

**LUISS GUIDO CARLI UNIVERSITY**

**GLOBAL ECONOMIC AND FINANCIAL  
INTEGRATION: AN EMPIRICAL AND THEORETICAL  
ANALYSIS**

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## ABSTRACT

Developed and emerging equity and goods markets have become more integrated in the aftermath of the subprime crisis. The effects of a relatively high degree of integration have been largely investigated by the most recent international finance and international business cycle (IBC) literature. Main results are: i) cross-country equity market returns tend to be highly correlated; ii) international equity prices are affected by global rather than local risk factors; iii) business cycles are more correlated across countries; iv) more efficient international risk sharing environment. However, some empirical findings suggest that international stock market prices are still affected by domestic factors and equity and goods markets are still segmented across countries (Bilson et al., 2001; Bekaert et al., 2011; Bacchetta and van Wincoop, 2013, among others).

This dissertation (composed by two papers) is aimed at examining the role of different degrees of integration on international equity market prices and cross-country movements in real and financial flows. In particular, it focuses on the determinants of the equity risk premium across countries and on the international diffusion of shocks in presence of complete markets.

The first paper (co-authored with L. Prospero) studies the role of two important global risk factors (i.e. global liquidity measures) on both developed and emerging stock market prices (i.e. excess returns). The paper focuses on a period characterized by a steep increase in the level of economic and financial integration (i.e. 2000-2010). In a conditional two-factor linear model, we find that i) emerging markets generate higher average unexpected excess returns (i.e. Jensen's alpha) than developed markets (*alpha puzzle*); ii) global liquidity measures, VIX and Open Interest, statistically affect the market price of risk and the quantity of risk, suggesting that both excess return and risk quantities are time-varying (*beta puzzle*). On the one side, we show a one period two country-two investor model with asymmetric quadratic costs (i.e. additional investment cost in frontier/emerging

markets) accounts for the alpha puzzle. On the other side, we observe that a standard conditional two-factor linear model is not able to address the two puzzles simultaneously.

The second paper employs a two country-two good model with recursive Epstein and Zin (1989) preferences, complete and frictionless markets, and highly correlated long-run innovations to examine the international diffusion of shocks under different degrees of co-movement between long-run shocks and economic integration. Differently from recent IBC studies (Devereux and Yetman, 2010; Devereux and Sutherland, 2011; Dedola and Lombardo, 2012; Perri and Quadrini, 2013), this paper shows that shocks are transmitted even if goods markets are highly segmented (see also Bacchetta and van Wincoop, 2013). In addition, a lower (or zero) cross-country long-run shocks correlation do not alter cross-country movements in consumption and stock prices. Nevertheless, relatively large changes in the degree of economic integration and cross-country shocks co-movement affect the real exchange rate volatility and the cross-country consumption growth correlation.