

# Selected Topics in International Economics

## GOALS

One of the most significant developments in macroeconomics during recent years has been the increasingly central role played by international transactions in both goods and assets. The primary goal of this course is to motivate and initiate innovative research in the field of international economics. You will find that we focus heavily on issues, models, and quantitative work at the heart of international economics. I am planning to cover some selected topics that constitute very important research agendas for many economists around the world.

First, we will study *firms in international trade*. For most of its lengthy history the field of international trade largely ignored the role of the firm in mediating the flow of goods and services. A new theoretical and empirical literature has emerged that examines international trade at the level of individual producers.

Second, we will study *financial globalization, capital flows, trade and FDI, and global imbalances*. Should policymakers be worried that the U.S. current account deficit is on track to set an all-time record in 2004, reaching a level near 6 percent of GDP? With the United States today absorbing roughly 70 percent of the current account surpluses of China, Japan, Germany, and of the entire world's other surplus countries, the increasingly popular view that the current situation is sustainable seems unlikely. This is all the more true when one considers that government deficits rather than high investment now account for the lion's share of the U.S. current account deficit.

Third, we will study *outsourcing*. According to Grossman and Helpman (2005) *we live in an age of outsourcing*. Outsourcing can happen both through transactions by firms, like phone call centers staffed in Bangalore to serve customers in New York and X-rays transmitted digitally from Boston to be read in Bombay, or with direct consumption purchases by individuals, like when someone hires an offshore firm to provide plans for redesigning or redecorating a living room.

## EVALUATION

Lectures are complemented by student presentations in class of research papers in the literature, and by the completion and presentation of an original research project.

### Class Presentations

You will have 45 minutes for the presentation. All students are required to read the paper that is being presented as I can randomly ask students questions related to the presentation. Each presentation should direct the questions such as

*What question is this paper trying to answer?*

*What sorts of tools does the author use to answer the question?*

*What is the answer that the author comes up with and does it make sense to you?*

You should derive the key equations and analytical expressions of the paper. Moreover, you should clearly explain the computational experiments and sketch the details of the numerical

algorithm. Each person's talk will be graded on its technical content, organization, clarity, thoroughness, and effectiveness. How well you handle questions from the other students will also be taken into account.

### **Tips on Preparing for the Presentations**

Communication of results is an essential component of economic research. Many economists prefer attending conferences, workshops, and seminars to reading working papers and journal articles as a way of picking up ideas. The fundamental ingredient in a good presentation is preparation. Try to practice the presentation more than once. When you are preparing slides, make sure that the font is large enough to be readable. Since time is precious to you in your presentation, you should think carefully about how you want spend it.

Long introductions are almost always a bad idea. What the audience usually wants to learn during the introduction is the question that you intend to answer, why the question and the answer are important, and, probably, what your answer is going to be. In general, audiences do not like research presentations to be mysterious. Surprise endings are fine for novels and films, but usually not for economic research. You will learn a lot in preparing for your presentation. You can also learn a lot at the class from the other presentations.

The final draft of the written research project is due on the scheduled final examination date. The research paper cannot be the same as that submitted to another class, in this or any other semester.

Your final grade in the class will be determined as the following weighted average of your work throughout the semester

Class Presentations and Participation	50%
Written Research Project	50%

### **COURSE OUTLINE**

What follows is a list of papers for this course. This list is much too long by design. The intention is to give you some sort of an organization of the literature along with a guide, by topic, of some of the recent work in the area in case you are interested in pursuing a particular topic in more detail. This list is not complete.

## I Firms in International Trade

Traditional trade theory explained the flow of goods between countries in terms of comparative advantage, that is, variation in the opportunity costs of production across countries and industries. Even the research focusing on differentiated varieties and increasing returns to scale that followed Helpman and Krugman continued to retain the characterization of the representative firm. However, the assumption of a representative firm, while greatly enhancing the tractability of general equilibrium analysis, is emphatically rejected in the data.

Recent research over the past decade has been an attempt to explore international trade from below: to understand the decisions of heterogeneous firms in shaping international trade and their effects on productivity growth and welfare. In spite of a decade of research, we are just beginning to explore the role of firms in mediating the effects of trade on the economy. The new detailed data on firms, products, and trade will allow us to ask important questions about firms engaged in international trade and investment.

This section is designed to introduce you to the new firm-level theories of trade and analyze their quantitative implications. What are the important features that firm-level models of trade can offer not attainable by previous theory? How can we construct a reasonable mapping of firm-level models of trade to the data? Can the firm-level models of trade be integrated in a unified macroeconomic framework, without losing the desirable properties that each model individually attains?

**Alvarez, Fernando and Lucas, Robert E.** “General Equilibrium Analysis of the Eaton-Kortum Model of International Trade.” *Journal of Monetary Economics*, September 2007, 54(6), pp. 1726-1768.

**Arkolakis, Costas.** “Market Penetration Costs and the New Consumers Margin in International Trade.” *NBER Working Paper Series*, No: 14214, August 2008.

**Arkolakis, Costas.** “[A Unified Theory of Firm Selection and Growth.](#)” Working Paper, Yale University, May 2009.

**Baldwin, Richard E. and Robert-Nicoud, Frédéric.** “Trade and Growth with Heterogeneous Firms.” *Journal of International Economics*, January 2008, 74(1), pp. 21-34.

**Bernard, Andrew B.; Eaton, Jonathan; Jensen, J. Bradford and Kortum, Samuel.** “Plants and Productivity in International Trade.” *American Economic Review*, November 2003, 93(4), pp. 1268-1290.

**Chaney, Thomas.** “[Distorted Gravity: The Intensive and Extensive Margins of International Trade.](#)” *American Economic Review*, September 2008, 98(4), pp. 1707-1721.

**Eaton, Jonathan and Kortum, Samuel.** “Technology, Geography, and Trade.” *Econometrica*, September 2002, 70(5), pp. 1741-1779.

**Eaton, Jonathan; Kortum, Samuel and Kramarz, Francis.** “Dissecting Trade: Firms, Industries, and Export Destinations.” *American Economic Review*, May 2004, 94(2), pp. 150-154.

**Ederington, Josh and McCalman, Phillip.** “Endogenous Firm Heterogeneity and the Dynamics of Trade Liberalization.” *Journal of International Economics*, March 2008, 74(2), pp. 422-440.

**Helpman, Elhanan; Melitz, Marc J. and Rubinstein, Yona.** “Estimating Trade Flows: Trading Partners and Trading Volumes.” *Quarterly Journal of Economics*, May 2008, 123(2), pp. 441-487.

**Melitz, Marc J.** “The Impact of Trade on Intra-Industry Reallocations and Aggregate Industry Productivity.” *Econometrica*, November 2003, 71(6), pp. 1695-1725.

**Ruhl, Kim J.** “[The International Elasticity Puzzle](#).” Working Paper, University of Texas at Austin, March 2008.

### **Useful Links**

**Eaton and Kortum Book:** [http://www.econ.umn.edu/~kortum/courses/spring06/s06\\_texas.htm](http://www.econ.umn.edu/~kortum/courses/spring06/s06_texas.htm)

**Tim Kehoe’s class notes:** <http://www.econ.umn.edu/~tkehoe/classes/8401-07.html>

**Thomas Chaney’s class notes:** <http://home.uchicago.edu/~tchaney/teaching.html>

**Pol Antràs’ notes:** [http://www.courses.fas.harvard.edu/~ec2535/Lectures\\_Notes/](http://www.courses.fas.harvard.edu/~ec2535/Lectures_Notes/)

## **II Financial Globalization, Capital Flows, Current Account, FDI, and Global Imbalances**

The last two decades have been characterized by a sharp increase in international capital flows and, in particular, by a rising globalization of equity markets. A central economic challenge of the first decade of the third millennium is “global rebalancing” – the re-alignment of current account balances between the three key economic regions of the US, the Euro area, and East Asia. There is a large theoretical literature that explains how current account balances (the trade balance plus net income from assets abroad) should evolve in idealized economies. However, that literature has been largely unsuccessful in empirically explaining real-world experiences. The broadening of the set of assets internationally traded, the switch to a floating exchange rate regime in 1973, and the larger size of gross asset and liability positions have made it increasingly necessary to incorporate valuation adjustments when computing net foreign asset positions.

Many analysts in academia, the private sector, and applied research institutions express increasing concern about the growing U.S. current account deficit. There is a general sense that current global imbalances are unsustainable and that adjustment must come sooner rather than later. The unprecedented magnitude of the U.S. current account deficit and the United States’ growing net foreign indebtedness have fueled these worries, with many analysts arguing that, unless something is done, the world will move toward a major financial crisis.

[Web Page on the Current Accounts of Advanced Countries](#)

**Antràs, Pol and Caballero, Ricardo J.** “Trade and Capital Flows: A Financial Frictions Perspective.” *Journal of Political Economy*, August 2009, 117(4), pp. 701-744.

**Backus, David; Henriksen, Espen; Lambert, Frederic and Telmer, Chris.** “[Current Account Fact and Fiction](#).” Mimeo.

**Blanchard, Olivier and Giavazzi, Francesco.** “Current Account Deficits in the Euro Area: The End of the Feldstein-Horioka Puzzle?” *Brookings Papers on Economic Activity*, 2002, 2, pp. 147-86.

**Caballero, Ricardo J.; Farhi, Emmanuel and Gourinchas, Pierre-Olivier.** “An Equilibrium Model of “Global Imbalances” and Low Interest Rates.” *American Economic Review*, March 2008, 98(1), pp. 358-393.

**Engel, Charles and Rogers, John H.** “The U.S. Current Account Deficit and the Expected Share of World Output.” *Journal of Monetary Economics*, July 2006, 53(5), pp. 1063-1093.

**Gourinchas, Pierre-Olivier and Jeanne, Olivier.** “[Capital Flows to Developing Countries: The Allocation Puzzle](#).” Working Paper, University of California Berkeley and John Hopkins University, June 2009.

**Henriksen, Espen.** “A Demographic Explanation of U.S. and Japanese Current Account Behavior .” Mimeo.

**McGrattan, Ellen R. and Prescott, Edward C.** “Openness, Technology Capital, and Development.” Forthcoming, *Journal of Economic Theory*.

**Mendoza, Enrique, G.; Quadrini, Vincenzo and Rios-Rull, Jose Victor.** “On The Welfare Implications of Financial Globalization without Financial Development.” *NBER Working Paper Series*, No: 13412, September 2007.

**Mendoza, Enrique, G.; Quadrini, Vincenzo and Rios-Rull, Jose Victor.** “Financial Integration, Financial Development and Global Imbalances.” *Journal of Political Economy*, June 2009, 117(3), pp. 371-416.

### III Outsourcing

It is increasingly common today that when U.S. consumers seek out help with their American-made product, the person handling the call or Internet chat session is sitting at a desk on the other side of the world. This is just one example of the growing tendency in the U.S. manufacturing sector to "outsource" key services -- which can include, among other things, technical support, medical claims processing, and software development -- to providers in other countries. The rapid expansion over the past five years of U.S. imports of information technology (IT) and IT-enabled services has been a clear boon to the economies of India, China, Singapore and a number of other developing countries.

**Antràs, Pol and Helpman, Elhanan.** "Global Sourcing." *Journal of Political Economy*, June 2004, 112(3), pp. 552-580.

**Feenstra, Robert C. and Hanson, Gordon H.** "The Impact of Outsourcing and High Technology Capital on Wages: Estimates for the United States, 1979-1990." *Quarterly Journal of Economics*, August 1999, 114(3), pp. 907-940.

**Feenstra, Robert C. and Hanson, Gordon H.** "Globalization, Outsourcing and Wage Inequality." *American Economic Review*, May 1996, 86(2), pp. 240-245.

**Grossman, Gene M. and Helpman, Elhanan.** "Outsourcing in a Global Economy." *Review of Economic Studies*, January 2005, 72(1), pp. 135-159.

**Grossman, Gene M. and Helpman, Elhanan.** "Integration versus Outsourcing in Industry Equilibrium." *Quarterly Journal of Economics*, February 2002, 117(1), pp. 85-120.

**Grossman, Gene M.; Helpman, Elhanan and Szeidl, Adam.** "Complementarities between Outsourcing and Foreign Sourcing." *American Economic Review*, May 2005, 95(2), pp. 19-24.

**Grossman, Gene M. and Rossi-Hansberg, Esteban** "Trading Tasks: A Simple Theory of Offshoring." *American Economic Review*, December 2008, 98(5), pp. 1978-97.

**Hsieh, Chang-Tai and Woo, Keong T.** "The Impact of Outsourcing to China on Hong Kong's Labor Market." *American Economic Review*, December 2005, 95(5), pp. 1673-87.

**Trefler, Daniel.** "Service Offshoring: Threats and Opportunities." *Brookings Trade Forum*, 2005, pp. 35-60.