**The Government of the Russian Federation**

**The Federal State Autonomous Institution of Higher Education ‘National Research University Higher School of Economics’**

**Saint-Petersburg School of Economics and Management**

**Department of Economics**

Course title: **World Economy**

Program 38.03.01 «Economics» (undergraduate)

Author:

Philip Ushchev, PhD, assistant professor, fuschev@hse.ru

Approved by the meeting of the School «\_\_\_»\_\_\_\_\_\_\_\_\_\_\_\_ 20

Head of the School \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Recommended by the section of Academic Council «\_\_\_»\_\_\_\_\_\_\_\_\_\_\_\_ 20

Chairman \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Approved by the Academic Council of the Faculty «\_\_\_»\_\_\_\_\_\_\_\_\_\_\_\_\_ 20

Academic Secretary \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Saint-Petersburg 2015

This document may not be reproduced or redistributed by other Departments of the University without permission of the Author

**Description of the course “World Economy”**

**(quarter 2, semester 1)**

1. **Title**: World Economy

2. **Lecturer:** Philip Ushchev, PhD, assistant professor, Department of economics

3. **Outline**

The main purpose of the course is that students get the first idea of what modern international economics is. In order to achieve this purpose, a discussion of the key concepts of the discipline, which are also essential for modern economics as a whole (love for variety, gravity, pricing-to-market, gains from trade, purchasing power parity), will be provided. It is also expected that the students will learn how to apply these concepts to better understand the problems international economists study: the structure of trade flows, gains from trade, trade policy issues, exchange rates formation. Finally, the course will briefly explain how the basic models of international economics are developed and used to study the relevant economic questions.

A novelty of this course compared to most of the others (including a masterful treatment by Krugman and Obstfeldt) is that the former stresses the role of demand side in international trade, while the latter focus mainly on the supply side. Another essential feature of the course is that students are supposed to read research papers in international economics and present them at the seminars in groups of 2 - 4 people.

The course relies on economic intuition rather than formal models. However, it requires from the students some knowledge in microeconomics, especially demand theory. Knowledge of some basic calculus and basic optimization is also strongly appreciated, though not absolutely necessary.

4. **Structure and content**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| № | Topic | Classes (hours) | Independent work (hours) | Total (hours) |
| 1 | Models of bilateral international trade | 6 | 12 | 18 |
| 2 | Measuring gains from trade | 8 | 12 | 20 |
| 3 | Gravity equation and predicting trade flows | 14 | 24 | 38 |
| 4 | Models of exchange rate behavior | 14 | 24 | 38 |
| Total | | 42 | 72 | 114 |

**Topic 1**. We cover the basic material related to the Dixit-Stiglitz-Krugman model (Dixit and Stiglitz,1977; Krugman, 1979) of bilateral international trade. We study the implications of the fundamental feature of this model, namely that it puts forward love for variety on the demand side and increasing returns to scale on the supply side as the key factors of bilateral international trade. After that, we deal with the next generation of love-for-variety models, which highlight another important dimension of firm exporting behavior – heterogeneity of firms in productivity (Melitz, 2003; Melitz and Ottaviano, 2008). We then turn to discussing recent studies extending that model to the case of variable markups (Behrens and Murata, 2007; Zhelobodko et al., 2012; Bertoletti and Epifani, 2014; Bertoletti and Etro, 2015), focusing mainly on the empirical relevance of these (Simonovska, 2015; Handbury and Weinstein, 2015). Finally, we tackle the problem of heterogeneities on the consumer’s side and its implications for global trade.

**Topic 2**. We study the welfare consequences of trade liberalization (or, in contrast, of increasing trade cost). The central problem is measuring gains from trade. The standard methods of solving this problem has recently been shown to lead to counter-intuitive consequences (Arkolakis et al., 2012; Behrens and Murata, 2012). We discuss the role of competition, variable markups and transportation frictions in these issues.

**Topic 3**. Gravity is ubiquitous in the global economy (Allen et al., 2014). We first study the basic logic of gravity as it stems from Newtonian mechanics. Then, we learn how to apply the idea of gravity to empirical studies of international trade flows, migration processes, transportation issues, etc. Next, we follow the evolution of methods of estimating the gravity equation, from OLS (McCallum 1995) to non-linear methods (Bossuyt et al., 2001), from reduced form estimation (Anderson and van Wincoop 2003) to structural models (Combes et al., 2005; Redding and Venables, 2004). Finally, we discuss the modern developments in gravity estimation (Head and Mayer, 2014).

**Topic 4**. Purchasing power parity (PPP) has been a central idea driving the studies of exchange rate behavior for decades. However, the fundamental premises of the PPP principle are that (i) markets are perfectly competitive, and (ii) international trade is frictionless. Both these assumptions being fairly unrealistic and counterfactual, our task here is to study how to make use of the monopolistically competitive paradigm in order to capture the impact of market imperfections on exchange rates behavior (Bergin and Feenstra, 2001).

5. **Prerequisites**

Microeconomics – basic

Calculus and optimization – basic

English – intermediate or higher

6. **Assessment:** final written exam, intermediate written exam, coursework

* Coursework (20%): individual performance at the seminars (including presentations of papers)
* Intermediate written exam (30%): 2 hours exam
* Final written exam (50%): 2 hours exam

7. **Reading list**

**Textbooksbooks:**

1. Combes P.P., Mayer T. and J-F. Thisse (2008). Economic Geography: The Integration of Regions and Nations, Princeton University Press.
2. Feenstra, R. (2004). Advanced international trade: theory and evidence. Princeton Univ Press.
3. Helpman, E. (2011). Understanding global trade. Harvard University Press.
4. Krugman P. R. International economics: Theory and policy, 8/E. – Pearson Education India, 2008.
5. Krugman P. R., Obstfeld M., Melitz M. (2015). International trade: theory and policy. Prentice Hall.

**Articles:**

1. Allen, T., C. Arkolakis, and Y. Takahashi, (2014). Universal gravity. NBER WP 20787.
2. Anderson, J. E., and E. van Wincoop (2003). Gravity with Gravitas: A Solution to the Border Puzzle. *American Economic Review* 93: 170-192
3. Arkolakis, C., Costinot, A., & Rodríguez-Clare, A. (2012). New trade models, same old gains? American Economic Review, 102(1), 94-130.
4. Behrens K., Murata Y. (2007). General equilibrium models of monopolistic competition: A new approach. Journal of Economic Theory. V. 136. P. 776 -- 787.
5. Behrens, K. and Y. Murata. (2012). Trade, Competition, and Efficiency, Journal of International Economics 87: 1-17
6. Bellone, F., Musso, P., Nesta, L., and Warzynski, F. (2015). International trade and firm-level markups when location and quality matter. Journal of Economic Geography, forthcoming.
7. Bergin, P. R., and R. C. Feenstra (2001). Pricing-to-market, staggered contracts, and real exchange rate persistence. Journal of international Economics, 54(2), 333-359.
8. Bernard, A. B., Redding, S. J., and P. K. Schott (2007). Comparative advantage and heterogeneous firms. Review of Economic Studies 74(1), 31-66.
9. Bertoletti, P. and P. Epifani (2014). Monopolistic competition: CES redux? Journal of International Economics 93(2), 227 – 38.
10. Bertoletti, P and F. Etro (2015) Monopolistic competition when income matters. Economic Journal, forthcoming.
11. Bossuyt, A., Broze, L., and V. Ginsburgh (2001). On invisible trade relations between Mesopotamian cities during the third millennium BC. The Professional Geographer, 53(3), 374-383.
12. Combes, P. P., Lafourcade, M., and T. Mayer (2005). The trade-creating effects of business and social networks: evidence from France. Journal of International Economics, 66(1), 1-29.
13. Davis, D. R. and D. E. Weinstein (2001). An account of global factor trade. The American Economic Review, 91(5), 1423 -1453.
14. Di Comite F., Thisse J.-F., and H. Vandenbussche (2014). Verti-zontal differentiation in export markets. Journal of International Economics. No. 93 (1), p. 50-66.
15. Dhingra, S., and J. Morrow (2013). Monopolistic Competition and Optimum Product Diversity Under Firm Heterogeneity, London School of Economics, mimeograph
16. Dixit, A. and J. Stiglitz (1977). Monopolistic competition and optimum product diversity. The American Economic Review, 67(3), 297 – 308
17. Eaton, J. & Kortum, S. (2002). Technology, geography, and trade. Econometrica, 70(5), 1741 - 1779.
18. Feenstra, R.C. (2003). A homothetic utility function for monopolistic competition models, without constant price elasticity. Economics Letters. V. 78. P. 79 – 86.
19. Feenstra, R.C. and D. Weinstein (2015) Globalization, markups, and U.S. welfare. Journal of Political Economy, forthcoming.
20. Head, K., and T. Mayer. Gravity equations: workhorse, toolkit, and cookbook. In: Gopinath, G., Helpman, E., and K. Rogoff. (Eds.). (2014). Handbook of international economics (Vol. 4). Elsevier.
21. Kichko S., Kokovin S, Zhelobodko E. (2014). Trade patterns and export pricing under non-CES preferences. Journal of International Economics. № 94, p. 129-142
22. Krugman, P. R. (1979). Increasing returns, monopolistic competition, and international trade. Journal of international Economics, 9(4), 469-479.
23. Melitz, M. and Ottaviano, G. (2008). Market size, trade, and productivity. Review of Economic studies, 75(1), 295 – 316.
24. Melitz, M. J. (2003). The impact of trade on intra-industry reallocations and aggregate industry productivity. Econometrica, 71(6), 1695 -1725.
25. McCallum, J. (1995). National borders matter: Canada-US regional trade patterns.The American Economic Review, 615-623.
26. Osharin, A., Thisse, J. F., Ushchev, P., and V. Verbus (2014). Monopolistic competition and income dispersion. Economics Letters, 122(2), 348-352.
27. Ottaviano G.I.P., T. Tabuchi, J.-F. Thisse (2002). Agglomeration and trade revisited, International economic review, Vol. 43, No. 2, pp. 409-435.
28. Redding, S., and A. J. Venables (2004). Economic geography and international inequality. Journal of international Economics, 62(1), 53-82.
29. Simonovska, I. (2015) Income differences and prices of tradables: Insights from an online retailer. Review of Economic Studies, 82(4): 1612 – 56.
30. Tarasov, A. (2014) Preferences and income effects in monopolistic competition models. Social Choice and Welfare, 42(3): 647 – 69.
31. Zhelobodko, E., Kokovin, S., Parenti, M., & Thisse, J.-F. (2012). Monopolistic competition: Beyond the constant elasticity of substitution. Econometrica, 80(6), 2765 – 2784.