

Open Economy Macroeconomics

Econ 513, Spring 2002

Time: Mon, Thu 1:10am-2:25pm

Room: CDE

Office Hours: Tue, Wed, Fri 2:00 - 4:00pm or by appt.

<http://www.williams.edu/Economics/dvorak>

Tomáš Dvořák

Office: Fernald 6

Phone: 597 3143

Email: tdvorak@williams.edu

Course description: This seminar will address how international financial transactions influence macroeconomic activity. Several policy issues will frame our discussions: What are the benefits and potential costs of capital market integration? How do international capital flows affect long run growth? Which exchange rate regime should countries choose? Should countries use Dollars or Euros instead of their own currency? Why are most capital flows to developing countries in terms of debt rather than equity? Why do some countries experience balance of payments crises? What are the appropriate responses to crises? What can be done to increase the stability of the international financial system? We will address these questions using both theoretical and empirical analyses. The emphasis will be on the empirical implications of our reasoning, and we will support our analyses with real world data. In the process we will learn about such concepts as balance of payments accounting, real exchange rate, purchasing power and interest rate parities, optimal currency areas, mechanics of speculative attacks, principles of international risk sharing, current account sustainability and others.

Prerequisites: The formal prerequisite is an intermediate macro course (Econ252 or Econ509). Informal prerequisites include a strong interest in applied international economics and enthusiasm to work with economic data.

Readings: There is a two volume packet of *required* readings. It includes published and unpublished papers and sections from a variety of books. A set of *recommended* readings is on reserve in the library. These readings are indicated with an asterisk on the course outline. A useful undergraduate level texts are *International Economics* by Pugel and Lindert (PL) and *International Economics* by Krugman and Obstfeld (KO). A recent comprehensive advanced textbook is *Foundations of International Macroeconomics* by Obstfeld and Rogoff (OR). Both books are on reserve in the library. In addition, you should read financial press such as the *Financial Times* and the *Economist* regularly so that you are able to discuss current issues in class.

Course requirements: For CDE students the requirements differ depending on whether you take open-economy macro as your primary or secondary seminar. Undergraduate students can select whether they would like to be treated as primary or secondary, and should discuss their selection with me no later than February 22nd. The final course grade will be determined according to the following table:

	primary	secondary
Midterm	15%	30%
Homework	15%	30%
Final	20%	40%
1st paper	5%	
2nd paper	10%	
3rd paper	15%	
Final paper	20%	

There will be 5 homework assignments. These will consist of problems, data manipulation and/or short essays. You are encouraged to discuss the homework with one another. However, each student must submit their work individually.

Tentative Course Outline:

I. Introduction

1. Course Overview and Motivation (January 31)

II. Open Economy

1. Benefits of Open Economies (February 4)
 - chapter 1 pp 1-22 in OR
2. Balance of Payments Accounting (February 7 & 11)
 - Handout on Balance of Payments Accounting
 - Balance of Payments Accounts and Analysis, Chapter 4 in *Macroeconomic Accounting and Analysis in Transition Economies*, IMF.
 - *Chapter 12 in KO - *more elementary treatment of BoP*
3. Capital Flows
 - Calvo, Guillermo A.; Leonardo Leiderman and Carmen Reinhart, 1996, "Inflows of Capital to Developing Countries in the 1990s," *Journal of Economic Perspectives* 10(2), 123-39.

III. Exchange Rates and Exchange Rate Regimes

1. Purchasing Power Parity and the Real Exchange Rate (February 14 & 18)
 - Rogoff, Kenneth, 1996, "The Purchasing Power Parity Puzzle." *Journal of Economic Literature* 34, 647-68.
 - *Chapter 15 in KO
2. Interest Rate Parity and the Exchange Rate Determination (February 21)

- Chapter 13 in KO
 - *Taylor, Mark P., 1995, “The Economics of Exchange Rates,” *Journal of Economic Literature* 33(1), 13-47.
3. Fixed Exchange Rates (February 25 & 28)
 - Chapter 17 in KO
 - Maurice Obstfeld, and Kenneth Rogoff, 1995, “The Mirage of Fixed Exchange Rates,” *Journal of Economic Perspectives* 9(4), 73-96.
 4. Floating Exchange Rates (March 4)
 - *Obstfeld, Maurice, 1995, “International Currency Experience: New Lessons and Lessons Relearned,” *Brookings Papers on Economic Activity* 1, 119-193.
 5. Optimum Currency Areas (March 7)
 - Mundell, Robert, 1961, “A Theory of Optimum Currency Areas,” *American Economic Review* 51(4), 657-65.

IV. Crises and the International Financial System

1. Theory of BoP Crises (March 11 & 14)
 - Maurice Obstfeld, 1996, “Models of Currency Crises with Self-Fulfilling Features” *European Economic Review* 40(3-5), 1037-47.
 - Calvo, Guillermo, 1996, “Varieties of Capital Market Crises,” mimeo.
 - *Diamond, Douglas W. and Philip H. Dybvig, 1983, “Bank Runs, Deposit Insurance, and Liquidity,” *Journal of Political Economy* 91(3), 401-19.
2. Mechanics of BoP Crises (March 8)
 - Annex IV to International Capital Markets, 1993, IMF.
3. International Financial Contagion (April 10)
 - Forbes, Kristin J., 2000, “The Asian Flu and Russian Virus: Firm-Level Evidence on How Crises are Transmitted Internationally,” mimeo.
4. Responses to Crises (March 13)
 - Nonstandard responses to crises, section 5 of *International Capital Markets* 1999, IMF, pp.169-185.
 - Reserve Impact of Forward Foreign Exchange Market Intervention, Box 2.11 from *International Capital Markets* 1998, IMF.
 - Edwards, Sebastian, 1999, “How Effective are Capital Controls?,” *Journal of Economic Perspectives* 13(4), 65-84.
5. Choice of Exchange Rate Regimes (March 15)
 - Chapter 3 in *Exchange Rate Regimes in an Increasingly Integrated World Economy*, IMF Occasional Paper #193.

- *Edwards, Sebastian, 2000, “Exchange Rate Regimes, Capital Flows and Crisis Prevention,” mimeo.
6. Dollarization
 - Hausmann, Richardo, “Should There Be Five Currencies or One Hundred ann Five?” *Foreign Policy*, Fall 1999.
 - Sachs, Jeffrey and Felipe Larrain, “Why Dollarization Is More Straitjacket Than Salvation,” *Foreign Policy*, Fall 1999.
 7. International Financial System (April 5)
 - Rogoff, Kenneth, 1999, “International Institutions for Reducing Global Financial Instability,” *Journal of Economic Perspectives* 13(4), 21-42.

V. International Capital Markets

1. Sovereign Debt
 - Easterly, William, 1999, “How Did Highly Indebted Poor Countries Become Highly Indebted?,” mimeo.
 - Eaton, Jonathan, 1990 “Debt Relief and the International Enforcement of Loan Contracts,” *Journal of Economic Perspectives* 4(1), 43-56.
 - “A New Approach to Sovereign Debt Restructuring” - address by Anne Krueger.
2. International Portfolio Diversification and the Cost of Capital (April 19)
 - Stulz, René M., 1999, Globalization of Equity Markets and the Cost of Capital, NYSE Working Paper 99-02.
 - *Henry, Peter Blair, 2000, “Stock Market Liberalization, Economic Reform, and Emerging Market Equity Prices,” *Journal of Finance* 55(2), 529-64.

Paper Presentations (May 8 and 10)