AEM/ECON 7670

Topics in International Finance

Fall 2009
Wednesdays 5:00 – 7:00 p.m.
Warren 345

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. We will discuss the causes and effects of the financial crisis and what implications it has for the research agenda in international finance and macroeconomics.

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

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.


**Topic 2: 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 readings:


**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


Obstfeld, Maurice, 1994, “Are Industrial-Country Consumption Risks Globally Diversified?” in *Capital Mobility: The Impact on Consumption, Investment and*


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:


For skeptical views on this framework, see:


Topic 6: Financial Globalization and Productivity Growth

A. What Drives GDP Growth in the Long Run


C. Reconciling Effects of Financial Flows on TFP Growth and GDP Growth


**Topic 7: 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. Decouping or Convergence of International Business Cycles?


**Topic 8: 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


Topic 9: Understanding the Causes and Dynamics of the Global Financial Crisis
A. Origins of the Crisis
B. Relative Importance of Factors Underlying the Crisis
C. Domestic and International Financial Regulation
D. Policy Responses to the Crisis and Exit Strategies

Topic 10: The International Financial Architecture
A. Aid Flows and Remittances
B. Practical Approaches to Capital Account Liberalization
C. New Players: Sovereign Wealth Funds


**Topic 11: 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


Key Dates

Tuesday, September 15: Panel discussion on Global Financial Crisis (Eichengreen, Kuttner, Prasad) Call Auditorium, Kennedy Hall @ 5:00 p.m.

Tuesday, October 6: Guest lectures by Dr. Ayhan Kose, IMF

Wednesday, October 7: Guest lectures by Dr. Ayhan Kose, IMF

Friday, October 16: Paper proposals due

Wednesday, October 21: Presentations of paper proposals

Friday, November 20: First drafts of papers due

Wednesday, November 24: Presentations of first drafts

Wednesday, December 9: Final drafts of papers due @ noon

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 Wednesday, December 9 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 Rahul Anand (ra254) and Carol Thomson (cmt8), with the subject line indicating “7670: Proposal” (or whatever the relevant document is).