

International Trade and Payments Theory

Econ 8403, Spring 2006, WF 2:30PM- 4:25PM, Blegen 255.

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Office Hours: 10:00-12:00 W or send me an e-mail to schedule an appointment.

This course is about studying business cycles in open economies with an emphasis on exchange rate dynamics and sovereign debt. I will start with an overview of some of the open questions that are on field. Then I will turn to cover recent papers mainly in two topics: exchange rates and sovereign debt. I will also briefly touch on the topics of crisis in emerging economies and international trade. The goal of the course is get you acquainted with the literature on these topics and to review some recent papers and developments that are in the frontier.

I plan to discuss the papers that are listed below with an asterisk * (tentative).

Reference Texts

Obstfeld, Maurice and Kenneth Rogoff, *Foundations of International. Macroeconomics*, MIT Press 1996.

Ljungqvist and Sargent, *Recursive Macroeconomic Theory*, 2nd Edition, MIT Press 2004.

Grading

The grading will be based on three parts: three referee reports (50%), e-mails with summary of papers (30%), and class participation (20%).

1. Three referee reports should be based on articles that are in the syllabus or some other articles we agree upon. You should contact me if you have additional papers in mind. The format should be the one in the handout.
2. You have to write me an e-mail before we start covering a new paper in the class with your assesment of the paper. The e-mail should cover the following points:
 - (a) A description of the main features of the paper.
 - (b) An assesment of why this paper is important or interesting (or not).
3. I expect you to participate in class discussions actively.

Overview

* Obstfeld, Maurice and Kenneth Rogoff. 2000. The Six Major Puzzles In International Macroeconomics: Is there a common cause? NBER Macroeconomics Annual 2000

International Risk Sharing

Backus, D., P. Kehoe and F. Kydland. 1992. International Real Business Cycles. *Journal of Political Economy*.

Backus, D., P. Kehoe and F. Kydland. 1984. Dynamics of the Trade Balance and the Terms of Trade: the J-Curve? *AER*.

Bai, Y. and J. Zhang. 2005. Can Financial Frictions Account for the Cross-Section Feldstein-Horioka Puzzle? University of Michigan Working Paper.

Baxter, M. and M. Crucini. 1992. Explaining Savings-Investment Correlations. *AER*.

Baxter, M. and M. Crucini. 1995. Business Cycles and the Asset Structure of Foreign Trade. *International Economic Review*

Cole, H. and M. Obstfeld. 1991. Commodity trade and international risk sharing: How much do financial markets matter? *JME* 28.

Feldstein, M. and C. Horioka. 1990. Domestic Saving and International Capital Flows. *Economic Journal* 90.

Gourinchas, P. O. and O. Jeanne. 2005. The Elusive Gains from International Financial Integration. *Review of Economic Studies*, forthcoming.

Gourinchas, P. O. and Helene Rey. 2005. International Financial Adjustment. UC Berkeley working paper

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

Heathcote, J. and F. Perri. 2004. The International Diversification Puzzle is Not as Bad as you Think. mimeo Georgetown

Kehoe, P. and F. Perri. 2000. International Business Cycles with Endogenous Incomplete Markets. *Econometrica*.

Lane, P. R. and G. M. Milesi-Ferretti. 2001. The External Wealth of Nations: Measures of Foreign Assets and Liabilities for Industrial and Developing Nations. *Journal of International Economics* 55: 263-294.

Lewis, K. 1999. Trying to explain the home bias in equities and consumption. *JEL* 37.

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

Tesar, L. 1991. Savings, Investment and International Capital Flows. *Journal of International Economics* 31, August.

Exchange Rates

Backus, D. and G. Smith. 1993. Consumption and real exchange rates. *JIE*. 1993.

* Alessandria, G. 2005. Consumer Search, Price Dispersion, and International Relative Price Volatility. Philadelphia Fed Working Paper.

* Alvarez, F., A. Atkeson, and P. Kehoe. 2002. Money, Interest Rates, and Exchange Rates With Endogenously Segmented Asset Markets. *Journal of Political Economy*, 110, 73-112.

Alvarez, F., A. Atkeson, and P. Kehoe. 2005. Time-Varying Risk, Interest Rates, and Exchange Rates in General Equilibrium. Mimeo Minnesota

* Atkeson, A. and A. Burstein 2005. Trade Costs, Pricing to Market, and International Relative Prices. Mimeo UCLA

Betts, C. and M. B. Devereux. 2000. Exchange Rate Dynamics in a Model of Pricing-to-Market. *Journal of International Economics*, 50, 215-244.

Betts, C. and T. J. Kehoe. 2002. Real Exchange Rate Movements and the Relative Price of Nontraded Goods. University of Minnesota and University of Southern California.

* Betts, C. and T. J. Kehoe. 2001. Tradability of Goods and Real Exchange Rate Fluctuations. University of Minnesota Working Paper.

Brandt, W., J. Cochrane, and P. Santa-Clara. 2004. International risk sharing is better than you think (or exchange rates are much too smooth). Forthcoming *Journal of Monetary Economics*.

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

* Chari, VV, P. Kehoe and E. McGrattan. 2002. Can sticky price models generate volatile and persistent real exchange rates? *Review of Economic Studies* 69, 533-563.

Lahiri, A. R. Singh, and C. Vegh. 2002. Segmented Asset Markets and Optimal Exchange Rate Regimes. mimeo, UCLA.

Lucas, R. E. 1982. Interest Rates and currency prices in a two country world. *JME* November

Engel, C. 1999. Accounting for U.S. Real Exchange Rate Changes. *Journal of Political Economy*, 107,507-538.

J. Imbs, H. Mumtaz, M. O. Ravn, and H. Rey. 2005. PPP Strikes Back: Aggregation and the Real Exchange Rate. *Quarterly Journal of Economics*, 120, 1-44.

Naknoi, K. 2003. Real Exchange Rate Fluctuations and Endogenous Tradability. Mimeo, Department of Economics, Stanford University.

* Verdelhan, A. 2005. A Habit-Based Explanation of the Exchange Rate Risk Premium. Boston University

Business Cycles in Emerging Economies

* Aguiar, M. and G. Gopinath. 2004. Emerging Market Business Cycles: The Cycle is the Trend. Harvard working paper

Aguiar, M., M. Amador and G. Gopinath. 2005. Efficient Fiscal Policy and Amplification. Harvard Working Paper.

Mendoza, E. 1991. Real Business Cycles in a Small Open Economy. *AER*.

Mendoza, E.. 1995. The Terms of Trade, the Real Exchange Rate and Economic Fluctuations. *International Economic Review*.

* Neumeyer, Pablo A. and F. Perri. 2004. Business Cycles in Emerging Markets: The Role of Interest Rates. *Journal of Monetary Economics*.

Schmitt-Grohe S. and M. Uribe .2003. Closing Small Open Economy Models. *JIE*.

Uribe, M. and Z. V. Yue. 2004. Country Spreads and Emerging Countries: Who Drives Whom? *JIE*

Currency Crises

Angeletos, George-Marios and Ivan Werning. 2005. Crises and Prices: Information Aggregation, Multiplicity and Volatility. Mimeo, MIT.

Burnside, C and M. Eichenbaum S. Rebelo. 2001. Prospective Deficits and the Asian Currency Crises. *Journal of Political Economy*.

Burnside, C and M. Eichenbaum S. Rebelo. 2003. Government Finance in the Wake of Currency Crises" mimeo, Northwestern University.

Calvo, G. A. 1987. Balance of Payments Crises in a Cash-in-Advance Economy," *Journal of Money, Credit and Banking*, 19, 19-32.

Calvo, G. and Mendoza, E. 2000. Capital Markets Crises and Economic Collapse in Emerging Markets: An Informational Frictions Approach. *American Economic Review P&P*, May 2000.

Céspedes, L., R. Chang and A. Velasco. 2005. Balance Sheets and Exchange Rate Policy. forthcoming *American Economic Review*.

Chang, R. and A. Velasco. 2001. A Model of Financial Crises in Emerging Markets. *Quarterly Journal of Economics*.

Chari, V. V., and P. J. Kehoe. 2003. Hot Money. *Journal of Political Economy* 111, 1262-92.

Cole, H and T. Kehoe. 2000. Self-Fulfilling Debt Crises", *Review of Economic Studies*, 67, 91-116.

Krugman, P. R. 1979. A Model of Balance of Payments Crises. *Journal of Money, Credit and Banking*, 11, 311-325, August.

Schneider, M. and A. Tornell. Balance Sheet Effects and Financial Crises. forthcoming *Review of Economic Studies*.

* Morris, S.. and H. S. Shin. 1998. Unique Equilibrium in a Model of Self-Fulfilling Currency Attacks. *American Economic Review* 88 , 587-97, June.

Empirical Facts

Frankel, J. and A. Rose. 1996. Currency Crashes in Emerging Markets: An Empirical Treatment. *Journal of International Economics*, 41, 351-368.

Kaminsky, G. and C. Reinhart. 1999. The Twin Crises: The Causes of Banking and Balance of Payments Problems. *American Economic Review* 89, 473-500.

Milesi-Ferretti, G.M and A Razin. 1999. Current account reversals and currency crises: Empirical Regularities.

Financial Imperfections and Sudden Stops

Alvarez F. A. Atkeson and P. Kehoe. 2002. Money, Interest Rates, and Exchange Rates with Endogenously Segmented Asset Markets. *Journal of Political Economy*, Vol. 110, n. 1, pp. 73-112.

Arellano, C. and E. Mendoza. 2002. Credit Frictions and ‘Sudden Stops’ in Small Open Economies: An Equilibrium Business Cycle Framework for Emerging Markets Crises. NBER WP No. w8880.

Caballero, R. and A. Krishnamurthy. 2001. International and Domestic Collateral Constraints in a Model of Emerging Market Crises. *Journal of Monetary Economics*.

Caballero, R. and S. Panageas. 2005. Hedging Sudden Stops and Precautionary Contractions. MIT Working Paper

Caballero, R. and S. Panageas. 2005. A Quantitative Model of Sudden Stops and External Liquidity Management. MIT Working Paper.

Calvo, G. A. 1998. Capital Flows and Capital-Market Crises: The Simple Economics of Sudden Stops. *Journal of Applied Economics*, v. 1, pp. 35-54.

Cavallo, M., F. Perri, N. Roubini and K. Kisselev. 2002. Exchange Rates Overshooting and the Costs of Floating. mimeo, Stern School of Business, NYU.

Chari, VV., P. Kehoe and E. McGrattan. 2005. Sudden Stops and Output Drops. Federal Reserva Bank of Minneapolis, Staff Report 353.

Christiano, L., C. Gust; and J. Roldos. 2002. Monetary Policy in a Financial Crisis. NBER working paper No. 9005, June.

Gopinath, G. 2003. Lending Booms, Sharp Reversals and Real Exchange Rate Dynamics,” mimeo, GSB University of Chicago.

Mendoza, E. 2001. Credit, Prices, and Crashes: Business Cycles with a Sudden Stop,” in *Preventing Currency Crises in Emerging Markets*, ed. by S. Edwards and J. Frankel, Univ. of Chicago Press, also available as NBER WP no. w8338..

Mendoza, E. and K. Smith. 2004. Margin Calls, Trading Costs, and Asset Prices in Emerging Markets: The Financial Mechanics of the Sudden Stops Phenomenon. Maryland Working Paper.

* Mendoza, E. 2004. Sudden Stops’ in an Equilibrium Business Cycle Model with Credit Constraints: A Fisherian Deflation of Tobin’s q . University of Maryland Working paper.

Oviedo, P. M. 2003. Macroeconomic Risk and Banking Crises in Emerging Countries. mimeo, Department of Economics, Iowa State University.

Sovereign Debt and Default

Amador, M. 2003. A Political Economy Model of Sovereign Debt Repayment. mimeo, Stanford University.

* Arellano, C. 2004. Default Risk and Income Fluctuations in Emerging Economies. mimeo, University of Minnesota.

* Arellano, C. 2005. Default and the Term Structure in Sovereign Bonds. Mimeo Minnesota.

Atkeson, A. 1991. International Lending with Moral Hazard and Risk of Repudiation. *Econometrica*, 59, 1069-89.

Broner, F., G. Lorenzoni and S. Schmukler. 2005. Why do Emerging Economies Borrow Short Term? MIT Working paper

* Bulow, J. and K. Rogoff. 1989. Sovereign Debt: Is to Forgive to Forget? *American Economic Review*, 79, 43-50.

Bulow, J. and K. Rogoff. 1989. A Constant Recontracting Model of Sovereign Debt. *Journal of Political Economy*, 97, 155-78, February.

Chari V.V. and P. Kehoe. 1990. Sustainable Plans. *Journal of Political Economy*.

Cole, H. and P. Kehoe. 1998. A General Reputation Model of Sovereign Debt. *International Economic Review*.

Cole, H. and T. Kehoe. 1996. A Self-Fulfilling Model of Mexico's 1994-95 Debt Crisis. *Journal of International Economics*, 41, 309-330.

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

Eaton, J. and R. Fernandez. 1995. Sovereign Debt. In *Handbook of International Economics*, edited by Gene M. Grossman and Kenneth Rogoff, Amsterdam: Elsevier, 2031-2076.

* Kletzer, K. and B. D. Wright. 2000. Sovereign Debt as Intertemporal Barter. *American Economic Review*, (90): 621-39, June.

Kovrijnykh, N. and B. Szentes. 2005. Competition for Default. University of Chicago Working Paper.

Tirole, J. 2003. Inefficient Foreign Borrowing: A Dual and Common-Agency Perspective. *AER*.

Tomz, Michael and Wright Mark L. J., 2005. Sovereign Debt, Defaults and Bailouts. Manuscript, Stanford University.

Wright, M. L. J. 2002. Reputations and Sovereign Debt. mimeo, Stanford University, September.

Yue, Vivian Z. 2005. Sovereign Default and Debt Renegotiation. Manuscript, New York University.

Empirical Facts

Reinhart, C, . K. Rogoff and M. A. Savastano. 2003. Debt Intolerance. in William Brainard and George Perry (eds.), *Brookings Papers on Economic Activity* , 1-74.

Rose, A. K. 2002. *One Reason Countries Pay their Debts: Renegotiation and International Trade*. University of California Berkeley.

Rose, A. K. and M. M. Spiegel. 2002. *A Gravity Model of Sovereign Lending: Trade, Default and Credit*. University of California Berkeley.

International Trade

Alvarez, F. and R. Lucas. 2004. *General Equilibrium Analysis of the Eaton-Kortum Model of International Trade*. Working Paper

Bernard, Andrew, Jonthan Eaton, Bradford Jensen, and Sam Kortum. 2003. *Plants and Productivity in International Trade*. AER

* Eaton, Jonathan and Sam Kortum. 2002. *Technology, Geography, and Trade*. *Econometrica*

Eaton, Jonathan, Sam Kortum, and Francis Kramarz. 2004. *An anatomy of International Trade, Evidence from French Firms*. mimeo

* Melitz, Marc. 2004. *The Impact of Trade on Intra-industry reallocations and aggregate industry productivity*. *Econometrica*

Keller, Wolfgang and Stephen Yeaple. 2004. *Multinational Enterprises, International Trade, and Productivity Growth: Firm Level Evidence for the United States*. mimeo Penn