

YALE UNIVERSITY
ECONOMICS 407 (ECON 407/GLBL 310), SPRING 2014
INTERNATIONAL FINANCE

General Information:

Instructor: Costas Arkolakis

Teaching Fellow (TF): Federico Esposito

Lecture: M and W, 09:00am – 10:15am, Luce Hall 202

Office: 28 Hillhouse, Room 312

Office Hours: Instructor: M 10:15am-11:15am & by apt. TF: Tue 10:00am -11:00am.

TF session: Fri 9:30am-10:20am or 10:30am-11:20pm.

Phone: 203 432 3527

Email: costas.arkolakis@yale.edu

Web page: www.econ.yale.edu/~ka265

Course Description

The aim of the course is that the students develop an understanding of the main implications of increasing integration of the world economy. By describing the various ways that countries are affected by each other -through trade linkages, multinational production, or financial markets- the course will try to explain how these forces affect the decisions of individuals and firms. Topics covered in the course include theories and facts about the trade costs, the current account, exchange rate determination, international macroeconomic co-movement, multinational production and gains from globalization. The class will maintain focus to applying this knowledge to real world applications. In this spirit, we will have a number of visitor's lectures that will share their experience about the topics discussed in class.

Course Structure

The course will be divided in two sections. The first section will be more like a traditional lecture class and will focus on theoretical models and empirical facts. The second section will be more like a seminar course with presentations by students and wide discussion on topics in international finance and international macroeconomics.

There will be two problem sets, a midterm, a short presentation, and a final term paper. The first part of the course will also provide important tools for the students with which to prepare their presentation and their term paper. For each topic, and after we finish the discussion of the empirical facts and possible explanations, students will be invited to express their own opinion about current events. In the presentations, students will put forth the main arguments and ideas that will be part of their term paper.

Background

The prerequisite for this class is Intermediate Macroeconomics or equivalent.

Notes for the class

There will be no official textbook for this class. We will draw some basic material for parts of the course from the online textbook: "International Macroeconomics" by Stephanie Schmitt-Grohe and Martin Uribe (henceforth S-U) that is available for download at <http://www.columbia.edu/~mu2166/UIM/notes.pdf>. Additional material for the class will be derived from class notes. We will also cover a number of papers as indicated in the tentative class schedule below. Relevant class material will be uploaded in the classes v2 website.

Other useful textbooks

International Economics, 2008, by Robert Feenstra and Alan Taylor (FT), Worth Publishers
Krugman, Paul and Maurice Obstfeld, International Economics: Theory and Policy, 2005, 7th edition, Addison Wesley

Class Web Page and email contact.

I will post all the class material on the classes' server (<http://classesv2.yale.edu>). You can also email me at costas.arkolakis@yale.edu provided that you put in the subject of the email "ECON 407".

Midterm exam and problem sets. In the midterm exam and two problem sets the students must illustrate that they have comprehended the class material. You are supposed to work independently and violations of academic integrity will be taken seriously.

Final Term Paper and presentation.

The final term paper is expected to be a small piece of original research that draws on the models and applications that are taught during this course. There will also be a short class presentation illustrating the main points and arguments made in the term paper.

I expect you to formulate a hypothesis/question and try to answer it with one or more tools. These tools could include surveying the literature, finding some data or empirical evidence, developing your own theoretical model. Whatever you do, it should be systematic and you should always maintain the focus on your main question and/or hypothesis. Note that the final term paper is due on **April 28th**, **by email**. This email needs to be titled "ECON 407 term paper" and addressed to the instructor and teaching fellow and yourself to make sure the term paper has been delivered. No extensions are allowed unless for documented reasons with the explicit written permission of the College Dean.

Grading Criteria:

The weights for the final grade will be as follows:

Term Paper:	30%
Class Presentations	10%
2 Problem Sets	15% each
Midterm	30%

Guest Lectures

There will be guest lectures that will be part of the regular class. Visitors will be people with years-long experience of the workings of the global economy. The dates of these lectures will be announced in class.

Tentative Course Schedule

Date	Lecture
Week 1	Current Account
Week 2	Global Imbalances / Exchange Rates
Week 3	Exchange Rates/ PS1 is handed
Week 4	Foreign Exchange Market
Week 5	International Financial Markets/Sovereign Debt
Week 6	Sovereign Debt/PS1 is due
Week 7	International Business Cycles/PS2 is handed
Week 8	Currency Crises and Banking Panics/Midterm

Week 9	Currency Crises and Banking Panics
Week 10	Gains from Openness/PS 2 is due
Week 11	Gains from Openness/Class Review
Week 12	Class Presentations
Week 13	Class Presentations

Tentative Class Material, by Topic

(Material indicated with (*) will be covered in class and will be the base for homework assignments and possibly for the midterm exam. The rest of the readings may be discussed in class but is also ideal material to draw ideas for your presentations and the term paper.

Current Account and Global Imbalances

*S-U chapters 1-3 and 7 and class notes.

*Lucas R., 1990, "Why Doesn't Capital Flow from Rich to Poor Countries?," *American Economic Review*, 80, pp. 92-96.

*Alfaro, L., S. Kalemli-Ozcan, and V. Volosovych, 2008, "Why Doesn't Capital Flow from Rich to Poor Countries? An Empirical Investigation," 90, 347-368.

*Blanchard O. and G. M. Milesi-Ferretti, 2009, "Global Imbalances: In Midstream?," IMF Staff Position Note, 09/29.

*Bartolini L. and A. Lahiri, 2006, "Twin Deficits, Twenty Years Later," Federal Reserve Bank of New York, *Current Issues in Economics and Finance*, 12.

Other Academic Readings

Barro, R. J., 1974, "Are Government Bonds Net Wealth?," *Journal of Political Economy*, 82, 1095-1117.

Caballero, R., E. Fahri, and P. Gourinchas, 2008, "An Equilibrium Model of 'Global Imbalances' and Low Interest Rates," *American Economic Review*, 98, pp. 358-393.

Mendoza, E., V. Quadrini, and V. Rios-Rull. 2009. "Financial Integration, Financial Development, and Global Imbalances." *Journal of Political Economy*, 117, pp. 371-416.

Obstfeld, M., and K. Rogoff, 2009, "Global Imbalance and the Financial Crisis: Products of Common Causes," CEPR Discussion Paper, 7606.

Other Readings

[Economist: Global Economic Imbalances](http://www.economist.com/node/12972083) (<http://www.economist.com/node/12972083>)

<http://www.federalreserve.gov/boarddocs/speeches/2005/200503102/>

<http://www.voxeu.org/article/did-global-imbalances-cause-financial-crisis>

Real and Nominal Exchange Rates and the Foreign Exchange Market

*S-U chapters 9 and 12 and class notes.

*Engel, C., 1999, "Accounting of U.S. Real Exchange Rate Changes", *Journal of Political Economy*, 107(3), 507-38.

*Engel, C. and J. Rogers, 1996, "How Wide is the Border?," *American Economic Review*, Vol. 86, pp. 1112-1125.

*Taylor, A. M. and M. R. Taylor, "The Purchasing Power Parity Debate," *Journal of Economic Perspectives*, 18, pp. 135-158.

Other Academic Readings

Mundell, R. A., 1963, "Capital mobility and stabilization policy under fixed and flexible exchange rates," *Canadian Journal of Economic and Political Science* 29, 475-485.

Fleming, J. M., 1962, "Domestic financial policies under fixed and floating exchange rates," IMF Staff Papers 9, 369-379.

Atkeson, A. and A. Burstein, 2008, "Pricing To Market, Trade Costs, and International Relative Prices," *American Economic Review*, 98, pp. 1998-2031.

Campa, J. and L. Goldberg, 2004, "Do Distribution Margins Solve The Exchange Rate Disconnect Puzzle?," New York Fed, mimeo.

Betts, C. and T. Kehoe, 2006 "U.S. real exchange rate fluctuations and relative price fluctuations," *Journal of Monetary Economics* 53, pp. 1297-1326.

Other Readings

[Economist, "Big Mac index."](http://www.economist.com/blogs/dailychart/2011/07/big-mac-index) (<http://www.economist.com/blogs/dailychart/2011/07/big-mac-index>)

[Economist: Fix or float, sink or swim?](http://www.economist.com/node/597868) (<http://www.economist.com/node/597868>)

International Financial Markets and Sovereign Debt

*S-U notes chapter 11 and class notes.

*Arellano, C., 2008, "Default Risk and Income Fluctuations in Emerging Economies," *American Economic Review*, 98, pp. 690-712.

*Eaton, J., and Gersovitz, M., 1981, "Debt with Potential Repudiation: Theoretical and Empirical Analysis," *Review of Economic Studies*, 48, 289-309.

*Lane P. and G. Milesi-Ferretti, 2005, "A Global Perspective on External Positions," NBER working paper, 11589.

*Lewis, K., 1999, "Trying to Explain Home Bias in Equities and Consumption," *Journal of Economic Literature*, 37, 571-608.

*Reinhart, C. M., 2010, "This time is Different Chartbook: Country Histories on Debt, Default, and Financial Crises," NBER working paper, 15185.

Other Academic Readings

Heathcote, J., and F. Perri, 2010. "The International Diversification Puzzle is not as Bad as you Think," mimeo, Federal Reserve Bank of Minneapolis.

Kehoe, T. J., and D. K. Levine, 1993, "Debt Constrained Asset Markets," *Review of Economic Studies*, 60, 865-888.

Other Readings

[Economist: Greece's sovereign-debt crisis: still a spin](http://www.economist.com/node/15908288) (<http://www.economist.com/node/15908288>)

[Economist: Global Debt Clock](http://www.economist.com/content/global_debt_clock) (http://www.economist.com/content/global_debt_clock)

International Business Cycles

*S-U chapter 4 and class notes.

*Backus, D., P. Kehoe, and F. Kydland, 1995, "International Business Cycles: Theory and Evidence", in Cooley, T., *Frontiers of Business Cycle Research*, Princeton.

*Kose, A., and K.-M. Yi, 2006, "Can the Standard International Business Cycle Model Explain the Relation Between Trade and Comovement," *Journal of International Economics*, 68, pp. 267-295.

*Lucas, R., 2003, "Macroeconomic Priorities," *American Economic Review*, 93, pp. 1-14.

Other Academic Readings

Backus, D., P. Kehoe, and F. Kydland, 1992, "International Real Business Cycles", *Journal of Political Economy*, 100, pp. 745-775.

Stockman, A. and L. Tesar, 1995, "Tastes and Technology in a Two-Country Model of the Business Cycle: Explaining International Comovements," *American Economic Review*, 85, pp. 168-185.

Corsetti, G., L. Dedola, and S. Leduc, 2008, "International Risk Sharing and the Transmission of Productivity Shocks," *Review of Economics Studies*, pp. 443-473.

Arkolakis, C. and A. Ramanarayanan, 2008, "Vertical Specialization and International Business Cycles Synchronization," *Scandinavian Journal of Economics*, 111, pp. 665-680.

Other readings

[Economist: Globalization and Trade, the nuts and bolts come apart](http://www.economist.com/node/13362027) (<http://www.economist.com/node/13362027>)

Currency Crises and Banking Panics

*S-U chapter 12 and class notes

*Krugman, P., 1979, "A Model of Balance of Payment Crisis," *Journal of Money, Credit and Banking* 11, 311-325.

*Kaminsky, G. L., "Varieties of Currency Crises," NBER Working Paper, 10193.

*Velasco, A., 1987, "Financial and Balance-of-Payments Crises," *Journal of Development Economics*, 27, 263-283.

*Calvo, G., 1998, "Varieties of Capital-Market Crises", in Calvo, and King (eds) *the Debt Burden and its Consequences for Monetary Policy* (New York: McMillan).

*Chang, R. and A. Velasco, 2001, "A Model of Financial Crises in Emerging Markets," *Quarterly Journal of Economics*, 116, 2001, 489-517.

*Gorton, G., 1988, "Banking Panics and Business Cycles," *Oxford Economic Papers*, 40, 751-781.

Other Academic Readings

Obstfeld, M., 1996, "Models of Currency Crises with Self-Fulfilling features," *European Economic Review* 40, 1037-47.

Obstfeld, M. and K. Rogoff, 2005, "Global Current Account Imbalances and Exchange Rate Adjustments," *Brookings papers on Economic Activity*, pp. 67-146.

Morris, S. and H. S. Shin, 2004, "Global Games: Theory and Applications," *Cowles Foundation Paper*, 1097.

Other Readings

[Economist: The Domino Effect](http://www.economist.com/node/11667810) (<http://www.economist.com/node/11667810>)

<http://www.voxeu.org/article/next-sudden-stop>

Gains from Openness

*Class notes

*Krugman, P., 1997, "Pop internationalism," Massachusetts: The MIT Press.

*Arkolakis C., T. Demidova, P. Klenow & A. Rodriguez-Clare, 2008, "Endogenous Variety and the Gains from Trade," *American Economic Review*, 2008, 98, pp. 444-450.

*Ramondo N. and A. Rodriguez-Clare, 2010, "Trade, Multinational Production, and the Gains from Openness," working paper, Pennsylvania State University.

*Helpman, E., 2011, "Understanding global trade," Massachusetts: Harvard University Press.

*Arkolakis C., N. Ramondo, A. Rodriguez-Clare and Steven Yeaple, 2011, "Innovation and Production in the Global Economy".

Other Academic Readings

Romer, P., 1994, "New Goods, Old Theory, and the Welfare Costs of Trade Restrictions," *Journal of Development Economics*, 43, pp. 5-38.

Klenow, P. and A. Rodriguez-Clare, 1997, "Quantifying Variety Gains from Trade Liberalization," working paper, Chicago Business School.

Arkolakis, C., A. Costinot and A. Rodriguez-Clare, 2010, "New Trade Theories, Same Old Gains?" NBER working paper, 15628.

Other Readings

<http://www.aflcio.org/Issues/Trade/U.S.-EU-Free-Trade-Agreement-TTIP>

Some additional interesting readings on crises and crashes:

Kindleberger C. and R. Z. Aliber, 2011, "Manias, Panics and Crashes: A History of Financial Crises," NY: Palgrave Macmillan, 6th edition.

Reinhart, C. M., and K. Rogoff, 2009, "This time is different: Eight centuries of financial folly," New Jersey: Princeton University Press.

Krugman, P. R., Rogoff, K. S., Fischer, S., and McDonough, W. J., 1999, "Currency crises," In *International Capital Flows*, pp. 421-466, Illinois: University of Chicago Press. Available at <http://papers.nber.org/books/feld99-2>

Shiller, R. J., 2005, "Irrational exuberance," New York: Random House Digital, Inc.