versus* Normative Economics
Figure 13-2. Fiscal Policy Behavior: Procyclical and Countercyclical
Figure 13-3: Germany. Evolution GDP. PE and Tx
Figure 13-4: France. Evolution GDP. PE and Tx
Figure 13-5: Italy. Evolution GDP. PE and Tx
Figure 13-6: Spain. Evolution GDP. PE and Tx
Figure 13-7: European Union. Evolution GDP. PE and Tx
Figure 13-8: United Kingdom. Evolution GDP. PE and Tx
Figure 13-9: Japan. Evolution GDP. PE and Tx
Figure 13-10: Brazil. Evolution GDP. PE and Tx
Figure 14-1: Daily Log-Returns of IBEX35 and Dow Jones Indices
Figure 14-2: Level and Log-Return of the IBEX35
Figure 14-3: Histogram and Descriptive Statistics of the Log-Return of IBEX35 and Dow Jones Indices

Figure 14-4: QQ-Plots for the Daily Log-Return of IBEX35 under Normal and Student's t Distributions
Figure 14-5: QQ-Plot for the Monthly Log-Return of IBEX35 under the Normal Distribution
Figure 14-6: Histogram and Descriptive Statistics of the Monthly Log Returns of the IBEX35 Index
Figure 14-7: Log-Returns and 95% VaR for the IBEX35 under the Normal and Student's t
Figure 14-8: Log-Returns and 99% VaR for the IBEX35 under the Normal and Student's t
Figure 14-9: Histogram and Normal and Student's t Fitted Densities of the Standardized IBEX35 (Left Tails)
Figure 15-1: Relationship Between the Variation of Financialization Rate* and the Variation of the Unemployment Rate for 22 OECD Countries for the Period 1995 – 2007
Figure 15-2: Relationship Between the Variation of Financialization Rate* and the Variation of the Employment Compensation in Percentage of Value Added for 20 OECD Countries for the Period 1995 – 2007
Figure 16-1: GDP Distribution in 1950, 1973, 2001 and 2010
Figure 16-2: World's FDI Share
Figure 16-3: FDI in Asia
Figure 16-4: FDI in South America
Figure 16-5: FDI in Southern and Eastern Europe

PART I:

INTRODUCTION

CHAPTER ONE

RECENT DEVELOPMENTS ON INTERNATIONAL ECONOMICS

CARMEN DÍAZ-ROLDÁN* AND JAVIER PEROTE

The goal of this chapter is to offer a broad overview of the recent developments on International Economics, both in the theoretical and empirical areas. The recent financial and economic crisis raised questions concerning the usefulness of several paradigms accepted by both academia and the advising government institutions. In such a framework, new theories and practical lessons stemming from empirical analyses are revealed as useful tools for international policy recommendations.

1.1. Introduction

In a globalized world characterized by huge international capital mobility, interest in International Economics has been renewed in academic circles as well as in economic policy forums and supranational institutions.

On one hand, capital markets have reached a remarkable development, due to increasing financial innovations and the widespread liberalization of capital movement. As a consequence, the evolution of the exchange rate has come to depend more and more on the movement of capital instead of on the international trade of goods. This greater reliance on capital movements is reflected in the high volatility of the values reached by the exchange rates.

On the other hand, the integration process evolution is quite complex and, indeed, different worldwide. Examples provided by Latin-American

* Corresponding author: Carmen Díaz-Roldán. Facultad de Derecho y Ciencias Sociales. Universidad de Castilla-La Mancha. 13071 Ciudad Real (Spain). Tel: +34-926-295300 Ext. 6657. E-mail: carmen.diazroldan@uclm.es.

countries contrast with the European case of the monetary union based on a new currency, namely the euro. Integration processes are intended to increase the flow of international trade and investment and, through a more efficient use of resources, a favourable result in the evolution of productivity and economic growth. As was the case for the credibility of anti-inflationary policy, the elimination of transaction costs and exchange rate uncertainty would be achieved much more clearly in a monetary union than in a system of fixed exchange rates. But the recent financial and economic crisis has cast doubt on the success of monetary unions, given the lack of independent monetary and exchange rate policies.

With those considerations in mind, in this book we provide some contributions with the intention of explaining the most recent developments in International Economics.

1.2. Modelling International Economics

Developed economies are interrelated in international markets through the interchange of goods and services, and the mobility flows of capital and labour. It is well known that the increasing vulnerability of open economies depends on the degree of openness of the country, as well as on its size.

The literature on International Trade and Economic Integration states that an open and large economy generates externalities on the outside world. Those characteristics are precisely the ones which define globalization, and the transmission and the effects of externalities depend crucially on the particular economic framework of the involved countries. Questions such as the exchange rate and the monetary regimes, the development of the financial system, and the role played by institutions, are not trivial.

After the Second World War, the international economic order envisioned by the Bretton Woods Treaty gave way to the neo-liberal economic order that remains prevalent today, promoting advancement towards a close global economy. This phase was consolidated at the end of the 20th century thanks to the gradually growing influence of the General Agreement on Tariffs and Trade (GATT), the growing presence, at the global level, of international companies that work as integrated production systems, the expansion of high capital mobility and a noticeable tendency towards the homogeneity of the models of development.

The Keynesianism that had led the economic policies of the 20th century focused on the prominent role of the public sector. The oil crisis of the 70's, however, questioned not only Keynesian models but also the

usefulness of economic policies in general. Nowadays, in the 21st century, the recent problems generated by the economic and financial crisis have triggered a debate on the role of economic policies. The question is to what extent a specific monetary policy regime would impose a restriction on policymakers; in particular, the cost of losing independence in the use of exchange rates and monetary policy, and the restrictions derived from the fiscal discipline required for supporting monetary agreements.

As an example, we can think about the expected success of the European Economic and Monetary Union (EMU), which relates to the benefits of the single currency, the higher degree of integration of financial markets, and also to the sound public finances guaranteed by the set of fiscal rules provided by the EMU. When signing the Stability and Growth Pact (SGP), Member States committed themselves to reaching a medium-term budgetary position close to balance. The Maastricht Treaty mainly stresses that every Member State of the EMU should avoid excessive deficits, and the reference values for deficit-to-GDP and debt-to-GDP ratios have in fact worked as an explicit fiscal rule. But, in practice, the policy orientation of the SGP has not been fully satisfied. This has opened a debate about the utility and effectiveness of fiscal rules within the EMU, and on their complementarities with discretionary fiscal policy measures and automatic stabilisers to deal with short-run fluctuations. For these reasons, it is useful to investigate how to deal with monetary (financial) shocks in a monetary union following fiscal rules. The particular interest here is in discovering interactions among those member countries showing a relatively high level of public debt, and those that seem to follow a more strict fiscal discipline.

In this book, **Chapters 2 and 3** are devoted to the analysis of the extent to which the recent episodes affecting the global economy can be explained by International Economics theories and models, paying special attention to the particular macroeconomic framework of monetary unions.

As addressed by Krugman (1998), there is a new approach for studying International Economics and International Trade. This new approach, the so called New Economic Geography (NEG), emerges from the study of geography itself and brings together disciplines such as urban, environmental, ethnic and gender economics, as well as location, distribution and the spatial organization of economic activities (see Krugman (1991), Krugman and Venables (1995) as seminal contributions). The theoretical bases rely on the same exploited by the "New Trade" and "New Growth" theories, i.e., general equilibrium models that derive aggregate behaviour from individual maximization. Stemming from economic growth, some NEG models try to explain the long-term growth of labour productivity

endogenously. These models incorporate the role of externalities associated with the accumulation of capital and technological innovation in the context of imperfect competition.

Some of these models show identification problems due to two types of observational equivalence; the *between-equivalence*, which appears when comparing the implications of NEG models with those of alternative models, mainly based on technological externalities; and the *within-equivalence*, produced using the implications of NEG models based on vertical linkages among firms, along with those of NEG models based on factor mobility, are compared.

In **Chapter 4,** an analysis of the observational equivalence of NEG theory is offered. In spite of the apparent empirical success of the NEG wage equation, some authors have asserted its observational equivalence, i.e., the consistency of those results with alternative frameworks, such as Urban Economics theories. However, few efforts have been made to empirically test this equivalence, with one reason possibly stemming from the lack of a commonly accepted approach for doing so.

New empirical approaches propose a procedure for showing that many empirical wage equations are actually proxying an underlying production function, augmented with locational information about the economic scale of the nearest neighbour(s). The method begins by presenting a NEG setting with capital stock, which encompasses several wage equations found in the literature. A baseline wage-type equation is then estimated by redefining the key variables of the model in several ways which are different from those that are commonly considered by the NEG empirical literature. The findings are similar to those of a standard NEG wage equation, which is the essence of the observational equivalence of NEG theory.

Finally, in **Chapter 5,** a key question for macroeconomic modelling is addressed. The proper inference of statistical parameters proves to be crucial for the forecast of the evolution of macro variables, and according to the Lucas critique, changes to the values of the parameters have serious implications for the design and implementation of economic policies. In an environment of growing economic interdependence and financial turmoil, the behaviour of the series of inflation is not a trivial question. Therefore, a new branch of econometric techniques is devoted to the analysis of the quarterly behaviour of macro variable series.

1.3. International Trade

Traditionally, classical theories of International Trade are designed to answer two basic and closely related questions: What are the causes of trade? Why do countries trade? In addition, questions also include: How would countries import and export products in different industries? And what are the effects of international trade on domestic production and consumption? But, during the second half of the 20th century, the lines of research have been widened, focusing on questions such as the role played by the external aid that is provided by benefactor countries to developing ones, relocation phenomena, or the sectorial differences produced by the results of expenditure on research and development, and expenditure on human capital. The reason behind the amplification of these fields of study relies on the new ways of examining the performance of international relationships, and the factors contributing to economic growth favoured by the development of new technologies.

Among the observed stylized facts of the last decades, the Official Development Assistance (ODA) flows have increased considerably. Consequently, a new branch of the literature has been devoted to the study of the impact of ODA on economic growth and the characteristics of recipient countries and donors' management practices, which influence its effects. **Chapter 6** analyzes new models, studying the impact of international aid on economic growth and welfare relative to the characteristics of recipient countries and donors' management practices. These new growth theories and studies take into account the endogeneity of aid and other variables as well as time and individual fixed effects. Results confirm the effectiveness of foreign aid in promoting economic growth, though it presents diminishing marginal returns. Furthermore, its effectiveness decreases if the country has recently been involved in armed conflicts, which probably reflects the lower quality of the institutions in such situations. On the other hand, aid fragmentation is found to have a positive effect on growth. In conclusion, aid has proved to be effective in encouraging economic growth, though there needs to be further consideration of aid heterogeneity and its impact on other aspects of development.

As a complement to foreign aid, and with regard to relocation phenomena, the process of globalization stimulates the availability of resources; foreign direct investment, and the outsourcing and offshoring methods of relocation; greater economic integration; and even the development of stronger social cohesion. In most of the cases, the increase in trade appears to be the result of offshoring, with manufacturing

becoming fragmented across borders because firms benefit from comparative cost advantages, the underlying economic logic being the reduction in cost. Through the relocation of economic activities, there is a transfer of jobs to other countries, if services are contracted with foreign companies or establish a base in sites outside the country of origin. Traditionally, relocation from one country to another was based on the production process (manufacturing or even accounting). But nowadays, it is also related to the supply of technical and administrative services.

In particular, the increase of offshoring – or, in other words, the relocation of some processes – of the production of a firm has not yet received the attention it deserves. Of equal importance to the first goal of reducing costs, there are several consequences of offshoring that are changing the traditional patterns of production. One of the most important is related to the reduction of the cost of labour units and its implications for productivity and employment. Within the study of the subject of offshoring and productivity, **Chapter** 7 proposes a simple framework for estimating the contribution of offshoring strategies to the growth rate of labour productivity from a time series perspective. This framework is useful to assess the impact of offshoring on skill upgrading and the labour share. Both empirical questions are quite relevant and need to be answered, especially considering the recent years of slow growth. The results would suggest that offshoring can improve labour productivity in industry. Moreover, offshoring is found to be the source of important changes among industries with different skills (skill upgrading) and an important factor behind the fall of the labour share.

As stated before, the classical theory of International Trade explains inter-industrial trade; that is, how countries import and export products in different industries. However, the classical theory does not take into account intra-industry trade, which occurs when a country exports and imports products which belong to the same sector or industry, and it also does not consider the weight of multinationals. On the contrary, the new theories on International Trade incorporate intra-industry trade, trade between similar countries, economies of scale and product differentiation, and also the role played by firm heterogeneity in the overall performance of International Trade.

The literature on heterogeneous firms states that when there are fixed costs of exporting, only the most productive firms export (extensive margin) and the export intensity (intensive margin) changes with the variable costs of exporting for those firms. On the other hand, the literature on gender, entrepreneurship and firm performance has found that women are less likely to become entrepreneurs, and, after having entered the

market, firms where one of the owners is a woman show a weaker performance (measured, among other variables and also by productivity).

Related to that, the new theories of endogenous growth have emphasized the role of externalities derived from the accumulation of capital. Endogenous growth models have assumed that knowledge spill-overs come from expenditure on research and development, and from expenditure on education and the training of workers, what is known as human capital. Summing up, it seems that women used to be less skilled workers than men, and putting together the contributions from both strands of literature, the role of the firm's decision-maker's gender in determining sectorial differences in export performance (propensity and intensity) turns out to be a new branch of research.

Chapter 8 studies the role of the decision-maker's gender in export performance when there are sectorial differences. The gender dummy is defined for firms where women are either the firm's top manager or the firm's sole owner. In general, it is found that there are significant differences at several levels between firms managed and owned by either gender, but these differences depend on firm size (correlated with productivity) and the sector in which the firm operates. Moreover, the gender differences across sectors are not always negative. After having controlled for firm size and sector of activity, women present a greater gap in the amount of sales they allocate to foreign markets (export intensity) rather than in deciding to start exporting (propensity to export), so the variable costs of exporting may be a greater constraint relative to the fixed costs.

From another point of view, **Chapter 9** is also devoted to analysing the impact of gender. Nowadays, a recent approach when studying International Trade analyses the impact of gender on tariffs, Foreign Direct Investment (FDI) and regulatory barriers' liberalization using computable general equilibrium models. FDI and facilitation of the new entry of domestic firms proves to be more important for workers than trade. This process is less beneficial for women because the less skilled workers and the ones that are more involved in the contracting agriculture sector used to have a lower salary.

1.4. Macroeconomic Aspects of International Trade and Finance

In the last years, capital markets have reached a remarkable level of development, due to increasing financial innovation and a widespread liberalization of the movement of capital. Consequently, nowadays the

exchange rate is more linked to the movement of capital than it is to the international trade of goods and services. This evidence has resulted in a sharp increase of the volatility of exchange rates.

One of the main issues, especially controversial and unresolved within the international context, is the choice of the optimal exchange rate regime. A system of flexible exchange rates ensures the existence of external balance. This, in turn, would allow the government to focus on achieving their internal goals. In addition, it would tend to insulate the economy from the effects of external shocks – particularly those affecting trade balance – and also guarantees greater autonomy with regard to monetary policy.

On the contrary, a system of fixed exchange rates imposes greater discipline for the authorities: the fixed exchange rate would act as an "anchor" to gain credibility and would lead to an anti-inflationary policy. However, in recent years, fixed exchange rates have proved to be extremely fragile and difficult to maintain. The final reason is the extraordinary development experienced by the international capital markets, which makes the system of fixed exchange rates highly vulnerable to speculative attacks on a massive scale.

The classical Mundell-Fleming model follows the so-called impossible trinity. This concept refers to the impossibility of simultaneously maintaining the following options: fixed exchange rates, monetary autonomy, and open capital markets, leading to the bipolar view (Obstfeld and Rogoff, 1995). This trilemma concludes that given a high mobility of capital and being more exposed to financial markets, there are only feasible corner solutions, i.e. hard peg regimes (dollarization, currency unions and currency boards) and free floating regimes.

To shed light on those questions, **Chapter 10** surveys the theoretical and empirical literature on exchange-rate regimes and also summarizes the main consensus available regarding the categorization of *de iure* and *de facto* exchange rate regimes.

One of the theoretical explanations of exchange rate movements is based on the expectations about the behaviour of the government. According to this theory, the exchange rate moves from one equilibrium to another depending on how agents formulate their expectations. But the role played by expectations is not only a useful tool for analysing exchange rate movements; on the contrary, it is one of the most studied issues, both from the theoretical and empirical viewpoint, when trying to explain a wide range of economic phenomena. Nowadays, this issue has acquired a renewed interest in policy circles, given that agents' expectations are one of the explanatory variables of the current economic

and financial crisis. The aim of **Chapter 11** is to shed further light on the determinants of individuals' expectations with respect to household finances and the general economic situation. The empirical study is performed relating to the case of Spain. This peripheral European country is of particular interest, since, in spite of the lower level of development in the Spanish economy, it has experienced a remarkable process of growth since its integration with the EU. But the trade deficits involved because of the increase in external openness has represented an unassailable obstacle to recovery after the current financial and economic crisis.

In the model proposed in this chapter, individual prospects regarding personal situations are simultaneously determined with people's opinions for the future economic situation, and also expectations for the general economy are an endogenous variable in the equation of expectations for personal financial situations. According to the results, it seems that families tend to believe that their personal financial situation is going to be better than forthcoming general economic conditions, and that general economic expectations are more sensitive to changes in economic growth rather than to contractions of the labour market.

In addition to the evolution of the exchange rate and the role played by expectations, International Trade developments are also highly dependent on the development of international agreements, usually leading to strengthened economic linkages and, consequently, promoting a deeper integration between countries.

Keeping in mind the European integration process, there have been several attempts to promote economic integration among the Latin American countries. Although the proposals have been mainly based on the creation of a common market, aimed to favour competitiveness and economic convergence, they have also served to renew interest in analysing the convenience of a monetary union. Nevertheless, there has been no explicit proposal for forming a monetary union similar to the EMU.

In practice, the discussions on the creation of a monetary union have been more academic than political, because it does not seem that there are enough arguments to support the creation of a single common currency, or even to adopt another country's currency. Theoretically, according to the analysis initiated in Mundell (1961), countries interested in sharing a common currency should form an Optimum Currency Area (OCA), i.e., a region characterized not only by trade integration, but also by price and wage flexibility, similar inflation rates and factor mobility among countries; and also by the mirroring of the external shocks the area would have to deal with. However, the Latin American countries would be far

from satisfying most of the criteria for establishing a currency area – see Edwards (2006) for a review.

Given that a common market requires some degree of macroeconomic harmonization among the involved economies, this harmonization process usually leads to a deeper economic integration that also contributes to achieving a greater economic convergence. Moreover, when the countries which belong to an OCA are exposed to similar external shocks, there would be no serious reason to use the exchange rate policy to increase competitiveness. This argument has been exposed as one of the potential benefits of forming a monetary union, since unexpected exchange rate fluctuations would hurt the integration process. In this sense, as pointed out by Eichengreen (1998, p. 7), "…Whether or not exchange rate movements threaten regional integration depends on two things: the depth of that integration and the source of the disturbances in response to which exchange rate moves".

Chapter 12 briefly describes the trade dynamism of the four founding members of the Southern Common Market (MERCOSUR) during 1991-2012 in order to present a comprehensive picture of the current state of regional integration. The trade openness ratio, the intraregional trade index and the Herfindahl-Hirschmann index show that the countries reached higher levels of openness during 2002-2012, intraregional trade was more intense in the first decade than in the second, and the diversification of exports by country of destination has increased since 2001. The assessment is completed with the exploration of the determinants of tariff and non-tariff barriers. The use of pre- and post-2008 crisis trade and protection data reveals that discriminatory measures implemented by Argentina and Brazil do not provide a better treatment for their MERCOSUR partners, but quite the opposite. To preview the chapter's conclusion: MERCOSUR is not *passé*, but it has somewhat shifted from its optimum path to success.

Among the implications of any integration process, we found changes in the macroeconomic framework of reference. Consequently, changes in the performance and implementation of economic policies should be taken into account. As has been addressed in the Introduction, a debate on the role of economic policies has been opened following the financial and economic crisis. It is well known that the success of particular policies depends not only on the improvement of macroeconomic indicators, but also on macroeconomic conditions such as monetary and fiscal policy regimes, and also the exchange rate adjustment adopted. The economic framework characteristics are particularly relevant in monetary unions, where fiscal policy is the only demand policy aimed at achieving the

stabilization goal, and monetary autonomy is obtained at the cost of losing direct control over the exchange rates. In the EMU, the fiscal policy is oriented to achieve output stabilization in the short-run, through the use of the public deficit and automatic insurance mechanisms. In the long-run, the fiscal policy should guarantee the sustainability of public finances, and it should also contribute to economic growth through the structure of revenues and expenditures, and public investment in physical and human capital (European Central Bank, 2004).

Keeping these points in mind, recent research contributions consider the impact of fiscal policies that have been implemented in recent years (see for instance, Barrios et al. (2010), Riguzzi (2011), and Karras (2012), among others). Some of these studies analyse times of growth and times of recession to determine, through comparative analyses between the two periods, the degree of effectiveness of the instruments of fiscal policy. In the case of fiscal policy, many questions arise relating to its behaviour and effectiveness, especially in times of recession. For example, what are the effects of a tax cut on the economy? How much does it matter whether they are financed by corresponding spending cuts or by corresponding increases in public debt, compared to the scenario of not implementing a tax cut? (Mountford and Uhlig, 2009) How persistent should spending cuts or tax increases be? What degree of fiscal stimulus should be considered? (Parker, 2011) **Chapter 13** attempts to answer all of these questions in the scenario of the current crisis, where both fiscal consolidations and the increase of economic growth are needed.

1.5. International Factor Movements and International Business

The 2007 financial crisis spread into a global economic shock and it was transmitted to the EMU. In fact, in 2009, there was negative growth in the Eurozone. In an attempt to restore trust in the financial system and recover growth rates, the macroeconomic policies in most economies focused mainly on short-term actions such as the bailout of banks and insurance companies, expanding money supplies and implementing large fiscal stimulus packages. Both the United States Federal Reserve and the European Central Bank have undertaken the largest monetary policy action in world history. Regarding the reforms and long-term responses, no significant measure has been implemented. In particular, the lack of fundamental changes in the banking and financial markets is one of the main concerns of some contributions to the International Monetary Fund's

publications (see Blanchard and Milesi-Ferreti (2009) and Merrouche and Nier (2010), among others).

One of the main concerns regarding financial markets is that the volatility in these markets has experienced a dramatic increase during the subprime and sovereign debt crises. Nevertheless, despite the well-known fact of the non-normality of asset returns in these scenarios, most financial institutions still report value at risk (VaR) measures based on the Gaussian distribution and thus underestimate their risk exposition. **Chapter 14** revises the main empirical features of high frequency financial data and studies the relative VaR performance of the methodologies based on either Normal or Student's t distributions. The analysis shows a clear outperformance of the latter that is found, in particular, in the context of high volatility scenarios such as the recent financial crises. The empirical analyses in this chapter focus on stock indices, but the results may be extended to other variables such as interest rates or exchange rates.

Since the 1970s, capitalism has undergone profound changes following a new wave of technological innovations and changes in social organization, with the result being the configuration of a new economic model. One of the peculiarities of this new economic model concerns the growing prominence of financial activities, which increase their importance in the direct production of goods and services, and set the standard level of return on capital for all economic activities, including the non-financial sector. The new model has been accompanied by a rapid removal of trade barriers and the free movement of capital around the world, which has contributed to the expansion of financial activities.

This process has accelerated the speed of investment flows, changing the strategic decisions of companies that are particularly oriented to meeting the expectations of their investors, which are focused on immediate short-term interests – trying to ensure the profitability of their investments, compromising the investment and production decisions of the firms in the long-term. This evidence has direct effects on the development of the labour market. In this new scenario, labour suffers increasing pressure to improve its productivity, which is achieved by greater flexibility conditions, in order to adapt the labour to increasingly competitive market conditions. This process tends to worsen working conditions, in order to keep labour costs adequate and increase production efficiency, i.e. the efficiency measure that ensures the profitability of the shareholders' investment.

In **chapter 15**, an empirical analysis is performed to assess some of the impacts of economic financialization on labour relations for a sample of developed countries. The empirical results seem to establish a negative

and significant relationship between the advance of economic financialization, and some key aspects concerning the equilibrium in the labour market – unemployment and labour compensation – and income distribution.

Finally, we cannot forget to mention the emerging markets phenomenon. In recent years, several large economic areas have experienced a rapid industrialization process and sustained growth. The most remarkable characteristic is that those economies have reached a considerable positive growth differential over the OECD average, due to the lower cost of their production processes and, in some cases, the rapid accumulation of technologies or even the catching-up phenomenon. For that reason they have been called the emerging markets: the ASEAN (Association of South East Asian Nations), the BRIC countries (Brazil, Russia, India and China), as well as Mexico, Indonesia and Turkey (see Hanson (2012) for an analysis).

The shift of international capital from the west to the east has configured a new set of actors in the international economy. The consequences of the rebalanced economic power implied by the *shifting wealth* process are wide and intense (OECD, 2011). The effects in terms of trade, financial flows and the catch-up of new technologies are impressive. But also, there are gains in growth, economic convergence and social cohesion. The countries involved are mainly large emerging economies, particularly China, which has been a strong worldwide competitor for years. Moreover, new multinational enterprises (MNEs), rooted in Asia and Latin America, are the new corporate giants at the expense of western and Japanese MNEs. China's companies have shifted to deliver complete high-end products.

To illustrate the phenomena, **Chapter 16** examines foreign direct investment (FDI) diversion, in particular the impact of firm-level foreign investments in China on FDI inflows into Asia. FDI in high performing recipients has mixed effects on its neighbours. FDI agglomeration around certain areas may divert new FDI from similar surrounding countries. However, MNEs seeking to expand their international production might spill-over FDI to border regions with favourable endowments. By means of the gravity equation, this research estimates the diversion of FDI extensive margin and aggregate flows in Asia due to greenfield investments and re-investments in China during 2003-2009. Results show that while new foreign projects in China deter FDI, re-investments expand FDI in Asia.

References

Bajo-Rubio, O. and Díaz-Roldán, C. (2003). "Insurance mechanisms against asymmetric shocks in a monetary union: a proposal with an application to EMU", *Recherches Economiques de Louvain*, 69, 73-96.

Bajo-Rubio, O. and Díaz-Roldán, C. (2007). "Vulnerability to shocks in EMU: 1991-2004", *Czech Journal of Economics and Finance*, vol. 57, nº 5-6, 225-234.

Bajo-Rubio, O. and Díaz-Roldán, C. (2011). *Macroeconomic analysis of monetary union: A general framework based on the Mundell-Fleming model*, Springer, Berlin.

Bajo-Rubio, O., Díaz-Roldán, C. and Esteve, V. (2006). "Is the budget deficit sustainable when fiscal policy is nonlinear? The case of Spain, 1964-2001", *Journal of Macroeconomics*, Vol. 28, nº 3, 596-608.

Bajo-Rubio, O., Díaz-Roldán, C. and Esteve, V. (2009). "Deficit sustainability and inflation in EMU: an analysis from the fiscal theory of the price level", *European Journal of Political Economy*, vol 25, 525-539.

Barrios, S., Langedijk, S. and Pench, L. (2010). "EU fiscal consolidation after the financial crisis. Lessons from past experiences", Economic Paper 418, Directorate-General for Economic and Financial Affairs, European Commission.

Blanchard, O. and Milesi-Ferreti, G.M. (2009). "Global imbalances: In Midstream?", International Monetary Fund Staff Position Note 09/29.

Díaz-Roldán, C. (2004a). "International monetary policy coordination under asymmetric shocks", *International Advances in Economic Research*, 10, 72-82.

—. (2004b). "On the desirability of coordinated supply-side intervention: does a monetary union matter?", *Czech Journal of Economics and Finance*, 54, 243-251.

Edwards, S. (2006). "Monetary unions, external shocks and economic performance: A Latin American perspective", *International Economics and Economic Policy* 3, 225-247.

Eichengreen, B. (1998). "Does Mercosur need a single currency?", Working Paper 6821, National Bureau of Economic Research.

European Central Bank (2004). "Fiscal policy influences on macroeconomic stability and prices", *Monthly Bulletin*, April, 45-57.

Hanson, G.H. (2012). "The Rise of Middle Kingdoms: Emerging Economies in Global Trade", *Journal of Economic Perspectives*, American Economic Association, vol. 26(2), pages 41-64.