AEM 767

Topics in International Finance: Financial Globalization, Growth and Volatility

Spring 2008, Wednesdays 10:10 a.m. – 12:25 p.m.

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, and analyze the implications of the rising prominence of hedge funds, sovereign wealth funds, and other institutional investors.

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.

Background Readings

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


Structure of Course

January 23: Organizational Meeting

January 30: 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.

February 6: Financial Integration and Growth

A. Macro Evidence

B. FDI and Growth

C. Equity Market Liberalizations and Growth

D. Costs of Capital Controls

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


February 12: Volatility, Crises

[Special time: 6:00-8:15 p.m. on Tuesday evening]

A. Financial Integration and Macroeconomic Volatility

B. Financial Crises

C. Globalization and the Growth-Volatility Relationship


**February 13: Implications of International Financial Integration for Current Account Sustainability**

Dr. Gian Maria Milesi-Ferretti (IMF) will give a guest lecture on his widely-used dataset on international financial integration, including some details about its construction and caveats. [10:10-10:50 a.m.] This will be followed by a seminar from 11:00 a.m. to 12:30 p.m. in Warren Hall 401. In this seminar, Dr. Milesi-Ferretti will present some of his new findings on the composition of U.S. external stocks and liabilities, and the implications for the sustainability of the U.S. current account deficit.

Related papers which you should read before the seminar so you can critically evaluate Dr. Milesi-Ferretti’s work:


**February 20: 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


February 27/March 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.

March 12: International Business Cycle Transmission

Dr. Ayhan Kose (IMF) will give a guest lecture summarizing the latest research on business cycles spillovers across countries, and how financial globalization has influenced these spillovers.

Background reading:


March 19: Spring Break Week—No Lecture

March 26, April 2: Student Presentations of Research Proposals

Written proposal must be circulated two days before presentation (no later than **12 noon on March 24 or March 31**, depending on whether your presentation is on March 26th or April 2nd). 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).

April 9: Global Imbalances: Facts and Implications

A. Uphill Flows of Capital

B. Implications of Capital Flows from Developing to Industrial Countries

C. Adjustment of Global Imbalances

D. Buildup of Foreign Exchange Reserves: Causes and Consequences


April 16: The International Financial Architecture

A. Aid Flows and Remittances

B. Practical Approaches to Capital Account Liberalization; Implications for Other Macroeconomic Policies

C. New Players: Institutional Investors, Hedge Funds, Sovereign Wealth Funds

D. New Roles for Old Players: IMF and World Bank


April 23, April 30: Presentations of Preliminary Drafts of Papers

Drafts must be circulated two days before presentation (i.e., no later than 12 noon on April 21 or April 28). 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).

Ground Rules for Research Paper

Final draft of paper due on Monday, May 12 at 12 noon. No exceptions.
Maximum length of paper: 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). 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.

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