Course Description:

We economists traditionally divide the general field of International Economics into two subfields: International Finance and International Trade. In this course we will ignore this division. We will start by studying models from International Trade — the Ricardian model, the Heckscher-Ohlin model, and variants of the New Trade Theory model of increasing returns and monopolistic competition. By emphasizing dynamic general equilibrium versions of these models, we will develop tools compatible with modern, general equilibrium macroeconomics. We will then use these sorts of models to address a number of topics, some of which are typically studied in International Finance courses. Specifically, we will try to answer the questions: (1) Why did static applied general equilibrium models of the North American Free Trade Agreement do such a poor job in predicting its impact on trade flows? (2) How can we best model real exchange rate fluctuations and the relationship of these fluctuations to international capital flows? (3) How can we use dynamic general equilibrium models to analyze the causes and consequences of international financial crises like those that afflicted Mexico in 1994–1995 and Argentina in 2001–2002 and are currently occurring in the Eurozone? (4) How does trade liberalization affect a country’s growth rate?

Office Hours:

Tuesday, 9:00 am – 10:30 am at 4-175 Herbert M. Hanson Jr. Hall, 612-625-1589. There is a sign-up sheet outside my door. If you need to meet at some other time, please do not call me at home; send me an e-mail message at tkehoe@umn.edu.

Assignments and Grading:

There will be four or five problem sets, a group project, and a final exam. All assignments must be completed in order to receive a final grade for the course. The mark for each problem set will be counted once and the mark for the group project and the mark for the exam will be counted twice. The lowest of these marks will be dropped and the remaining marks averaged. Notice that this means that, if the lowest grade is that of the group project or that of the exam, its weight will be halved, but it will not be completely dropped.

Group Project:

Students will form groups to work on projects. Each group will consist of two, three, or four students. Topics for projects will be related to empirical issues in international economics, such as predictions of the gravity “model” for world trade flows, or to issues of current policy relevance, such as the modeling financial crises. Each group will make a 50 minute presentation of its research at the end of the course.
Late Policy:

Any late assignment will be penalized 10 (out of 100) points for each class period it is late, up to a maximum of 40 points.

Cooperation on Assignments:

Students are permitted (and encouraged) to discuss the answers to problem sets together. Copying from another student's answers is not allowed. No cooperation on the final is allowed.

Readings:

Copies of many of the readings will be available on the course web site.

There is no textbook for this course. A good textbook in international trade — which will be especially useful the first few weeks of the course for anyone who has not studied international trade previously — is


The best textbook in open economy macroeconomics is


We will also spend time talking about depressions and crises. A useful reference is


This book has a web page with data sets, computer programs, and a link to the book’s web page at Amazon.com:


List of Topics and Readings

0. Traditional Trade Theory


Feenstra, Chapters 1–3.


1. **Increasing Returns and Imperfect Competition**

Feenstra, Chapter 5.


2. **Dynamic Trade**


Obstfeld and Rogoff, Chapters 4 and 5.


3. Models with Heterogeneous Firms


4. Empirical Evidence


5. **Applied General Equilibrium Analysis of Trade Policy**

Feenstra, Chapter 6.


6. **Real Exchange Rates**


Obstfeld and Rogoff, Chapters 8, 9, 10.


7. Capital Flows and Crises


Note:

We will take the material in topic 0 for granted, reviewing some of it selectively throughout the course. We will cover topics 1, 2, 3, and some of topic 4 for sure. We will not have time to do all of topics 5, 6, and 7. We hope to cover at least one of these three topics (probably 7).