

International Economics 4th Module, 2020

Course Information

Instructor: Yan Bai

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Office Hour: by appointment

Classes:

Lectures: Tuesday & Friday, 8:30-10:20am (April 24 – May 22)

Venue: online

Course overview:

This is the first half of the doctoral level course of international economics. In this part, we focus on international macroeconomics. Topics covered in the course include small open economy models of intertemporal trade, international business cycles, puzzles in international economics, global capital flow, sovereign debts and defaults, financial crises and real exchange rate fluctuations.

Prerequisites: first-year doctoral level microeconomics and macroeconomics

Reference books

Foundations of International Macroeconomics, by Maurice Obstfeld and Kenneth Rogoff, Cambridge, MA, MIT Press

The Handbook of International Economics, ed. by Gene Grossman and Kenneth Rogoff, North Holland - Elsevier Press

Recursive Macroeconomic Theory, by Lars Ljungqvist and Thomas J. Sargent, Cambridge, MA MIT Press

Requirements:

1. *Class participation (10%)*. You are expected to attend the class regularly, read papers before class, and participate actively in class discussion
2. *Two homework assignments (90%)*

Course Outline and Tentative Schedule:

Lecture 1 (April 24, Fri) Introduction

- Issues in international macroeconomics and one good exchange economy.

Obstfeld, M. and K. Rogoff, "The Six Major Puzzles in International Macroeconomics: Is There a Common Cause?" NBER Macro Annual, 2000.

Obstfeld and Rogoff, chapters 1 – 3.

Ljungqvist and Sargent, *Recursive Macroeconomic Theory (2nd ed)*, ch 8 (sections 1-6, 8-9); similar to chapter 7 of the first edition (pp 143-48, 152-58).

Lecture 2 (April 28, Tue) International business cycle: two-country stochastic growth models

Backus, Kehoe, and Kydland, "International Real Business Cycles," JPE, 1992.

Backus, Kehoe, and Kydland, "Dynamics of Trade Balance and the Terms of Trade: the J-Curve", AER 1994.

Baxter and Crucini, "Business Cycles and the Asset Structure of Foreign Trade", IER, 1995

Lecture 3 (April 29, Wed) International business cycle (continued)

Lecture 4 (May 5, Tue) Small open economies

Mendoza “Real Business Cycles in a Small Open Economy: The Canadian Case,” AER 1991.
Schmitt-Grohe and Uribe, "Closing small open economies," JIE, 2003

Lecture 5 (May 8, Fri) Business cycles in emerging markets

Neumeyer and Perri, “Business Cycles in Emerging Markets: The Role of Interest Rates,” JME, 2005.
Aguiar and Gopinath, “Emerging Market Business Cycles: The Cycle is the Trend,” JPE 2007.

Lecture 6 (May 12, Tue) International capital flows and risk sharing

*Bai, Y. and J. Zhang (2010), “Solving the Feldstein-Horioka Puzzle with Financial Frictions”, *Econometrica* 78 (2).
Cole and Obstfeld, "Trade and risk-sharing," JME, 1991.
Bai and Zhang, “Financial Integration and International Risk Sharing,” JIE 2012
Gourinchas and Jeanne, “The Elusive Gains from International Financial Integration”, *Review of Economic Studies* 2006

Lecture 7 (May 14, Fri) Sovereign defaults

Eaton and Gersovitz, “Debt with Potential Repudiation: Theoretical and Empirical Analysis,” REStud, 1981.
Bulow, J. and K. Rogoff, “Sovereign Debt: Is to Forgive to Forget?,” AER, 1989.
Arellano, “Default Risk and Income Fluctuations in Emerging Economies”, AER 2008
Arellano and Ramanarayanan, “Default and the Maturity Structure in Sovereign Bonds”, JPE 2012
Arellano and Bai, “Linkages Across Sovereign Debt Markets”, manuscript, 2014
Chatterjee and Eyigungor, “Maturity, Indebtedness, and Default Risk”, AER

Lecture 8 (May 19, Tue) Sovereign default and firm dynamics

Lecture 9 (May 22, Fri) Open economy monetary policy

Readings:

1. Interesting works

Bocola, “The Pass-Through of Sovereign Risk”, Upenn, 2014
Mendoza and Yue, “A General Equilibrium Model of Sovereign Default and Business”, *Quarterly Journal of Economics* 2012
Caballero, Farhi, and Gourinchas, “An Equilibrium Model of Global Imbalances and Low Interest Rates”, *American Economic Review* 2008.
Devereux and Sutherland, “Country Portfolio Dynamics”, working paper, UBC, 2006.
Demina Pouzo, “Optimal Taxation with Endogenous Default under Incomplete markets”, working paper, UC Berkeley
Alessandro Dovis, “Efficient Sovereign Default”, working paper, University of Minnesota 2013
Gennaioli, Martin, and Rossi, “Sovereign Default, Domestic Banks, and Financial Institutions”, 2012
Backus, Cooley, Henriksen, Moller, “Capital Flows and Demography”, NYU slides, 2012
Lukasz and Nosal, “Understanding International Prices: Customers as Capital”, *American Economic Review* 2011
Aguiar, Amador, and Gopinath, “Investment Cycles and Sovereign Debt Overhang”, *Review of Economic Studies* 2009
Heathcote and Perri, “The International Diversification Puzzle is Not as Bad as You Think”, NBER working paper 13483
Jin, “Industrial Structure and Financial Capital Flows”, *American Economic Review* 2012, 102 (5): 2111-1246.
Karabarbounis and Neiman, “The Global Decline of Labor Share”, QJE 2014

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2. Basic models

Multigood exchange economies

Backus, D., "Terms of trade," JIE, 1993.

Backus, Kehoe, and Kydland, "Relative price movements," Handbook chapter, 1994.

Cole and Obstfeld, "Trade and risk-sharing," JME, 1991.

Goldberg and Knetter, "Prices and exchange rates," JEL, 1997.

3. International Business Cycles

Two-Country Models

Stockman, A., and L. Tesar, "Tastes and Technology in a Two-Country Model of the Business Cycle: Explaining International Co-Movements," AER 1995.

4. Puzzles in International Macroeconomics

Consumption and Home Bias

French, K. and J. Poterba, "Investor Diversification and International Equity Markets," AER 1991.

Tesar, L. and I. Werner, "Home Bias and High Turnover," Journal of International Money and Finance, 1994.

Feldstein-Horioka Puzzle

Feldstein, M. and C. Horioka, "Domestic Saving and International Capital Flows," Economic Journal, 1980.

Tesar, L., "Savings, Investment and International Capital Flows," JIE, 1991.

Asymmetric transmission puzzle

Burstein, A., C. Kurz and L. Tesar, "International Trade, Production Sharing and the Transmission of Business Cycles" University of Michigan, 2005.

Heathcote, J. and F. Perri, "Financial Globalization and Real Regionalization," JET, 2004.

Kehoe, T. and K. Ruhl, "Trade Intensity and International Business Cycles," University of Texas, 2005.

5. Global Capital Flow

The composition, direction and volatility of capital flow

Chuhan, P. and F. Sturzenegger, "Default Episodes in the 1990s: What Have We Learned?," Manuscript, the World Bank and Universidad Torcuato Di Tella, 2003.

Lane, P. R. and G. M. Milesi-Ferretti, "The External Wealth of Nations: Measures of Foreign Assets and Liabilities for Industrial and Developing Countries," JIE, 2001.

Reinhart, C., K. Rogoff and M A. Savastano, "Debt Intolerance," NBER Working Paper 9908, 2003.

Rose, Andrew K., "One Reason Country Pay Their Debts: Renegotiation and International Trade," Manuscript, 2002.

Sovereign debt: Classical theory

Atkeson, A., "International Lending with Moral Hazard and Risk of Repudiation," Econometrica, 1991.

Kehoe and Perri, "Competitive Equilibrium with Limited Enforcement", JET, 2004.

Cole, H. and P. Kehoe, "Models of Sovereign Debt: Partial v.s. General Reputations," IER, 1998.

Cole, H. and T. Kehoe (1996), "A Self-Fulfilling Model of Mexico's 1994-95 Debt Crisis," JIE, 1996.

Eaton, J. and R. Fernandez, "Sovereign Debt," In Handbook of International Economics, edited by Gene M. Grossman and Kenneth Rogoff, Amsterdam: Elsevier, 1995.

Sovereign debt: Recent extensions

Aguiar, M. and G. Gopinath, "Defaultable Debt, Interest Rates and the Current Account," JIE 2005.

Arellano, C., "Default Risk, Income Fluctuations and Real Exchange Rates," *American Economic Review* 2008.

Yue, V., "Sovereign Default and Debt Renegotiation," *Journal of International Economics*, 2010.

Benjamin and Wright, "Recovery Before Redemption: A Theory of Delays in Sovereign Debt Renegotiations", UCLA working paper

D'Erasmus, "Government Reputation and Debt Repayment", University of Maryland working paper, 2011

6. Financial Crisis

Empirical facts

Milesi-Ferretti, G.M. and A. Razin, "Current Account Reversals and Currency Crises: Empirical Regularities," NBER Working paper No. 6620, 1998.

Calvo, G. and E. Mendoza, "Reflections on Mexico's Balance of Payments Crisis: A Chronicle of a Death Foretold," JIE, 1996.

Frankel, J.A. and A.K. Rose, "Currency Crashes in Emerging Markets: An Empirical Treatment," JIE, 1996.

Kaminsky, G. and C.M. Reinhart, "The Twin Crises: The Cause of Banking and Balance- of- Payments Problems," AER, 1999.

First generation models

Krugman, P., "A Model of Balance of Payment Crises," JMCB, 1979.

Craig, B., M. Eichenbaum and S. Rebelo, "Prospective Deficits and the Asian Currency Crisis," JPE, 2001.

Calvo, G., "Balance of Payments Crises in a Cash-in-Advance Economy," JMCB, 1987.

Uribe, M., "A Fiscal Theory of Sovereign Risk," JME, 2005.

Self-Fulfilling Expectation and Crises (Second-Generation Models)

Angeletos, M., A. Pavan and C. Hellwig, "Coordination and Policy Traps", Mimeo, MIT, 2005.

Morris, S. and Shin, H., "Unique Equilibrium in a Model of Self-Fulfilling Currency Attacks," AER, 1998.

Cole, H. L. and T. Kehoe, "Self-Fulfilling Debt Crises," REStud, 2000.

Credit Frictions and Crises/Sudden Stops (Third Generation Models)

Allen, F. and D. Gale, "Optimal Currency Crises," Carnegie-Rochester Conference Series on Public Policy, 2000.

Arellano, C. and E. Mendoza, "Credit Frictions and Sudden Stops in Small Open Economies: An Equilibrium Business Cycle Framework for Emerging Markets Crises," NBER WP 8880, 2002.

Mendoza, E. and K. Smith, "Margin Calls, Trading Costs and Asset Prices in Emerging Markets: The Financial Mechanics of the Sudden Stop Phenomenon," JIE 2006.

7. Exchange Rate Dynamics

Alessandria 2005: Consumer Search, Price Dispersion, and International Relative Price Volatility

Burstein, Neves and Rebelo 2003: Distribution Costs and Real Exchange Rate Dynamics During Exchange-Rate-Based Stabilizations, JME

Chari, Kehoe and McGrattan 2002: Can sticky price models generate volatile and persistent real exchange rates? REStud 69/3

Academic Honesty and Plagiarism

It is important for a student's effort and credit to be recognized through class assessment. Credits earned for a student work due to efforts done by others are clearly unfair. Deliberate dishonesty is considered academic misconducts, which include plagiarism; cheating on assignments or examinations; engaging in unauthorized collaboration on academic work; taking, acquiring, or using test materials without faculty permission; submitting false or incomplete records of academic achievement; acting alone or in cooperation with another to falsify records or to obtain dishonestly grades, honors, awards, or professional endorsement; or altering, forging, or misusing a University academic record; or fabricating or falsifying of data, research procedures, or data analysis.

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