## YALE UNIVERSITY ECONOMICS 407, SPRING 2011 INTERNATIONAL FINANCE

## **General Information:**

Instructor: Costas Arkolakis Lecture: Tue and Th, 09:00 pm – 10:15 pm Office: 28 Hillhouse, Room 207 Office Hours: Tuesdays 4:45pm-6:15pm & by appt Phone: 203 432 3527 Email: <u>costas.arkolakis@yale.edu</u> Web page: <u>www.econ.yale.edu/~ka265</u>

## **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 comovement, multinational production and gains from globalization. The class will maintain focus to applying these 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 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 <u>http://www.columbia.edu/~mu2166/UIM/notes.pdf.</u> Additional material for the class will be derived from class notes and 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 (available on the library reserve)

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

## **Class Web Page**

I will post all the class material on the classes' server (http://classesv2.yale.edu).

**There will be no midterm exam**. Instead there will be two problem sets in which students will illustrate that they have comprehended the class material. There will also be a presentation and a final paper.

## Final Term Paper

# This final paper is expected to be a small piece of original research that draws on the models and applications that are taught during this course.

I expect you to formulate a hypothesis/question in 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 hypothesis.

## **Grading Criteria:**

The weights for the final grade will be as follows:Term Paper:30%Class Presentations20%2 Problem Sets25% each

## **Guest Lectures**

There will be a series of 3-4 guest lectures of 30 minutes each that will be part of the regular class. Visitors will be people with years-long experience of the workings of the global economy. The timing of the lectures will be announced in class.

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|----------------------------|--|
| Date                       | Lecture                                    |
| Week 1                     | Current Account                            |
| Week 2                     | Current Account / Exchange Rates           |
| Week 3                     | Exchange Rates                             |
| Week 4                     | International Borrowing and Lending        |
| Week 5                     | Business Cycles Co-movement/ PS1 is handed |
| Week 6                     | Business Cycles Co-movement                |
| Week 7                     | Multinational Production/ PS1 is due       |
| Week 8                     | Multinational Production/PS2 is handed     |
| Week 9                     | Gains from Openness                        |
| Week 10                    | Gains from Openness/ PS 2 is due           |
| Week 11                    | Class Presentations                        |
| Week 12                    | Class Presentations                        |
| Week 13                    | Class Presentations/Review Class           |

#### **Tentative Course Schedule**

## **Tentative Class Material, by Topic**

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

#### The Current Account

\*S-U notes chapters 1 and 2 and class notes.

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

#### Academic Readings

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

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.

Other Readings Economist: The Domino Effect

#### **Exchange Rates and The Law of One Price**

\*S-U notes and class notes for the Mundell-Fleming model.

Academic Readings

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.

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."

#### **International Macroeconomic Co-movement**

\*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.

#### 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 again

#### **International Borrowing and Lending**

\*Class notes

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

#### Academic Readings

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

Mendoza, E., V. Quadrini and V. Rios-Rull, 2009, "Financial Integration, Financial Deepness and Global Imbalances", Journal of Political Economy, 117.

Heathcote, J., and F. Perri, 2002. "Financial Autarky and International Business Cycles," Journal of Monetary Economics, 49, pp. 601-627.

#### Other Readings Economist: Greece's sovereign-debt crisis: still a spin

#### **Multinational Production**

\*Class notes

#### Academic Readings

Arkolakis, C, N. Ramondo, A. Rodriguez-Clare, and Steven Yeaple, 2011, TBA. Ramondo, N. and A. Rodriguez-Clare, 2010, "Trade, Multinational Production, and the Gains from Openess," working paper, Pennsylvania State University.

#### Other Readings

Economist: Manufacturing in Asia, The problem with Made in China

#### **Gains from Openess**

\*Class notes

\*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 Openess," working paper, Pennsylvania State University.

\* C. Arkolakis, N. Ramondo, A. Rodriguez-Clare and Steven Yeaple, 2011, TBA.

#### 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

General discussion on globalization: Go to an online bookstore and purchase a paperback book on globalization that was written in the past decade (A simple search of the term globalization yields dozens of suggestions. Coordinate with me so that not more than 2 people get the same book). We will have a general discussion in the class about globalization based on the reading of each one of us.