The Economics of International Transfers

Steven Brakman and Charles van Marrewijk

Reviews

Book review by **John A. Carlsson**, USA; **Journal of Economic Literature**, 2000

Book review by **Koji Shimomura**, Japan; **Review of International Economics**, 2002

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Reviewer: Prof. Dr. John A. Carlsson, Purdue University, USA

***The Economics of International Transfers*.**
By Steven Brakman and Charles van Marrewijk.
Cambridge; New York and Melbourne: Cambridge University Press, 1998. P p. x ii, 219.
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This book is thorough, rigorous, and understandable, pulling together a coherent analysis of many strands in the literature on the economics of international transfer payments. While there is some appeal to data and to the potential relevance of various assumptions, the book is primarily one of theory. It does not deal with empirical issues of when and where critical distortions might actually exist.

After a brief discussion of large international transfers in the past, Brakman and van Marrewijk suggest that the attention paid to the topic in general and to the German reparations after World War I in particular can be attributed to the debate in the *Economic Journal* between Keynes and Ohlin about the consequences of those reparations. Interestingly, in this debate Ohlin was the Keynesian who stressed the income effects of a transfer on demand while Keynes was more concerned with the relative-price, or terms-of-trade, effects. The authors stress that the lack of a formal analysis made the discussion unnecessarily complicated.

The overriding concern throughout the book is to assess the welfare effects of a transfer on both the recipient and the donor under a variety of conditions. To make the analysis more relevant to current issues, the authors point out that in recent years foreign aid is an important form of international transfer.

Chapter 3 starts with a geometric illustration of the following claim: “Example 1 (Leontief). It is possible to construct an example involving two goods and two countries under perfect competition such that a transfer from one country to the other paradoxically benefits the donor and hurts the recipient” (p. 36). The authors then introduce duality theory, which is used extensively throughout the book. With a simple three equation model, they prove “Samuelson’s theorem” to the effect that Leontief’s paradox is not possible under conditions of Walrasian stability. This analysis also shows that any terms-of-trade effects depend on relative marginal propensities to consume.

Subsequent chapters systematically modify the basic model to analyze the effects of various complications. The authors are very good about attributing specific results to particular contributors. Chapter 4 shows that the introduction of public goods, non-traded goods, or many goods does not alter the result that the donor loses and recipient gains from an international transfer in a two-country, Walrasian-stable economy.

Chapter 5 is provocatively titled “Clouds on the Horizon I: Distortions.” With costs of administration, existence of unemployment, lobbying incentives, or tariffs, for example, Samuelson’s theorem may not always hold. It may fail under situations with backward-bending offer curves or inferior goods.

Chapter 6 deals with third parties or “bystanders.” Adding a third country is not a trivial extension, although once again transfer paradoxes, with donor enrichment or recipient impoverishment generally require backward-bending offer curves or inferior goods.

Chapter 7 addresses an interesting issue. Can the approach be used to justify the existence of multilateral agencies by showing when there are welfare gains from multilateral rather than bilateral aid? The answers turn out to hinge on relative marginal propensities to consume particular goods. Part of the chapter raises a question about the incentives for the existence of aid itself and postulates a “meta” welfare function in which the welfare of potential recipients enters into the donor’s welfare function. The decision to give aid can then be treated as an optimization problem.

Chapter 8 looks at data on the extent of tied aid relative to untied aid for ten large donor countries in different years. The extent of tying of aid varies widely from country to country. Estimates in the literature of the limited extent to which tied aid actually changes a donor's exports suggests to the authors that tied aid is not effective in general; so, after discussing the analytics of tied aid in which transfer paradoxes are possible, they turn to what is called "forced choice" approach. The welfare effects do not appear to be much changed by this latter approach.

Chapter 9 represents something of an analytical departure from other chapters that use the duality approach. It introduces imperfect competition. In this model, a "love of variety" effect may, depending on elasticities of substitution, dominate the more familiar terms-of-trade and direct-income effects of an international transfer. Finally, Chapter 10 addresses a few dynamic issues. A mathematical appendix reviews results from duality theory.

Overall, this book is a useful reference for anyone concerned with theory underlying the welfare effects of international transfers.

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Reviewer: Prof. Dr. Koji Shimomura, Kobe University, Japan.

The Economics of International Transfers
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Koji Shimomura[*]

The transfer problem is one of the oldest economic problems discussed by many classical and contemporary economists. Considering the enormous amount of overseas development assistance, many people may agree that not only does the transfer problem have a long history but that it is also a lively academic subject. However, while most textbooks of international economics devote one chapter to the subject, there have been surprisingly few comprehensive books in the past, at least to the reviewer's knowledge, which focus on it from the theoretical viewpoint.

Steven Brakman and Charles van Marrewijk have made a good contribution to the subject by publishing a well-written book. Chapter 1 gives a concise history of international transfers, ranging from the implications of David Hume's argument on pricespecie-flow mechanisms for the transfer problem to a brief discussion about the German transfer problems after the destruction of the Berlin Wall. The main purpose of the historical review is to point out that the emphasis of the transfer problem has been shifted from balance-of-payments adjustment to the welfare effects of transfers, the main issue of this book. Chapter 2 summarizes the famous debate between John Maynard Keynes and Bertil Ohlin concerning the reparation payments after World War I. One of the purposes of this chapter is to exemplify the importance of formal analysis. Chapter 3 presents a simple formal model to prove and discuss the central theorem of this book, which they call Samuelson's theorem: "In a perfectly competitive, two-good, two-country and Walrasian-stable world the donor always loses and the recipient always gains as a result of a transfer. The donor's terms of trade deteriorate, causing a 'secondary burden' if, and only if, the donor's marginal propensity to consume its own export good is lower than the recipient's marginal propensity to consume the donor's export good" (quoted from pp. 44–5).

Using a simple two-country model, Brakman and van Marrewijk suggest that the difference in opinion between Keynes and Ohlin could have been made more transparent if they had made use of the modern trade model based on duality theory. Chapter 4 extends Samuelson's theorem to take into account public goods, nontraded goods, and an arbitrary but finite number of traded goods. The following three chapters discuss the possibility that Samuelson's theorem does not hold. Chapter 5 shows that transfer paradoxes (i.e., donor-impoverishment and/or recipient-enrichment) may arise under the presence of distortions like the cost of administration, sticky wages, rent-seeking activities, and tariffs. Chapter 6 is a review of the well-known result due to Gale (1974) that Samuelson's theorem is vulnerable to the existence of a bystander country and introduces the economic interpretation of this result which was originally presented by Bhagwati, Brecher and Hatta (1983). Chapter 7 considers a trade model in which the donor, recipient, and bystander countries are all multiple in order to show that generally donor and recipient countries prefer bilateral transfers to multilateral ones through international organizations like the IMF and the World Bank. They also outline the (general) impossibility of strict Pareto-improving differential multilateral transfers which was originally presented by Turunen-Red and Woodland (1988). Chapter 8 shows that tied aid can be another source of transfer paradox by introducing the argument in the works of Murray C. Kemp and Shoichi Kojima (1985a,b, 1987), and then that under Albert Schweinberger's "forced choice" approach (1990) to tied aid the paradox is impossible. Chapter 9, which is based on the authors' original contribution (Brakman and Van Marrewijk, 1995), basically shows that the main result of the previous chapter can be carried over to a model of monopolistic competition. Chapter 10 briefly discusses a way of incorporating dynamic optimization into the economics of transfers.A concise and clear review of some duality concepts follows as a Mathematical Appendix.

The book has many virtues. First, the argument in it is very clear, perhaps owing to the adoption of a unified framework throughout the book. Second, it covers the welfare effects of international transfer, and it provides a useful guidance for any researcher who wants to contribute to this research field.Third, the mathematics used in the book is not too advanced, and the book should be readable by many nontechnical readers without difficulty. Fourth, almost all propositions which appear in the book are standard. I believe that students learning the theory of international trade will benefit from carefully reading this book.

The book has another virtue, certainly a virtue in oriental societies like my country. It seems to me that the authors are possibly a little bit too modest to make explicit and assert their own original view on the transfer problem. I would like to conclude this review by raising several points on the transfer problem that are not fully discussed in the book.

First, it seems that one of the serious problems in overseas development assistance is that a transfer improves the welfare of only a small portion of people in the recipient country, perhaps the richest and socially strongest portion. That is, even if we consider a two-country framework, the donor and recipient countries, there are three types of agents—donor, recipient, and bystander—the last of which consists of most residents in the recipient country. In such a context, the three-agent model originated in Gale might be more relevant.

Second, the economic analysis of political process may be necessary for the problem of transfer. I have personally come to believe the importance of it after experiencing the Kobe earthquake in January 1995. After the earthquake took place, Kobe City Council and other local councils near Kobe received a large amount of money from overseas and from other parts of Japan. However, most of the big donations were left unused for a long time! That is mainly because the local governments were not able to find a politically agreeable way of spending the money on Kobe residents.

Third, perhaps by mentioning the welfare economics of customs union, the authors could say a little more in Chapter 7. Finally, we can interpret the Kemp–Wan proposition (1976) as saying that a Pareto-improving multilateral transfer is possible if it involves the imposition of a common tariff vector by a part of trading countries.

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