

# **Economics 6284**

## **Survey of International Macroeconomics and Finance Theory and Policy**

Spring '13

### **Course Overview:**

For graduate students in fields other than economics. The program of this course emphasizes macroeconomic issues and policies in an open-economy setting. We will examine the balance of payments, the determination of exchange rates, money and prices in open economies, the interaction of the exchange rate and domestic economic activity, ways of organizing the international monetary system, and international financial markets. Recent issues such as the global financial crisis, the crisis in the euro area, the Asian financial crisis, Argentina's exchange rate crisis, the creation of the euro, the size and persistence of global imbalances, as well as the general performance of the foreign exchange market and government intervention in that market will all receive extensive attention. The goal of the course is to provide you with a set of tools to enable you to examine these topics in a systematic way, and to provide you with a deeper understanding of the theoretical issues and policy problems of the monetary realm of the international economy.

### **Prerequisites:**

Intermediate micro and macroeconomics (Econ 6217-8 or equivalent)

### **Course Information:**

Lecture Times: Monday 5:10-7:00

Location: Phillips Hall 306

Instructor Jay C. Shambaugh

Office Hours Monday 2:00-4:00 pm, Thursdays 11:00-12:00

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## Course Materials

**Text:** *International Economics* (9<sup>th</sup> edition), 2012, Paul Krugman, Maurice Obstfeld, and Marc Melitz [**required**]. Please note that the 9<sup>th</sup> edition is new and has changed since the 8<sup>th</sup> edition. If you already have the 8<sup>th</sup> edition and would like to use that, please discuss it with me. I recommend against buying a used older edition. There should be some used 9<sup>th</sup> editions available. A crucial difference is that for the sections we read, the chapter numbers are off for the first 5 chapters. That is, in edition 9, chapter 13 is the same as what was chapter 12 in edition 8. I've posted a pdf of the table of contents from the 9<sup>th</sup> edition so you can figure out what material you should be reading if you have a different edition.

**Study Guide:** *Study guide to accompany Krugman, Obstfeld, Melitz International economics, theory & policy, ninth edition / Linda Goldberg, Michael Klein, Jay Shambaugh, Hiroyuki Ito.* [**Recommended, not required**] This provides summaries of chapters, additional problems, and answers to the odd numbered problems in the book.

Various on-line sellers have the text, and some have the study guide, but it is important that you get the correct edition (not always easy to tell with some on-line sellers). You can find the book and the study guide on-line directly from the publisher at:

If you have problems or questions finding / purchasing the book, please let me know.

**Additional Book:** *Exchange Rate Regimes in the Modern Era*, Michael W. Klein and Jay C. Shambaugh, MIT Press 2009 (in paperback in 2012). [**Recommended, not required**] This book provides a detailed analysis of one of the core questions in the class: what to do with the exchange rate, peg or float? We won't read the whole book, and it is not required for purchase (I'll make sure a copy is available at the library). Most on line sellers have the paperback version now.

**Other Readings:** Additional readings from journals are available on the web through the class's blackboard site (look under the assignments section of blackboard site and then click on readings). Some are recommended and some are required (marked in the syllabus below). In addition, there are a number of articles from the *Economist* and *New York Times*. The last sheet of the syllabus will tell you to which chapters these articles are relevant. They are short real world applications of the theories we are studying and will hopefully help demonstrate the ways the theories can help frame world events. I will announce ahead of time if we will be discussing a specific article.

**Other:** Students are expected to be aware of major developments in the world economy. This can be accomplished by reading newspapers such as *The Wall Street Journal*, *Financial Times*, or *New York Times* on a daily basis, by reading *The Economist* on a weekly basis, or by looking at a variety of on-line resources.

## **Course Requirements:**

There will be one in class exam and a final exam. Dates are in the syllabus, and you should take note of these. They will not change.

There will also be three problem sets, they do not have to be handed in (and hence are not graded). Problem sets are intended to help you learn the material. It is also strongly recommended that you try the suggested practice problems from the book. You do not have to hand them in, but the material in this class is best learned by practice, and attempting these problems on a regular basis will be very helpful for you. A list of all the problems (called “Suggested Problems”) will be available on blackboard under “Assignments.”

There are two written assignments done in groups. First, there will be a brief (no more than 5 page) policy memo due toward the end of the term. I will hand out some suggested topics during the term. Groups can pick an alternate topic with my approval. In addition, there is a brief data assignment due toward the end of the semester. It involves using data to test some of the theories we have covered in class and then to write up a short report explaining your results. Neither should be considered a term paper. They are short writing assignments. Both will be done in groups of 2-3 people (of your choosing). More details on both projects will be handed out later in the term. One is due on 4/22, the other is due on 5/1. Your choice which to hand in first (it may depend on which topic you are choosing and when we cover the relevant material).

Finally, participation in class is expected. I will ask questions to the class on a regular basis and expect questions from you as well. Students who participate on a regular basis will receive full credit for the participation section of your grade. Students who are frequently absent or do not participate will receive lower scores. On some occasions, I will post some general questions about the readings we will be discussing. They will be in the “Questions for Class” folder, under Assignments on Blackboard. This will provide an opportunity for those of you who are less comfortable speaking in public to be well prepared for the questions.

## **Grading**

Policy Memo:	15%
Data Assignment	10%
Midterm	25%
Final Exam	40%
Participation	10%

Participation in class will also count at the margin, helping students who are between of two grades.

## Course Schedule and Readings

GUIDE TO READINGS: **Readings with an asterisk are recommended but not required. Readings listed as “also see” will not be discussed in class** and are not in on blackboard, but may be of interest to some students. The main outside readings can be found on blackboard under assignments and then under readings.

The dates that material will be covered are somewhat flexible. NOTE: sometimes more than one topic is covered in one class. I will let you know what readings are important for the following class during each lecture. NOTE: we miss two classes early on and then have 2 in the final week. Please be prepared for the extra workload at the end.

### **I Introduction** 1/14

### **II The Current Account and Balance of Payments** 1/14

- Krugman & Obstfeld (hereafter K&O), chapter 13
- Also read Economist articles 1, 2, & 3 [see last page of syllabus]
- Cavallo, Michele, “Exchange Rate Movements and the US International Balance Sheet,” *FRBSF Economic Letter* no. 2004-25
- Blanchard, Olivier, and Gian Maria Milesi-Ferretti, “Global Imbalances: In Midstream?” IMF Staff Position Note, 12/22/2009  
<http://www.imf.org/external/pubs/ft/spn/2009/spn0929.pdf>
- \*Ghosh, A. and K. Ramakrishnan, “Do Current Account Deficits Matter, IMF Finance and Development 2006 <http://www.imf.org/external/pubs/ft/fandd/2006/12/basics.htm>
- \*Lane and Milesi Ferretti, “Examining Global Imbalances,” March 2006, Volume 43, Number 1
- \* Bergin, Paul, “Asset Price Booms and Current Account Deficits” *FRBSF Economic Letter* 2011-37 December 5, 2011,

### **III Asset Markets and the Exchange Rate** 1/28

- K&O chapter 14
- Froot, K. and R. Thaler, “Anomalies: Foreign Exchange,” *Journal of Economic Perspectives*, vol 4 no. 3 Summer 1990 pp. 179-92.
- Also read Economist articles 4 through 7
- \* Cavallo, Michele, “Interest Rates, Carry Trades, and Exchange Rate Movements,” *FRBSF Economic Letter* no. 2006-1

### **IV Money, Interest Rates, and Exchange Rates** 2/4

- K&O chapter 15
- Also read Economist articles 11 and 12

- John Williams, “Monetary Policy, Money, and Inflation,” FRBSF Economic Letter 2012-21 July 9, 2012
- also see:
  - Dornbusch, R., “Expectations and Exchange Rate Dynamics,” *Journal of Political Economy*, 84, 1976, pp. 1161-1176.

***Problem Set #1 (on chapters 13-15) suggested finished by 2/11***

**V Prices and Exchange Rates in the Long Run 2/11**

- K&O chapter 16
- Also read Economist articles #13 - 15
- Alan M. Taylor and Mark P. Taylor, “The Purchasing Power Parity Debate,” *Journal of Economic Perspectives*, Volume 18, Number 4—Fall 2004—Pages 135–158
- \* George Alessandria and Joseph Kaboski, “Why are goods so cheap in some countries?” *Philadelphia Federal Reserve Business Review* Q2 2008
- \*Rogoff, K., “The Purchasing Power Parity Puzzle,” *Journal of Economic Literature*, vol. XXXIV (June 1996), pp. 647-668. *focus on pages 647-658.*

**VI Output and the Exchange Rate 2/25**

- K&O chapter 17 (including the on-line appendix to Chapter 17 re: ISLM)
- Also read Economist articles #17-19
- \*Goldberg, P, M. Knetter, “Goods Prices and Exchange Rates: What Have We Learned ?” *Journal of Economic Literature*, vol. XXXV (September 1997), pp. 1243-1272.

***Problem Set #2 (on chapters 15-16) suggested finished by 3/4***

**VII Fixed Exchange Rates 3/4**

- K&O chapter 18 pp 463-5, 469-76

**VIII Intervention 3/4**

- K&O chapter 18 pp 465-468, 479-84
- Conclusion to Dominguez, K and J. Frankel, *Does Foreign Exchange Intervention Work*, Institute for International Economics, Washington D.C., September 1993. pp. 135-140.
- Economist readings on intervention (#20 - # 22)

## **MIDTERM 3/18 covers material in sections I-VIII**

### **IX The Gold Standard and Breton Woods** 3/25

- K&O chapter 18, pp. 484-89, chapter 19 up to p. 528
- Section 2.5 of Chapter 2 in *Exchange Rate Regimes in the Modern Era*
- Economist article 23
- \*Ghosh, Atish, Anne-Marie Gulde, and Holger Wolf, *Exchange Rate Regimes: Choices and Consequences*, chapter 2, pages 6-22
- \*Rockoff, Hugh, "The Wizard of Oz as a Monetary Allegory," *Journal of Political Economy*, 98 (August, 1990), pp.739-760

### **X Floating Rates and Policy Coordination** 4/1

- K&O chapter 19 from 529-554
- Obstfeld, M. and K. Rogoff, "The Mirage of Fixed Exchange Rates," *Journal of Economic Perspectives*, 1995, vol. 9, no. 4, pp. 73-96.
- Chapters 2, 4, and 8 in *Exchange Rate Regimes in the Modern Era* (Klein and Shambaugh)
- Economist articles 24, 26, 27, & 30
- \*Bernanke, Ben, "International Monetary Reform and Capital Freedom" Speech at the Cato Institute, 10/14/2004
- \* Klein, M. and Jay Shambaugh, "The Nature of Exchange Rate Regimes," NBER Working Paper no. 12729
- \* Frankel, Jeff, "Experiences and Lessons of Exchange Rate Regimes in Emerging Economies," NBER Working Paper No. 10032, October 2003.

### **XI Optimum Currency Areas** 4/8

- K&O chapter 20
- De Grauwe, P., "The Euro at Stake? The Monetary Union in an Enlarged Europe," *CESifo Economic Studies*, Vol. 49, 1/2003, p. 103-121. [only 103-6 is required, the rest can be skimmed]
- Lane, Philip, "The Real Effects of EMU," *Journal of Economic Perspectives* Vol. 20, No. 4, Fall 2006.
- Israel Malkin and Fernanda Nechio, "U.S. and Euro-Area Monetary Policy by Regions" *FRBSF Economic Letter* 2012-06, February 27, 2012
- Economist articles: 31, 32, 35, & 37
- \* Krugman, Paul, "Monomoney Mania," *Slate*, 4/16/99 <http://slate.msn.com/id/25210/>
- \* Feldstein, M., "The Political Economy of the European Economic and Monetary Union," *Journal of Economic Perspectives*, 1997, vol. 11, no. 4, pp. 23-42

- also see:
  - De Grauwe, P., *The Economics of Monetary Integration*, (Oxford: Oxford University Press, 1994).
  - Canzoneri, Grilli and Masson eds. *Establishing a Central Bank: Issues in Europe and lessons from the U.S.* (Cambridge: Cambridge University Press, 1992). Especially articles by Eichengreen and Sachs/Salai Martin.

***Problem Set #3 (chapters 18-20) suggested finished by 4/15***

**XII The Global Capital Market 4/15**

- K&O chapter 21 (except pp 597-9)
- Neely, Christopher J., “An Introduction to Capital Controls,” *Federal Reserve Bank of St. Louis Review*, November/December 1999.
- IMF, “Effects of Financial Globalization on Developing Countries: Some Empirical Evidence,” 3/17/03. p. 5-11, 31-37, 48, 58  
see <http://www.imf.org/external/np/res/docs/2003/031703.pdf>
- Olivier Jeanne, “Capital Flow Management”, AER Papers and Proceedings, 2012
- Economist articles: 40-46
- \* Obstfeld, M., “The Global Capital Market: Benefactor or Menace?” *Journal of Economic Perspectives*, fall 1998,12(4), pp. 9-30.

**FIRST ASSIGNMENT DUE 4/22 (your choice, either memo or data assignment)**

**XIII Developing Countries, Dollarization, and Growth 4/22**

- K&O chapter 22 (except 641-2, 647-650)
- Eswar Prasad and Lei Ye, “Will the Renminbi Rule?” *Finance & Development*, March 2012, Vol. 49, No. 1
- Economist articles 54-58
- \*Levy-Yeyati, Eduardo, and Frederico Sturzenegger, “Dollarization: a primer”, July 2001, <http://cep.lse.ac.uk/events/conferences/dollarization/Levy-Yeyati.pdf>
- \* Schuler, Kurt, “Basics of Dollarization” staff report of the Joint Economic Committee. Available at <http://users.erols.com/currency/basicsup.htm>. *note: the author is somewhat biased in favor of dollarization, but it is an excellent discussion of the mechanics and details of dollarization.*
- \* Berg, Andrew and Eduardo Borenzstein, “Full Dollarization,” *Economics Issues* no. 24, IMF December 2000.

**XIV Exchange Rate Crises 4/29**

- K&O chapter 18 pp 476-9, box on 480, appendix 2
- K&O chapter 21 pp 597-9

- K&O chapter 22 pages 641-2, 647-650
- Krugman, P., “Currency Crises” available on Krugman’s website at (web.mit.edu/krugman/www/crises.html)
- M. Allen, C. Rosenberg, C. Keller, B. Setser, and N. Roubini, “A Balance Sheet Approach to Financial Crisis,” IMF Working Paper 02/210 December 2002
- Fischer, S. “On the Need for an International Lender of Last Resort,” *Journal of Economic Perspectives*, fall 1999, 13(4).
- Calvo, G. “Lender of last resort: Put it on the agenda!” <http://www.voxeu.org/index.php?q=node/3327>
- Economist articles 49, 52, 53, 59, & 61-63
- also see
  - Krugman, P. “A Model of Balance of Payments Crises,” *Journal of Money Credit and Banking*, 1979, 11: 311-25.
  - Obstfeld, M. “The Logic of Currency Crises”, *Cahiers Economiques et Monetaires*, 1994, 43:189-213.

## SECOND ASSIGNMENT DUE on 5/1

### XV The Recent Global Financial Crisis and the Euro Crisis 5/1

- K&O page 601-8
- Fender, Ingo, and Jacob Gyntelberg, 2008, “Overview: global financial crisis spurs unprecedented policy actions,” *BIS Quarterly Review*, December 2008
- Frederic Mishkin, “Over the Cliff: from the subprime to the global financial crisis,” *Journal of Economic Perspectives*, winter 2011 49-70.
- Gorton and Metrick, “Getting up to speed on the financial crisis: a one weekend reader’s guide” (working paper)
- Obstfeld, Shambaugh, Taylor (2009) NBER working paper “Financial Instability, Reserves, and Central Bank Swaps in the panic of 2008”
- Reinhart and Rogoff, “The Aftermath of Financial Crises” NBER WP 14656
- \* M. Ayhan Kose, Prakash Loungani, and Marco E. Terrones, “Tracking the global recovery,” IMF Finance and Development June 2012, Vol. 49, No. 2 <http://www.imf.org/external/pubs/ft/fandd/2012/06/kose.htm>
- \*Setser, B., “Financial de-globalization, illustrated” <http://blogs.cfr.org/setser/2009/03/23/financial-de-globalization-illustrated/>
- \* Michael Lewis, “Wall St. on the Tundra” *Vanity Fair*, April 2009
- Economist articles 67-69
- Europe**
- K&O page 580-2
- Jay C. Shambaugh, The Euro’s Three Crises, *Brookings Papers on Economic Activity*, Spring 2012.
- Philip Lane, “The European Sovereign Debt Crisis,” *Journal of Economic Perspectives*, Volume 26, Number 3, Summer 2012—Pages 49–68
- Economist articles 70-73

**FINAL EXAM** : [TBD, Monday, May 6 - Tuesday, May 14] **Final is cumulative**



Articles from *The Economist*, *New York Times*, and *Wall St. Journal* (*Economist unless otherwise noted*)

Article	Date	Topic	Chapter
1) "Figures to Fret About" p.76	7/11/98	Current Acct	13
2) "The O'Neill doctrine" p.12	4/27/02	Current Acct	13
3) "Forever Free" in Survey: The World Economy	9/22/05	Current Acct.	13
4) "Instant Returns"	10/5/06	Exch. Rts	14
5) "Exchange Rates and the Economy" NYT	6/3/04	Exch.Rts	14
6) "Gambling Against the Dollar" NYT	11/1/06	Exch. Rts	14
7) "All Eyes on the Carry Trade"	7/6/08	Exch Rts	14
8) "Better Than Guesswork ?" p.88	10/30/99	Exch. Rts.	14-16
9) "Misleading Misalignments"	6/21/07	Exch Rts	14-17
10) "Up and Away"	2/5/09	Exch Rts	14-17
11) "Bags of Bricks"	8/24/06	Money	15
12) "Economic Scene: Why Is That Dollar Bill in Your Pocket Worth Anything" NYT	1/15/04	Money	15
13) "Ying and Yuan" p.53-5	8/30/03	PPP	16
14) The Big Mac Index	7/28/12	PPP	16
15) "Burger Thy Neighbour Policies"	2/5/09	China	16-17
16) "China's Surplus: fair play or foul?"	4/21/12	China	16-17
17) "Weaker Dollar Has Yet to Spur Boom..." <i>NYT</i>	8/21/02	Pass-through	17
18) "Currency winds hit home" <i>WSJ</i>	12/4/12	hedging	
19) "Currency Hedging Provides Shelter for importers" <sup>1</sup>	11/15/04	Hedging	
20) "Intervention: divine or comic ?" p.89-90	9/23/00	Intervention	18
21) "Divine Intervention"	5/27/08	Intervention	18
22) "Switzerland's buttoned down central bank bets it all"	1/9/13	Intervention	18
23) "The dollar and the deficit" p.74	9/14/02	fixed regimes	19
24) "When a flow becomes a flood"	1/22/09	imbalances	
25) "Currency Dilemmas" p.90	11/18/00	fix / float	19-22
26) "What's in a peg ?" p. 75	11/2/02	fix / float	19-22
27) "The Dollar is Still King for Now" <i>WSJ</i>	11/5/12	floats	19-22
28) "Currencies: the weak shall inherit the earth"	10/6/12	floats	19-22
29) "In search of demand"	2/12/12	floats	19-22
30) "Global Currency Tensions Rise" <i>WSJ</i>	12/24/12	floats	19-22
31) "Eleven into one May Go" p.81-2	10/17/98	EMU history	20
32) "Can One Size Fit All ?" p.74	3/28/98	EMU	20
33) "Euroland frays at the edges" p. 46	11/30/02	EMU	20
34) "Growing Apart" p.78	10/2/04	EMU	20
35) "The euro and its troubles," p.69-70	6/11/05	EMU	20
36) "Britain and the euro: No again" p. 51-2	6/14/03	EMU	20
37) "A Decade in the Sun"	6/5/08	EMU	20
38) "Waltzing Me Dollar" p.93	10/14/00	opt cur theory	20
39) "One World, One Money" p.80	9/26/98	opt cur theory	20-21
40) "Two Kinds of Openness" p.92	9/12/98	Asia Crisis	21-2
41) "Capital Controversies" p.72	5/23/98	capital flows	21-2
42) "Putting Things in Order" p.82	3/19/05	capital controls	21-2
43) "Third Thoughts on foreign capital"	11/16/06	capital controls	21-2
44) "Hot and Bothered"	6/26/08	capital flows	21-22

<sup>1</sup> Wine Business Monthly 11/15/04

45) "An Embarrassment of Riches"	6/10/08	capital flows	21-22
46) "Tide Barriers"	10/6/12	capital controls	21-2
47) "Confidence Trick"	9/20/07	Bank Runs	21
48) "Huff, Puff, and Pay" p.70	5/5/01	IMF/Crises	
49) "Lender without Limit" p.85	10/10/98	IMF	21-2
50) "Chinatown Bank Endures Run ..." <i>NYT</i>	4/23/03	Bank Runs	21
51) "A Better Way to Go Bust" p. 64	2/1/03	Defaults	21-22
52) "Paying for Saddam's Sins" p. 68	5/17/03	Defaults	21-2
53) "A victory by default?" p.67-9	3/5/05	Defaults	21-2
54) "Catching Up" p. 62	8/26/03	Developing C	22
55) "Dream on?"	7/12/12	Developing C	22
56) "No more Peso?" p.69	1/23/99	Dollarization	17, 22
57) "Divided about the dollar" p.32	1/6/01	Dollarization	22
58) "El Salvador learns to love the Greenback" p.34	9/28/02	Dollarization	22
59) "When Countries Go Bust" p.88	11/27/99	Crises	17, 22
60) "Floating into the Unknown" p.31-2	2/9/02	Crises	17, 22
61) "A Worthless Currency"	7/17/08	Crises	17, 22
62) "Down with the Rand" p.39-40	7/4/98	Crises	17, 22
63) "What Would Bagehot Do?"	8/16/07	Crises	17, 22
64) "Argentina on the Danube"	2/19/09	Crises	17, 22
65) "The Whiff of Contagion"	2/26/09	Crises	17, 22
66) "Reaping the Rewards of Indolence"	3/5/09	Crises	17, 22
67) "Getting a Grip"	12/1/12	Global Fin. Crisis	
68) "Forever Poorer"	3/17/12	Global Fin. Crisis	
69) "When the Chips are down"	6/23/12	Global Fin. Crisis	
70) "Euro-area current accounts"	9/11/12	Euro Crisis	
71) "The Euro Crisis: Exchange Rates, Headaches"	7/24/12	Euro Crisis / Exch. Rts	
72) "No Short-cuts; short term austerity ..."	10/27/12	Euro Crisis	
73) "Step by Step with a ripped map"	12/14/12	Euro Crisis	