

M.A. Economics

International Economics: Theory & Evidence

(Professor Syed Ahsan & Dr. Soumya Datta)

Course Outline and Readings

This course consists of two modules. The first module, **International Finance**, comprises of about one-third of the course and will be taught during about first one month of the semester. The second module, **International Trade Theory & Policy** will continue through the rest of the semester. Detailed outlines of each module is provided below.

Course Evaluation: The course will be evaluated as follows.

- (a) Class Participation / Assignment: 10 %
- (b) Mid-semester Examination: 30 %
- (c) End-semester Examination: 60 %

Note: *Both mid-semester and end-semester examination will be open-book.*

Module 1
International Finance

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Lectures: Mon 11 am – 1 pm & Tue 2 – 4 pm

Office: Room # 328

Office Hours: Tue 11 am – 1 pm or by appointment

This module deals with a selection of topics from international finance and open economy macroeconomics. On completing this section, the students are expected to be familiar with standard contemporary models of small open economy, international asset pricing and exchange rate determination. They will also be acquainted with some of the recent developments in international financial system and financial instruments.

References and Textbooks: Selected chapters from following textbooks will be used for various sections, in addition to journal articles listed below. Each topic will have a set of required and optional readings, marked separately.

Martín Uribe and Stephanie Schmitt-Grohé (2017), *Open Economy Macroeconomics*, Princeton University Press (**USG**)

Nelson C. Mark (2001), *International Macroeconomics and Finance: Theory and Econometric Methods*, Wiley Blackwell (**NM**)

Geert Bekaert and Robert Hodrick (2012), *International Financial Management*, Prentice Hall (**BH**)

List of topics:

1. **A Few Recent Developments in International Asset Markets**

Microstructure of international asset markets, segmentation in international equity markets, carry trade, derivatives: futures, options (including American and European options) and swaps, credit default swaps, momentum and algorithmic trading.

Required Reference:

- Lecture slides / notes
- BH Chapt. 20 & 21 (selected sections)

Optional Reference:

- Sager and Taylor (2006), "Under the microscope: The structure of the foreign exchange market", *International Journal of Finance and Economics* 11: 81-95.
- Bekaert, Harvey, Lundblad and Siegel (2011), "What segments equity markets?", *The Review of Financial Studies* 24(12): 3841-3890.
- Akram, Rime and Sarno (2008), "Arbitrage in foreign exchange market: Turning on the microscope", *Journal of International Economics* 76: 237-253.
- Baba and Packer (2009), "From turmoil to crisis: Dislocations in the FX swap market before and after the failure of Lehman Brothers", *Journal of International Money and Finance* 28, 1350-1374.
- Chaboud, Chiquoine, Hjalmarsson and Vega (2014), "Rise of Machines: Algorithmic Trading in the Foreign Exchange Market", *The Journal of Finance* LXIX (5): 2045-2084.

2. Small Open Economy Models & International Asset Pricing

[Overview of small open economy models in presence of stochastic shocks: in Arrow-Debreu economy and with incomplete markets, six major puzzles in international macroeconomics]

Required Reference:

- USG Chapt. 3 & 4 (selected sections)
- Lecture slides / notes.

Optional Reference:

- Solnik (1974), "An equilibrium model of the international capital market", *Journal of Economic Theory* 8: 500-524.
- Stulz (1981), "A model of international asset pricing", *Journal of Financial Economics* 9: 383-406.
- Schmitt-Grohé and Uribe (2003), "Closing small open economy models", *Journal of International Economics* 61(1): 163-185.
- Obstfeld and Rogoff (2001), "Six major puzzles in international macroeconomics: is there a common cause?", in *NBER Macroeconomics Annual 2000*, (ed.) Bernanke and Rogoff, MIT Press.

3. Exchange Rates & Currency Markets: Theory & Policy

Theories of exchange rate determination and Meese-Rogoff puzzle, spot and forward currency markets, efficiency of foreign exchange markets: forward premium anomaly and peso problem, optimal exchange rate policy before and after Global Financial Crisis, optimal capital controls.

Required Reference:

- NM Chapt. 3, 4 & 6 (selected sections)
- USG Chapt. 9 (section 3 only) & 10 (selected sections)
- Lecture slides / notes

Optional Reference:

- Schmitt-Grohé and Uribe (2012), "Managing currency pegs", *American Economic Review: Papers & Proceedings* 102(3): 192-197.
- Fama (1984), "Forward and spot exchange rates", *Journal of Monetary Economics* 14: 319-338.
- Krasker (1980), "The peso problem in testing the efficiency of forward exchange markets", *Journal of Monetary Economics* 6(2): 269-276.

Module 2

International Trade Theory & Policy

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Monsoon 2018
Office Hours: J 11.00-1200
&/or by appointment

Objectives:

In this module, International Trade Theory & Policy, we examine both positive and normative questions. Among the positive ones, we raise issues, such as: Why do countries trade? What goods do they trade? What are the implications of openness for the location of production, industries, occupations, and innovative activity? What impedes trade and why do some countries deliberately erect various trade barriers? The course also takes up normative issues, such as: Is trade openness beneficial to an average citizen? And, are there winners and losers from trade and if so, can we identify them? Throughout, these issues are approached in neoclassical settings as well as those where the market fails, at the industry-level as well as the firm-level, and in the presence of both mobile and immobile factors (e.g., FDI, offshoring of tasks, multinational firms and immigration).

Text & Readings: The book by Feenstra has been chosen as the primary TEXT for this part of the course (the version in the Library 2012), though in addition, some chapters of Krugman & Helpman will be found most helpful. Occasionally additional items, mainly journal articles, will be identified as required/recommended reading for certain topics and announced in class. Some of these readings have already been enumerated below under each topic; however, **both the list of topics & associated readings will be rationalized as the course evolves.**

Feenstra, Robert. C. (2012), *Advanced International Trade: Theory and Evidence*, Princeton University Press (FNS).

Helpman, E and P. Krugman (1985), *Market Structure and Foreign Trade*, MIT Press (HNK)

Schedule of Lectures & Suggested Readings

Topic 1: Introduction to Trade Issues & an overview of new developments

[Scope of trade in the economy, composition & openness; global vs regional trading blocs, development of international economics literature from neoclassical ideas in the early 19th century, to the new theories and on to the empirical research of late 20th century]

Lecture Notes # SA_1

Topic 2: The Two-Sector Models of Trade: '200 years of Comparative Advantage'

[The Ricardian Model, basic structure of the 2 × 2 models & Heckscher-Ohlin ideas, factor price equalization, the Stolper-Samuelson as well as the Rybczynski theorems]

Lecture Notes # SA_2

FNS, Ch 1

Golub, S., and C.T. Hsieh (2000) "Classical Ricardian Theory of Comparative Advantage Revisited," *Review of International Economics*, 8(2), 221-234.

Topic 3: The Heckscher-Ohlin & Heckscher-Ohlin-Vanek (HOV) Models

[The $2 \times 2 \times 2$ model of trade, extension to many factors & many goods (i.e., the HOV model), Leontief Paradox & the recent empirical research]

Lecture Notes # SA_3

FNS, Ch 2

Trefler, D. (1995) "The case of the missing trade and other HOV mysteries," *American Economic Review* 85.

Trefler, D. (1993) "International factor price differences: Leontief was right!", *Journal of Political Economy*, 961-987.

Topic 4: Trade with Many Goods & Factors

[Factor price equalization 'revisited, the 'specific factor' (or, Ricardo-Viner) model and the Davis-Weinstein empirics]

Lecture Notes # SA_4

FNS, Ch 3

Dornbusch, R., S. Fischer, P. A. Samuelson (1977), "Comparative Advantage, Trade, and Payments in a Ricardian Model with a Continuum of Goods," *American Economic Review*, Vol. 67, No. 5, 823-839.

Topic 5: Trade in Intermediate Inputs

[Structure of relative wages & employment, trade in Intermediate inputs, Outsourcing, demand for skilled workers & non-traded goods]

Lecture Notes # SA_5

FNS, Ch 4

Baldwin, R., and G. Cain (2000), "Shifts in Relative U.S. Wages: The Role of Trade, Technology and Factor Endowments", *Review of Economics and Statistics* 82, 580-595.

Borjas, G., R. Freeman and L. Katz (1997), "How Much do Immigration and Trade Affect Labor Market Outcomes?", *BPEA* 1, 1-90.

Feenstra, R. and G. Hanson (1999), "The Impact of Outsourcing and High-Technology Capital on Wages: Estimates for the US, 1979-1990", *Quarterly Journal of Economics* 114, 907-940.

Wood, A. (1995), "How Trade Hurts Unskilled Workers", *Journal of Economic Perspectives* 9, 57-80.

Topic 6: Increasing Returns & the Gravity Equation in International Economics

[Monopolistic competition in models of trade, the 1989 Canada-US free trade agreement, gravity equation & its applications]

Lecture Notes # SA_6

FNS, Ch 5

Helpman, E. and P. Krugman (1985), Ch 2.

Hummels, D. and J. Levinsohn (1995), "Monopolistic competition and international trade: Reconsidering the evidence," *Quarterly Journal of Economics* 110, 799-836.

Krugman, P. (1979), "Increasing Returns, Monopolistic Competition, and International Trade", *Journal of International Economics*, Vol. 9, No. 4, 313-321.

Krugman, P. (1980), "Scale Economies, Product Differentiation, and the Pattern of Trade," *American Economic Review*, Vol. 70, No. 5, 950-959.

Topic 7: Regional vs Global/multi-lateral Trade Agreements

[Do gains from trade always offset the losses? factor taxes, subsidies & Pareto Efficiency, GATT & the Doha round of WTO, Canada-US & NAFTA examples & evidence]

Lecture Notes # SA_7

FNS, Ch 6

Bhagwati J. and T. N. Srinivasan (2002), "Trade and Poverty in the Poor Countries", *The American Economic Review*, Vol. 92, No. 2.

Cadot, O., J. de Melo and M. Olarreaga (2001), "Can Bilateralism Ease the Pains of Multilateral Trade Liberalization?", *European Economic Review* 45, 27-44.

Ethier, W. (1998), "Regionalism in a Multilateral World"; *Journal of Political Economy* 106, 1214-1245.

Krueger, A. (1997), "Free Trade Agreements vs. Customs Unions"; *Journal of Development Economics* 54, 169-187.

Panagariya, A. (1999), "The Regionalism Debate: An Overview", *World Economy*, 477-511.

Topic 8: Political Economy of Trade Policy

[A primer on import tariffs & quotas, dumping & export subsidies, Strategic application of trade policy measures, median voter model & 'protection for sale' idea]

Lecture Notes # SA_8

FNS, Ch 9

Blonigen, B. and J. H. Park (2004), "Dynamic Pricing in the Presence of Antidumping Policy: Theory and Evidence", *American Economic Review* 94, 134-154.

Finger, J. Michael; K. Hall and D. Nelson (1982), "The Political Economy of Administered Protection", *American Economic Review* 72, 452-466.

Krishna, K. (1989), "Trade Restrictions as Facilitating Practices", *Journal of International Economics* 26, 251-270.

Milanovic, B. (2003), "The Two Faces of Globalisation: Against Globalisation as We Know it", *World Development*, Vol. 31, No. 4, pp 667-684.

Rodrik, D. (1992), "The Limits of Trade Policy Reform in Developing Countries", *The Journal of Economic Perspectives*, Vol. 6, No. 1, 87-105

Rosenberg, T. (2002), "The Free Trade Fix", *New York Times Magazine*, 18 August 2002.

Stiglitz, J. (2014), "On the wrong side of Globalisation", *New York Times*, 15 March 2015.