

# **Crisis Propagation in a Globalized World: The 2008 Recession in Historical Perspective (Economics 4999-007)**

**University of Colorado**

Spring 2009

## **Instructor: Professor Wolfgang Keller**

Time & place : MWF 1:00 – 1:50 pm in MCOL E186

Office : Economics 206C

Office hours : MW 2:00 – 3:30 pm

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Course web page: <http://spot.colorado.edu/~kellerw/courses/4999s09/Econ4999s09.htm>

## **Class Overview:**

In world economic history, crises strike with some regularity. Their origins vary; the current crisis goes back to financial innovations that led to excessive lending especially in the US subprime mortgage market, the Asian crisis of 1997 started when the Thai government to stop fixing its exchange rate versus the dollar because holding on to it became unsustainable, and the Great Depression of 1929 was triggered by a stock market crash in the US caused by inexperienced investors after the essentially cyclical expansion of the 1920s came to an end.

Irrespective of the cause of crisis, if it affects many countries at the same time it can have a massive impact on economic welfare. When crises spread around the globe, we say they *propagate*. This course is about that (it is *not*, in particular, about the *causes* of crises). Crisis propagation depends on the structure of the world economy, and we can learn about this structure by studying (1) the world economy's *technologies* (describing the way how international transactions can occur) as well as (2) the *institutional setting* in which the technologies are used.

One of these technologies is international trade. As an example, a crisis may move from one country to another because if we export fewer goods this means that another country imports fewer goods, and if these are important intermediate goods our lowering exports might bring down production abroad. Consequently, crisis propagation depends on how much exports there are, and what type of goods are being exported. This will depend on the relevant trade costs (by ship, air, rail, etc). Other important linkages in the world economy today result from international capital movements, international migration flows, foreign direct investment, and offshoring.

The institutional setting of the world economy matters in a number of ways. First, countries may allow international transactions to a varying extent. North Korea, for example, prohibits many types of imports, which in economic terms means that these goods are infinitely costly. Second, there may be formal international organizations that countries can be part of, and these institutions affect the cost of international transactions. Today the World Trade Organization governs trade relations for many countries in the world, for example, and its rules generally favor free trade (absence of tariff and non-tariff barriers); that lowers trade costs. And third, the institutional setting affects also the kind of policy responses that countries can engage in as a response to a crisis abroad. For example, if a chunk of high-risk loans in one country threatens that country's financial sector, is it possible to adopt policies that suspend or reduce international capital flows?

History is replete with episodes where these factors played a major role, and for this reason we take a historical perspective in this course.

## **Goal of the Class:**

We try to better understand how globalization, that is the greater economic integration in the world, has affected the propagation of crises.

Each student is to analyze a specific and narrowly-defined aspect of the 2008 crisis and show how globalization can help explain differences in the propagation of the crisis. This will lead to a paper that will be presented in

class.

Examples of topics:

- (1) To what extent is the economic contraction in Mexican industries higher because these industries are more open to US foreign direct investment?
- (2) Are European economies that did not permit participation in the US subprime mortgage market less affected by the mortgage crisis?
- (3) Is the reduction in international trade volumes as a consequence of the crisis lower (or higher) in industries that are relatively protected?
- (4) How does the remittance behavior of international migrants affect the propagation of the crisis?

Thus, the topic and paper must be on a particular sector, country, or mechanism, and it needs to address a particular question with quantitative evidence. You choose your topic in consultation with me. Because the year 2008 is not yet covered in many official statistics, the quantitative analysis should also be based on a comparison with episodes in the past.

### Course Requirements

Each student has to do the following:

1. One twenty minutes presentation of an assigned paper, together with another student; I will form these two-student teams randomly.
2. Two presentations on a topic of your choice (germane to the course), one of them 12 minutes around midterm time, the second 25 minutes towards the end of the course.
3. Take an exam (in-class, closed-notes, closed-books) on March 16.
4. Hand in a paper not to exceed 15 pages (including references and supporting material, that is, references, tables, figures, etc), based on the second presentation before May 2, 4pm, at my office (Econ 206C).

### Grading

Your final grade will be computed as follows:

Assigned paper presentation	25%
12-Minutes Presentation	20%
In-class Exam	25%
Final Paper and Presentation	30%
Class Attendance	$\geq 75\%$ <b>required to pass the class</b>

Course Schedule (subject to change)

Jan 12 to Feb 2 : Lectures on major channels of globalization  
Feb 4 to Feb 16 : Presentation of assigned papers  
Feb 18 to Mar 2 : Students present an introduction to their own work (12 minutes)  
Mar 4 to Mar 30 : Individual advising  
Apr 1 to May 1 : Students present their final papers  
May 2 : Paper is due

There will be no class on April 20 and April 24 due to out-of-town commitments. The class time will be made up as needed.

### Readings

There is no textbook for this class. Readings are given in the syllabus below, in addition to the following:

I. Introduction to the causes and consequences of recent trends in the world's economic integration. These are general-interest books which are not meant only for economists:

- *Why Globalization Works*, by Martin Wolf, Yale University Press, 2004.
- *Globalization and its Discontents*, by Joseph Stiglitz, Norton, 2002.
- *In Defense of Globalization*, by Jagdish Bhagwati, Oxford University Press, 2004.
- *Has Globalization Gone Too Far?*, by Dani Rodrik, Institute for International Economics, 1997.

You should consult all of these books.

II. Discussion of the history of globalization. The single most useful book, which also gives references to further reading, is

*Globalization in Historical Perspective*, edited by M. Bordo, A. Taylor, and J. Williamson, The University of Chicago Press for the NBER, 2003.

This book will be put on reserve at Norlin library.

III. A good undergraduate textbook on International Economics that covers key channels of globalization. The best texts are

- Ø *International Economics* by Robert Feenstra and Alan Taylor, Worth Publishers, 2008
- Ø *International Economics: Theory and Policy*, by Paul Krugman and Maurice Obstfeld, Addison & Wesley, 7<sup>th</sup> edition, 2005 (and newer).

Mastery of the economic concepts is important for giving your analysis strong analytical underpinnings. Copies of the Feenstra and Taylor book should be available at the bookstore.

IV. Readings on the propagation of the 2008 crisis. The 2008 crisis has started only very recently, which is why many sources will not yet contain relevant evidence.

Go to the website of the *International Monetary Fund* at [www.imf.org](http://www.imf.org), for example, and find that the latest data on this site for the Currency Composition of Official Foreign Exchange Reserves (COFER) is for the third quarter of the year 2008, while the most recent data on China's imports and exports of machinery and equipment at the *World Trade Organization's* website ([www.wto.org](http://www.wto.org)) is for the year 2007. For this reason, this is the area where your own initiative will be most strongly required.

At the same time, there are a number of sources where you will likely find relevant information. They include

- 1) Major business newspapers, both online and print version, such as *The Financial Times*, *The Wall Street Journal*, *The Economist*, as well as the business section of *The New York Times*.
- 2) Business-oriented internet news websites such as *CNN Money* and others
- 3) Economic and financial intelligence websites such as *Roubini's Global Economics Monitor* ([www.rge.com](http://www.rge.com)), *VOX* (<http://www.voxeu.org/>), as well as business and economics blogs
- 4) Working papers at the *National Bureau of Economic Research* <http://www.nber.org/papers/> and discussion papers at the *Centre for Economic Policy Research* <http://www.cepr.org/pubs/new-dps/dplist.asp>.

To the extent that these sources require paid subscriptions, you should try accessing them through CU's library website. In addition, depending on your topic I will often be able to direct you to additional sources.

### **Prerequisites**

Econ 3070 (Intermediate Micro Theory) and Econ 3080 (Intermediate Macro Theory) are prerequisites for this course.

## Syllabus

- I. International trade with product differentiation and scale economies  
Feenstra and Taylor, Chapter 6  
Krugman and Obstfeld, Chapter 6
- II. International trade based on comparative advantage  
Feenstra and Taylor, Chapter 2  
Krugman and Obstfeld, Chapter 3  
Dornbusch, R., S. Fischer, and P. Samuelson, "Comparative Advantage, Trade, and Payments in a Ricardian Model with a Continuum of Goods", *American Economic Review* 67: 823-829.
- III. Offshoring and FDI  
Feenstra and Taylor, Chapters 5, 7
- IV. International capital movements and fixed exchange rate regimes  
Krugman and Obstfeld, Chapters 13, 17  
Obstfeld, M., "The Global Capital Market: Benefactor or Menace?", *Journal of Economic Perspectives* 12, 4 (Autumn, 1998): 9-30.
- V. International migration of labor  
Feenstra and Taylor, Chapter 5  
Krugman and Obstfeld, Chapter 7

## Papers to be presented

- Keller, W., and C. Shiue, "Institutions, Technology, and Trade", NBER Working Paper # 13913.
- Hummels, D., "Transportation Costs and International Trade in the Second Era of Globalization", *Journal of Economic Perspectives*, Vol 21, No 3, pp 131-154.
- Gorodnichenko, Y., J. Svejnar, and K. Terrell, "Globalization and innovation in emerging markets", NBER Working Paper # 14481.
- Alfaro, L, and A. Charlton, "Intra-Industry Foreign Direct Investment", NBER Working Paper # 13447.
- Hanson, G. "The Economic Consequences of the International Migration of Labor", NBER Working Paper # 14490.
- Rauch, J., and V. Trindade, "Ethnic Chinese Networks in International Trade", *Review of Economics and Statistics*, February 2002.
- Burstein, A., C. Kurz, and L. Tesar, "Trade, production sharing and the international transmission of business cycles", mimeo, November 2004.
- Giannone, D., M. Lenza, and L. Reichlin, "Business Cycles in the Euro Area", NBER Working Paper # 14529.
- O'Rourke, K., "The European Grain Invasion, 1870-1913", *Journal of Economic History* 57: 775-801.
- Mitchener, K. and M. Weidenmier, "Trade and Empire", NBER Working Paper # 13765

- Bordo, M., and M. Flandreau, “Core, Periphery, Exchange Rate Regimes, and Globalization”, NBER Working Paper # 8584
- Reinhart, C., and K. Rogoff, “Banking Crises: An Equal Opportunity Menace”, NBER Working Paper # 14587

**NOTE**

I am willing to accommodate the special needs of students with disabilities and particular needs for religious observations, but please contact me immediately if you have such concerns. Finally, you should be aware of the honor code and policy for student classroom behavior. The campus policies for these and other issues, including policies regarding course prerequisites, may be found at <http://www.colorado.edu/Economics/courses/index.html>