

INTERNATIONAL ECONOMICS: THEORY AND PRACTICE,  
7<sup>th</sup> edition, Paul R. Krugman and Maurice Obstfeld, 2005,  
Addison-Wesley, Boston, 680 pp.

Review\*

Paul R. Krugman and Maurice Obstfeld are the authors of one of the most influential textbooks in the world for departments of international economics, international trade and international finances in undergraduate courses. Both authors have for their entire working lives been engaged in scholarly work in the area of international economics. Paul Krugman is one of the influential theoreticians of the 1980s and 1990s in the area of foreign trade and the theory of international trade (introduction of imperfect competition into foreign trade theory, the gravitational model of trade, the model of specific factors and the theory of strategic trade) as well as one of the main students of the balance of payments crisis, and the first model describing these crises is actually called the Krugman model. He was a teacher at MIT, at Stanford and is now at Princeton; he has won numerous prizes in the area of economics. Maurice Obstfeld is one of the better known international finance and open economy model theorists of the 1990s (the open economy model, economic policy in an open economy, in conjunction with fixed and with floating exchange rates) and one of the main students of the balance of payments crises, particularly the second generation model.

The book is composed of four parts and in all twenty two chapters.

Part 1, “The Theory of International Trade”, deals with the standard theories of international change (pure foreign trade theories) such as the Ricardo and Heckscher-Ohlin model. Along with a unified explanation of the application of both models to data and various situations (increase in the quantity of labour, influx of capital via direct foreign investment), Krugman and Obstfeld introduce new theories of international trade based on imperfect competition (the model for which Krugman is particularly celebrated).

In Part 2, “International Trade Policy”, the standard topics of foreign trade policy like the effects of customs duties and other constraints on international trade and the effects of liberalisation are discussed. Certainly a novelty is the discussion concerning foreign

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trade policy in developing countries and an explanation of what is called strategic trade (the modelling of which is a particular speciality of Krugman).

The third part, “Foreign Currency Exchange Rates and the Macroeconomics of the Open Economy”, is an introduction to international finance, and deals with topics of the balance of payments and its effect on the domestic product, the exchange rate and currency market, and goes on to the interdependence of money, exchange rates, prices and production in the open economy. A new departure is a chapter about foreign currency interventions and exchange rate trends, i.e., about the exchange rate management policies run by central banks in countries with floating exchange rate regimes such as the US.

Part 4, “International Macroeconomic Policy”, tells of the running of economic policy in the international system of economies that are increasingly open. It starts with a description of the international monetary system since Bretton Woods, and later on the problems of running economic policy with a flexible exchange rate and the increasing openness of world economies are discussed, via optimum currency areas, using the example of the EU and the euro. This part closes with a discussion on international financial markets and their impact on the running of the economic policies of the developed countries (the needs for the coordination of the economic policies of the G-7) and the problems of running exchange rate and balance of payments policies in developing countries. From this section it is worth highlighting the description of the balance of payments crises in developing countries, both authors being among the most quoted in academic writing in this domain.

Precisely because of the combination of authors, of Krugman and Obstfeld, which ensures the writing its masterly grounding in science, this is one of the most influential of international economic textbooks. But the two authors are able to adjust their enormous scholarship to the needs and capacities of the undergraduate level, explaining with ease the most recent knowledge and theories to the average reader. Paul Krugman has proved this with countless columns in mass market papers and journals like the *New York Times* and *Fortune*. Although the book is primarily a textbook aimed at the undergraduate market (some parts can be combined in graduate studies as well), because of the simplicity of the writing it is acceptable to a wider circle of readers, particularly to those interested in problems of international economics, international trade, foreign trade policy, exchange rates, the international monetary system, the balance of payments and open-economy economic policy. A translation of this textbook will be an outstanding contribution to the Croatian-language literature relating to international economics.

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