

Title: The balance-of-payments constraint on small open economies: from gap models to financial fragility

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ABSTRACT

The objectives of this paper are, first, to analyse the main heterodox approaches to the balance-of-payment (BOP) constraint on small open economies and, second, to propose a dynamic accounting model to integrate these approaches.

The text is organised in five sections. Section one starts the analysis with a comparison between Harrod's (1939) fixed-coefficient model and Chenery's and Bruno's (1963) two-gap model. It is shown how the latter corresponds to an extension of the former to include imports as a basic input in a Leontief aggregate production function. Session two analyses Thirlwall's (1979) demand-led growth model with flexible coefficients of production, discussing its main limitations and long-run implications. Section three discusses the extensions of Thirlwall's model to account for a more active role of capital flows, showing under which conditions one can obtain a BOP constrained growth rate with unbalanced trade. Section four presents a dynamic accounting model that explains the BOP constraint in terms of Minsky's (1982) concept of financial fragility, discussing how this approach can be integrated with Thirlwall's trade-driven model. Section five concludes the analysis with a synthesis of the trade and financial constraints on small open economies.

References:

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