

International Finance

The objective of this course is to study how international capital flows affect the workings of national economies. The grade is based on a final exam. All readings below are required.

0. Preliminaries

Brief introduction to stochastic calculus, stochastic dynamic programming and continuous-time finance.

Dixit, A. and R. Pindyck, Investment Under Uncertainty, Princeton University Press, 1994. Chapters 3 and 4.

Class notes on optimal portfolio choice and mutual fund theorems.

1. Savings, Investment and the Current Account

The intertemporal approach to the current account. The terms of trade and the real exchange rate. Government debt and the current account. The Feldstein-Horioka finding and other empirical regularities. The role of investment: adjustment costs and investment risk.

Obstfeld, M. and K. Rogoff, "The Intertemporal Approach to the Current Account," in G. Grossman and K. Rogoff, eds. Handbook of International Economics, Elsevier, 1995.

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

French, K. and J. Poterba, "Investor Diversification and International Equity Markets," *American Economic Review*, 1991.

Kraay, A. and J. Ventura, "Current Accounts in Debtor and Creditor Countries," *Quarterly Journal of Economics*, 2000.

Kraay, A. and J. Ventura, "Current Accounts in the Long and the Short Run," in M. Gertler and K. Rogoff eds. Macroeconomics Annual 2002, NBER, forthcoming.

Ventura, J., "Towards a Theory of Current Accounts," NBER WP9163 and CEPR DP3545, 2002.

2. Country Portfolios

The complete-markets model and its empirical problems. Nontraded goods and assets. The benefits of international risk sharing. Sources of shocks. Sovereign risk and differences in technology.

Obstfeld, M., "Risk-taking, Global Diversification and Growth," *American Economic Review*, 1994.

Pesenti, P. and E. van Wincoop, "Can Nontradables Generate Substantial Home Bias?" *Journal of Money, Credit and Banking*, 2000.

Bottazi, L., P. Pesenti and E. van Wincoop, "Wages, Profits and the International Portfolio Puzzle," *European Economic Review*, 1996.

Athanosoulis, S and E. van Wincoop, "Growth Uncertainty and Risk-Sharing," *Journal of Monetary Economics*, 2000.

Kraay, A., N. Loayza, L. Servén, and J. Ventura, "Country Portfolios," NBER WP7795 and CEPR DP2974, 2000.

3. Sovereign Debt, Default and Restructuring

Why do countries repay their debts? Potential inefficiencies associated with foreign borrowing. Contractual vs. statutory approaches to default and restructuring. Short-term debt, liquidity shortages and the role for an international lender of last resort.

Eichengreen, B., "Historical Research on International Lending and Debt," *Journal of Economic Perspectives*, 1991.

Rose, A.K., "One Reason Countries Pay Their Debts: Renegotiation and International Trade," NBER W8853 and CEPR DP3157, 2002.

Fernandez, R. and J. Eaton, "Sovereign Debt," in G. Grossman and K. Rogoff, eds. Handbook of International Economics, Elsevier, 1995.

Tirole, J. "Inefficient Foreign Borrowing: A Dual-and-Common-Agency Perspective," mimeo, University of Toulouse, 2002.

Rogoff, K. and J. Zettelmeyer, "Bankruptcy Proceedings for Sovereigns: A History of Ideas, 1976-2001" IMF WP/02/133, 2002.

Bolton, P., "Towards a Statutory Approach To Sovereign Debt Restructuring," mimeo, Princeton University, 2002.

Rodrik, D. and A. Velasco, "Short-Term Capital Flows," NBER WP7364, 1999.

Broner, F., G. Lorenzoni and S. Schmukler, "Optimal Debt Management in Developing Countries: Supply of Funds and Debt Maturity," mimeo, University of Maryland, Princeton University and The World Bank, 2002.

Jeanne, O. and C. Wyplosz, "The International Lender of Last Resort: How Large is Large Enough?" CEPR DP2842, 2001.

Chamon, M., "Can Contingent-Bond Bids Rule Out Self-Fulfilling Liquidity Crises?" mimeo, Harvard University, 2003.

4. Currency Crises

Fiscal imbalance and the timing of speculative attacks. Self-fulfilling currency crises. Public and private information. The role of large agents. Endogenous policy.

Flood, R. P. and P. M. Garber, "Collapsing exchange-rate regimes: Some linear examples," *Journal of International Economics*, 1984.

Broner, F., "Learning, Coordination and the Timing of Balance of Payments Crises," mimeo, University of Maryland, 2003.

Obstfeld, M., "Models of Currency crises with Self-Fulfilling Features," *European Economic Review*, 1996.

Morris, S. and H. S. Shin, "Unique Equilibrium in a Model of Self-Fulfilling Currency Attacks," *American Economic Review*, 1998 (A correction to Theorem 2 of this paper is provided by Frank Heinemann, "Unique Equilibrium in a Model of Self-Fulfilling Currency Attacks: Comment," *American Economic Review*, 2000).

Ventura, J. "Some Thoughts on the Role of Large Investors in Currency Crises: A Comment to Corsetti et al.," in S. Edwards and J. Frankel, eds. Preventing Currency Crises in Emerging Markets, University of Chicago, forthcoming.

Corsetti, G. A. Dasgupta, S. Morris and H.S. Shin, "Does One Soros Make a Difference? A Theory of Currency Crises with Small and Large Traders," *Review of Economic Studies*, forthcoming.

Angeletos, G., C. Hellwig and A. Pavan, "Coordination and Policy Traps in Currency Crises," mimeo, MIT, UCLA and Northwestern University, 2002.

5. Bubbles, Economic Reforms and Capital Flows

The theory of rational asset price bubbles. Financial frictions and bubbles. On the effects of capital account liberalization and other economic reforms. Bubbles and capital flows.

Tirole, J., "Asset Price Bubbles and Overlapping Generations," *Econometrica*, 1985

Weil, P., "Confidence and the Real Value of Money in an Overlapping Generations Economy," *Quarterly Journal of Economics*, 1987.

Grossman, G. and N. Yaganawa, "Asset Bubbles and Endogenous Growth," *Journal of Monetary Economics*, 1993.

Abel, A.B., N.G. Mankiw, L.H. Summers and R.J. Zeckhauser, "Assessing Dynamic Efficiency: Theory and Evidence," *Review of Economic Studies*, 1989.

Ventura, J., "Economic Growth with Bubbles," mimeo, CREI-UPF, 2003.

Ventura, J., "Bubbles and Capital Flows," NBER WP9304 and CEPR DP3657, 2002.