AEM/ECON 7670

Topics in International Finance

Fall 2015
Thursdays 4:30-7:00 p.m.
Warren Hall 113

Professor Eswar Prasad

This course will provide a selective overview of topics at the cutting-edge of academic research and policy debates about the international financial system. Main areas will include the effects of financial globalization on growth, volatility, and the transmission of business cycles. We will also examine the determinants of the direction and composition of capital flows. We will then discuss the causes and effects of the financial crisis and what implications it has for the research agenda in international finance and macroeconomics, with particular emphasis on the implications for monetary policy and financial regulation.

This course is intended for advanced Ph.D. students, especially those in search of thesis topics, and will require extensive student involvement in preparing research proposals and critiques of existing literature. Students will be expected to have basic graduate-level training in modeling techniques and familiarity with empirical tools (both panel data and time series).

There will be no exams. All registered candidates will be required to write a paper in order to receive a passing grade. The course will be graded S/U only.

Course Support: Carol Thomson (cmt8)
201 Warren Hall

Office Hours: By appointment (through Carol Thomson)

Teaching Assistant: Maulik Jagnani (mvj22)
Background Readings

*Foundations of International Macroeconomics*, Maurice Obstfeld and Kenneth Rogoff, MIT Press. [OK]


Structure of Course

**Topic 1: Measurement of Financial Openness**

A. Measures of Asset Market Integration Based on Price Data

B. Capital Controls

C. De Facto Measures of Integration Based on Quantities—Flows, Stocks

D. Evolution of De Facto Measures

E. Brief Presentation on Sources of International Macro Data

References for this lecture can be found in Section III of KPRW. For a different approach to construction of capital control indexes and for detailed chronologies of capital controls in specific emerging markets, see the relevant chapters in: *Capital Controls and Capital Flows in Emerging Economies: Policies, Practices, and Consequences*, 2007, Sebastian Edwards, ed. Chicago, IL: University of Chicago Press.

*The Dollar Trap*, Chapters 3-6.


Topic 2: Financial Integration and Growth

A. Macro Evidence

B. FDI and Growth

C. Equity Market Liberalizations and Growth

D. New Thinking on Capital Controls

References for this lecture can be found in Sections V and VI of KPRW. Additional readings:

The Dollar Trap, Chapter 10.


**Topic 3: Risk Sharing**

A. International Risk Sharing—Patterns and Channels

B. Intrastate Risk Sharing as a Benchmark

C. Risk Sharing, Specialization and Growth

D. Risk Pooling and GDP-Linked Bonds


**Topic 4: Volatility, Crises**

A. Financial Integration and Macroeconomic Volatility

B. Financial Crises

C. Globalization and the Growth-Volatility Relationship


**Topic 5: A New Framework: Collateral Benefits and Thresholds**
The framework is summarized in Section VII of KPRW. We will go over the specifics of this framework in detail, and critically examine its theoretical basis and empirical relevance. Sections VIII and IX of KPRW contain the key references.

For some evidence and more detailed discussion of a key collateral benefit, see:


For a detailed literature survey and related evidence on threshold effects, see:


**Topic 6: International Business Cycle Transmission**

A. Properties of Business Cycles in Emerging Markets

B. How Does Financial Integration Affect Domestic Business Cycles

C. Implications of Financial Integration for Business Cycle Transmission

D. Decoupling or Convergence of International Business Cycles?


**Topic 7. Understanding the Causes and Dynamics of the Global Financial Crisis**

*The Dollar Trap*, Chapters 1-2, 7-8, 11.


**Topic 8: Implications of Financial Globalization (and the Crisis) for Monetary Policy Frameworks in Emerging Markets**

A. Monetary Policy: The New Neoclassical Synthesis
B. Does Financial Openness Make Monetary Policy Less/More Effective, Less/More Relevant

C. Optimal Monetary and Exchange Rate Policies for Emerging Markets


Topic 9: Capital Flow Management, Safe Assets

A. Managing Volatile Capital Flows When Capital Markets are Integrated

B. Models of Safe Assets


**Topic 10: Integrating Macroeconomics and Finance**

A. Macroeconomic Models with a Financial Sector

B. Macro-Prudential Policies


Key Dates

Thursday, October 15: Paper proposals due @ noon
Friday, November 13: First drafts of papers due @ noon
Friday, December 4: Final drafts of papers due @ noon

Please adhere strictly to deadlines. I will not provide detailed feedback if you do not get your assignment in on time.

Research Proposals

Maximum length of proposal: 10 pages of double-spaced text including cover page and appendixes but excluding references, charts and tables (use 12 point font, at least 1 inch margin on all sides).

Preliminary Drafts of Papers

Maximum length of draft: 20 pages of double-spaced text including cover page and appendixes but excluding references, charts and tables (use 12 point font, at least 1 inch margin on all sides).

Structure, Format for Research Paper

Final draft of paper is due on Friday, December 4 at 12 noon. No exceptions.

Maximum length of final draft: 25 pages of double-spaced text including cover page and appendixes but excluding references, charts and tables (use 12 point font, at least 1 inch margin on all sides). Cover page should contain an abstract—maximum of 150 words.

Introduction should clearly convey the objective of your paper, provide a clear motivation (why the questions you are addressing are of interest), what the main original contribution of your paper is, and the key results.

Do not include an extensive literature survey. In the text, discuss only a few key papers that you are building on. Footnote the remaining papers.

Tables and figures should have self-explanatory titles and footnotes, with axes labeled clearly and showing relevant units.

Empirical work should be described clearly (dataset, variable transformations, exact specifications etc.) in a manner that allows for easy replication by other researchers. Theoretical work should have clear and consistent notation.

Email all documents to me (eswar.prasad), with cc to Maulik Jagnani (mvj22) and Carol Thomson (cmt8), with the subject line indicating “7670: Proposal” (or whatever the relevant document is).