"I would like to know how the macroeconomic model that I more or less believe can be reconciled with the trade models that I also more or less believe. [...] What we need to know is how to evaluate the microeconomics of international monetary systems. Until we can do that, we are making policy advice by the seat of our pants."

Paul R. Krugman (1995), "What Do We Need to Know about the International Monetary System?" in Peter B. Kenen, ed., *Understanding Interdependence*, Princeton U Press.



**Fig. 1.** Business cycle properties of offshoring to Mexico. Note: The data series are from Federal Reserve Board (for the U.S. manufacturing IP and U.S. real GDP), INEGI (for Mexico's manufacturing IP, real GDP, the maquiladora real value added, and the number of establishments), and the International Financial Statistics via Haver Analytics (for Mexico's maquiladora and non-maquiladora exports in dollars, deflated by PPI). The series are seasonally adjusted, converted in natural logs, and expressed in deviations from a Hodrick–Prescott trend. The shaded areas represent the U.S. recessions during 1990:Q3–1991:Q1 and 2001:Q1–2001:Q4, as defined by the NBER. If the U.S. and Mexico's real GDP are used instead of manufacturing IP, the correlations are largely similar: 0.54 and 0.45 for the U.S. GDP with the maquiladora value added and Mexico's GDP; 0.34 for the U.S. GDP with and the number of maquiladora establishments; 0.55 and 0.34 for the U.S. GDP with Mexico's maquiladora and non-maquiladora real exports, respectively.



Fig. 4. Impulse responses, (1) baseline model vs. (2) model with no offshoring (GM05).



**Fig. 7.** Offshoring and output comovement. Note: "Fixed extensive margins" refers to the model with fixed firm entry and fixed cutoffs for offshoring and exporting. The alternative calibrations vary the share of offshoring in Southern exports (on the horizontal axis) while keeping the ratios of exports to GDP in the North and the South close to their steady-state levels from the baseline model.







## TABLE 7: TRADE INTEGRATION AND GDP COMOVEMENT

	$\Delta corr(Y_{R,t}, Y_{R,t}^*)$ —Producer Currency Price				
	$\frac{Trade}{GDP} = 0.1$	$\frac{Trade}{GDP} = 0.2$	$\frac{Trade}{GDP} = 0.35$		
Historical Rule	0.36	0.45	0.49		
Peg	0.05	0.19	0.27		
Ramsey	0.07	0.29	0.43		
Nash	0.28	0.35	0.48		
	$corr(Y_{R,t}$	$corr(Y_{R,t}, Y^*_{R,t})$ —Local Currency Price			
	Trade 0.1	Trade 0.0	Trade 0.05		

	$\frac{Trade}{GDP} = 0.1$	$\frac{Trade}{GDP} = 0.2$	$\frac{Trade}{GDP} = 0.35$			
Historical Rule	0.33	0.42	0.47			
Peg	0.05	0.20	0.27			
Ramsey	0.36	0.53	0.62			
Nash	0.28	0.36	0.42			

## TABLE 6: TRADE INTEGRATION – NON STOCHASTIC STEADY STATE Ramsey Gain **Ramsey Inflation** $\frac{Trade}{GDP} = 0.1$ 0.34%1.40% $\frac{Trade}{GDP} = 0.2$ 0.22%1.20% $\frac{Trade}{GDP} = 0.35$ 0.16%1.05%



Home product market deregulation, flexible regulation in foreign. Historical policy (solid) versus optimal policy (dashes).



Fig. 2. (b) Home product market deregulation, productivity and labor reallocation effects.

## Table 3 Welfare effects of reforms, non-stochastic steady state.

Market reform	$\Delta$ Welfare (Historical)		∆Welfare (Ramsey)		Ramsey inflation	
	Home (%)	Foreign (%)	Home (%)	Foreign (%)	Home (%)	Foreign (%)
Status quo (Flexible Foreign)	0	0	0.54	0.27	1.85	1.38
PMR LMR JOINT	2.34 3.93 6.10	0.04 0.17 0.21	2.84 4.23 6.37	0.31 0.43 0.46	1.81 1.40 1.36	1.37 1.36 1.36

*Note*:  $PMR \equiv product market reform; LMR \equiv ; labor market reform; JOINT \equiv product and labor market reform; <math>\Delta Welfare (historical) \equiv welfare change under historical policy; and <math>\Delta Welfare (Ramsey) \equiv welfare change under Ramsey policy.$