

# Small Open Economy Extension (IRBC)

Macro II - Fluctuations

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## Introduction and Basic Facts

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What are the classical reasons to open economy to trade

- ▶ trade integration

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  - ▶ comparative advantage
- ▶ financial integration
  - ▶ smooth shock / insurance

# From RBC to IRBC

After the success of RBC models to match business cycles it didn't take long before the same methodology was applied to International Business Cycles

- ▶ Most famous: Backus, Kehoe, Kydland (1992) (freshwater economists)

Very successful methodology:

- ▶ facts at odd with theoretical predictions have been called “puzzles”