

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

University of Colorado
Spring 2010

Instructor : Professor Wolfgang Keller

Time & place : TR 2:00-3:15pm in ECON 117

Office : Economics 206C

Office hours : TR 12:30 – 1:30, 3:15 – 4:00

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<http://spot.colorado.edu/~kellerw/courses/4999s10/Econ4999s10.htm>

Class Overview

In world economic history, crisis strikes 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.

When a crisis moves from its source country to other countries, we say it *propagates*. One expects this propagation to be affected by the existing economic interactions between countries, especially (but not only)

1. International trade
2. International foreign direct investment
3. International capital movements
4. International migration
5. Economic policy responses towards 1. to 4.

This class is about how these factors have affected the propagation of the 2008 crisis (the class is *not* about the origin of the 2008 crisis). 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

Each student is to analyze a specific and narrowly-defined aspect of the 2008 crisis and show whether international economic relations can help explain differences in the propagation of the crisis. This will lead to a term paper to be presented in class.

Suggestions on term paper topics are given below.

Course Requirements

Each student has the following tasks:

- i. In a team with another student, you present an assigned paper
- ii. You hand in three typed comments/discussion points on each assigned paper before they are presented

- iii. You present your paper (the topic of which is subject to my approval) twice
 - a. The first 12 minutes around midterm time
 - b. The second 25 minutes towards the end of the course
- iv. You give a short critique of one presentation by one of your class mates
- v. You take an exam on February 25
- vi. You prepare a final paper, not to exceed 15 pages including references, tables, and figures, which is based on your presentations. The paper is to be handed in before May 4, 4pm, at the main ECON office (Econ 212).

Grading

Your final grade will be computed as follows:

Assigned paper presentation	: 15%
12-Minutes Presentation	: 15%
In-class Exam	: 25%
Final Paper and Presentation	: 25%
Comments on assigned papers	: 10%
Discussion of classmate's work	: 10%

Class attendance : $\geq 90\%$ **required to pass the class**

Course Schedule (subject to change)

Jan 12 to Feb 2	: Lectures on major channels of crisis propagation
Feb 4 to Feb 16	: Presentation of assigned papers
Feb 18 to Mar 2	: Students make their first presentation of their research
Mar 4 to Mar 30	: Individual advising
Apr 1 to Apr 29	: Students make their second presentation
May 4	: Final paper is due

Readings

There is no text book for this class. The assigned papers below are required reading. In addition, you should consult the following sources.

- I. *The Great Trade Collapse: Causes, Consequences and Prospects*, edited by Richard Baldwin, a VoxEU.org publication, November 2009; can be downloaded at <http://www.voxeu.org/index.php?q=node/4297>

This book gives information on various aspects regarding crisis propagation in the recent crisis. Important are also the cited works which will help you with your own, original research.

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

This provides essays on the history of globalization, which will be useful as reference point for the current crisis propagation.

- III. A good undergraduate textbook on International Economics. The introductory lectures on globalization I will present in the first part of the course are self-contained. However, for a strong research paper many students will benefit from a textbook. I recommend *International Economics* by Robert Feenstra and Alan Taylor, Worth Publishers, 2008
- IV. Readings on the propagation of the 2008 crisis. The onset of the current crisis is still very recent, which is why relevant data can be hard to come by. In addition to the sources and the material cited in *The Great Trade Collapse*, there are a number of sources where you will likely find relevant information. They include
 - 1) International economic organizations, such as the International Monetary Fund (www.imf.org), the OECD (www.oecd.org), the World Trade Organization (www.wto.org), and others
 - 2) National economic organizations; for the United States, for example, there is the US the Census Bureau's data on foreign trade <http://www.census.gov/foreign-trade/index.html>, and the BEA's (www.bea.gov) data on foreign direct investment.
 - 3) 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*.
 - 4) Business-oriented internet news websites such as *CNN Money* and others
 - 5) Economic and financial intelligence websites such as *Roubini's Global Economics Monitor* (www.rge.com), *VOX* (<http://www.voxeu.org/>), as well as business and economics blogs
 - 6) 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 - as of January 11, 2010

- 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

Assigned Papers

- Hummels, D., "Transportation Costs and International Trade in the Second Era of Globalization", *Journal of Economic Perspectives*, Vol 21, No 3, pp 131-154.
- Keller, W., and C. Shiue, "Institutions, Technology, and Trade", NBER Working Paper # 13913.
- 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

Strategies for picking your research topic

Remember that the goal of the class is to better understand how international economic links have affected the propagation of the 2008 crisis. Thus, first you want to decide which aspect of international economic links you will focus on.

Within "1. International trade" on page 1 above, that could be the increased vertical specialization in international trade (this is the idea that many products that we consume have parts that come not only from one but many different countries).

The first part of your paper should consist of an explanation of why this factor, here the increased vertical specialization in international trade, should matter for crisis propagation. This is the conceptual (theoretical) part of your work.

The second part of your work is empirical, requiring you to obtain data and analyze it. There are mainly two paths you can take, and either can lead to an excellent research paper.

First, you can ask whether this factor explains differences in the propagation of the 2008 crisis. In the present example, the research questions might be:

- (1) Do cross-country differences in the degree of vertical specialization in international trade explain by how much these countries' trade volumes have contracted in the 2008 crisis?
- (2) Do cross-industry differences in the degree of vertical specialization of the industries of country X explain by how much these industries' trade volumes have contracted in the 2008 crisis?

Another example, where the factor potentially affecting the propagation of crisis is the international portfolio diversification of investors:

- (3) Do cross-country differences in the international portfolio diversification explain by how much these countries' trade volumes have contracted in the 2008 crisis?
- (4) Do cross-country differences in the international portfolio diversification explain by how much these countries' GDPs have contracted in the 2008 crisis?

Thus, the general structure of these research topics is:

"Do differences in [factor affecting propagation] explain differences in [outcome measure, such as aggregate trade, FDI, GDP, poverty, or economic welfare] across countries/industries/products?"

Second, you can adopt a temporal approach by comparing crisis propagation in the 2008 case with an earlier one, such as the Great Depression, or the 1997 Asian Crisis. For the factor vertical specialization in trade, this could be:

- (5) Does the change in vertical specialization in international trade between the years 1997 and 2008 explain why the 2008 crisis spread faster than the 1997 crisis?

The general structure here is:

"Does the change in [factor affecting propagation] between the [earlier crisis] and the 2008 crisis explain differences in the responses of [aggregate outcome, such as trade, FDI, GDP] across countries/industries/products?"

Bottomline: First, a good conceptual discussion of why a particular factor affects crisis propagation. Second, you need good data measures to make your point empirically, and moreover, you have to rule out as far as possible alternative explanations for your empirical findings.