

McGill University
Department of Economics
Class Time: Mon/Wed 8.35-9.55
Class Room: ENGMC 11

Instructor: Dhanoos (Dee) Sutthiphisal
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Office Hours: Mon/Wed 11.30-12.15
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**ECON 424: INTERNATIONAL PAYMENTS
MAJORS**

WINTER 2011

Course Objectives

This course is centered on macroeconomic issues in open economies. Particularly, we will focus on:

- 1) Developing a theoretical framework to understand how a country's monetary and fiscal policies affect its exchange rates, prices, interest rates and output in the short and long run.
- 2) Applying this framework to analyze current policy issues such as choosing an exchange rate regime among many alternatives (e.g. fixed, float, and currency board) and identifying the causes of financial crises in Asia and Latin America.

Course Requirements

There are 3 exams in this course: (1) First Midterm, (2) Second Midterm and (3) Final. The first midterm is on Wednesday Feb 2. The second midterm is on Wednesday March 16. The final is cumulative and is on the date given by the university. These exams will consist of T/F, problem-solving and essay questions.

Textbooks

The recommended textbook for this course is Paul Krugman and Maurice Obstfeld, *International Economics: Theory and Policy*, either Eighth Edition (Addison Wesley, 2008) or Ninth Edition (Prentice Hall 2011). Henceforth, "KO."

- I will provide detailed class notes. So, the textbook is not really necessary.
- Older, but not too long ago, editions of this textbook are fine and may be less expensive.

Class Notes, Readings and Problem Sets

Class notes, readings and problem sets (with solutions) will be posted on the Class Web. Use them at your own risk. I have tried to eliminate typing errors when preparing these materials. However, it is very likely that there are still (a few) errors in the notes and the solutions. You must use your own judgment when utilizing these materials. (I would appreciate it if you could let me know where the errors are so that the future generation of students can benefit from better class materials.)

Although the problem sets will not be counted towards your grade, it is in your best interest to familiarize yourself with the concepts given in class by solving the problems. Also, an understanding of the required readings will be helpful in answering questions in the exams.

Financial Press, International Economic Data and Other Resources

Since this course will focus on not only theoretical financial economic models but also policy issues, students are encouraged to be up to date on current economic and financial events by reading articles and commentary from several sources such as The Economist (www.economist.com), Financial Times (www.ft.com) and the Wall Street Journal (www.wsj.com), Nouriel Roubini's web site (www.roubini.com), Paul Krugman's web site (www.krugmanonline.com). As for economic information specific to Canada, go to Statistic Canada (www.statcan.ca).

Office Hours and Review

Regular office hours are listed on the first page. For each exam, I will schedule extra office hours which will be announced in class a week before the exam. However, you should not accumulate any doubt until the week before an exam. It is not healthy to be panic in the last minute and it is difficult to work things out under pressure.

For students with a legitimate time conflict with the office hours, you can make an appointment with me by e-mail when you need help. In addition, I will give a review for each exam on the class right before the exam.

Communication Policies

In addition to office hours, please feel free to ask me questions via the Internet. I encourage you to use the Class Discussion function in WebCT to ask me questions since they may also benefit your classmates. Should you need to contact me via email, please use the WebCT email system. Please do not contact me via my usual McGill email. For the night before each exam, I will answer your e-mails if and only if I receive them BEFORE 10 PM.

If there is an important announcement such as extra office hours and review, I will also e-mail you. To be able to receive my announcements, you need to update your email address in Minerva.

Exam Policies

The midterm scores and grades will be posted on WebCT. You are not allowed to keep your exams. If you would like to review your exams, please see me during my office hours or make an appointment.

Grade Appeals

If you are not satisfied with how your exam/term project (or any part of it) is graded, you may submit a grade appeal in WRITING. If you choose to do so, your entire exam/term project will be reviewed. There will not be a partial re-grading, and you may receive a lower grade after the appeal.

Grade Assignment

There are 4 possible grading schemes for the course. For Schemes 1-3, you will receive a letter grade for each exam which is based on a class distribution.

<u>Scheme 1</u>		<u>Letter Grade</u>	<u>Numeric Grade</u>	<u>Course Grade Lower Bound</u>
First Midterm	40%			
Second Midterm	0%	A	4.0	3.85
Final	60%	A-	3.7	3.50
		B+	3.3	3.15
<u>Scheme 2</u>		B	3.0	2.85
		B-	2.7	2.50
First Midterm	0%	C+	2.3	2.15
Second Midterm	40%	C	2.0	1.85
Final	60%	C-	1.7	na
		D+	1.3	na
<u>Scheme 3</u>		D	1.0	0.85
		D-	0.7	na
First Midterm	30%	F	0.0	0.00
Second Midterm	30%			
Final	40%			

For Scheme 4, you will receive the grade for the course based on the McGill percentage scale.

<u>Scheme 4</u>		<u>Total Score</u>	
		<u>Letter Grade</u>	<u>Lower Bound</u>
First Midterm	30%		
Second Midterm	30%	A	85%
Final	40%	A-	80%
		B+	75%
		B	70%
		B-	65%
		C+	60%
		C	55%
		D	50%
		F	0%

The grade you receive will be from the scheme that yields the highest grade. For example, suppose you receive 100 out of 200 for the first midterm, 120 out of 200 for the second midterm and 80 out of 100 for the final; and the curves give you a B for the first midterm, a B+ for the second midterm and an A for the final. Scheme 2 is obviously better than Schemes 1 and 3. It will give you: $3.3 \times 0.4 + 4.0 \times 0.6 = 3.72 < 3.85 \rightarrow$ an A-. Scheme 4 gives you $(80/200) \times 0.3 + (100/200) \times 0.3 + (80/100) \times 0.4 = 59\% \rightarrow$ a C. Hence, your course grade would be an A-.

Supplemental Exam Policy

The supplemental exam will account for 40% of your grade. The remaining 60% of your grade come from BOTH midterms (i.e. 30% for each midterm). Note that because I will not be able to curve your score, your grade for the course will be based on the McGill percentage scale as in Scheme 4 if you take the supplemental exam.

Academic Integrity Statement (It is mandatory that I put this in the syllabus.)

McGill University values academic integrity. Therefore all students must understand the meaning and consequences of cheating, plagiarism and other academic offences under the Code of Student Conduct and Disciplinary Procedures (see <http://www.mcgill.ca/integrity> for more information).

Right to Submit in English or French Written Work that is to be Graded

In accord with McGill University's Charter of Students' Rights, students in this course have the right to submit in English or in French any written work that is to be graded.

Course Schedule (Dates for topics to be covered are tentative and subject to changes. The KO chapter number is based on the Eighth Edition.)

1. Introduction

Key Issues: Why do we need to understand the mechanics of international finance?

Dates: Wed Jan 5

Required: Obstfeld, Maurice (1998). "The Global Capital Market: Benefactor or Menace?" *Journal of Economic Perspectives* 12 (4), pp. 9-30.

Optional: Rodrik, Dani (2000). "How Far will International Economic Integration Go?" *Journal of Economic Perspectives* 14 (1), pp. 177-186.

Fischer, Stanley (2003). "Globalization and Its Challenges," *American Economic Review* (May), pp. 1-30.

2. National Income Accounting and the Balance of Payments

Key Issues: Relationship between current accounts and budget deficits.

Dates: Mon Jan 10 & Wed Jan 12

Required: Note 1

"In Defence of Deficits," *The Economist* (December 16, 1995), pp. 68-69.

"Overconsumption versus Overinvestment: The Crisis in Mexico and Thailand Compared," *World Economic Outlook: Crisis in Asia*, IMF, December 1997, pp. 10-11.

Optional: KO, Chapter 12.

"Capital Flows to Emerging Markets – A Historical Perspective," *International Capital Markets: Developments, Prospects, and Key Policy Issues*, IMF, November 1997, pp. 234-251.

Otto, Glenn (1992). "Testing a Present Value Model of the Current Account: Evidence from U.S. and Canadian Time Series," *Journal of International Money and Finance* 11, 414-430.

3. Exchange Rates and the Foreign Exchange Market: An Asset Approach

Key Issues: Arbitrage and interest parity.

Dates: Mon Jan 17, Wed Jan 19 & Mon Jan 24

Required: Notes 2 and 3.

Optional: KO, Chapter 13.

4. Money, Interest Rates, and Exchange Rates

Key Issues: How monetary policies affect exchange rates.

Dates: Wed Jan 26 & Mon Jan 31

Required: Note 4

“Wading in the Yen Trap,” *The Economist* (July 22, 1999).

Optional: KO, Chapter 14.

Rogoff, Kenneth (1999), “Perspectives on Exchange Rate Volatility,” in *International Capital Flows*, edited by Martin Feldstein, pp. 441-53.

Midterm 1: WED FEB 2.

5. Price Level and the Exchange Rate in the Long Run

Key Issues: Generalized monetary approach to explain exchange-rate movements in the long run. That is how Law of One Price, thereby (absolute and relative) Purchasing Power Parity, as well as the Fisher effect affect exchange rates in the long run.

Dates: Mon Feb 7, Wed Feb 9, Mon Feb 14 & Wed Feb 16

Required: Notes 5-7

“The Big Mac Index,” *The Economist* (May 27, 2004).

Optional: KO, Chapter 15.

Rogoff, Kenneth (1996). “The Purchasing Power Parity Puzzle,” *Journal of Economic Literature* 34 (June), pp. 647-88.

Obstfeld, Maurice and Kenneth Rogoff (2000). “The Six Major Puzzles in International Macroeconomics: Is There a Common Cause?” *NBER Working Paper* No. 7777.

6. Output and the Exchange Rate in the Short Run

Key Issues: Impacts of monetary and fiscal policies on exchange rates and output level in the short run.

Dates: Mon Feb 28, Wed Mar 2, Mon Mar 7, Wed Mar 9 & Mon Mar 14

(No class during Feb 21 – Feb 27.)

Required: Notes 8-11

Optional: KO, Chapter 16.

Midterm 2: WED MAR 16.

7. Fixed Exchange Rates and Foreign Exchange Intervention

Key Issues: How an economy under fixed exchange rates responds to shocks and how effective monetary and fiscal policies would be under such an exchange rate regime.

Dates: Mon Mar 21, Wed Mar 23, Mon Mar 28, Wed Mar 30 & Mon Apr 4

Required: Notes 12-15

Optional: KO, Chapter 17.

“Summers on Mexico: Ten Lessons to Learn,” *The Economist* (December 23, 1995), pp. 46-48.

8. Policy Topics

We will spend the last two classes (Wed Apr 6 and Fri Apr 8) on some of the following issues.

8.1 The International Monetary System, 1870-1973

Key Issues: Historical review on the international monetary and exchange-rate arrangements during: (1) the Gold Standard Era, (2) the Interwar Period and (3) the Post-World War II.

Optional: KO, Chapter 18.

8.2 Macroeconomic Policy and Coordination under Floating Exchange Rates

Key Issues: Performance of floating exchange rates as compared to that of fixed exchange rates.

Required: Obstfeld, Maurice and Kenneth Rogoff (1995). “The Mirage of Fixed Exchange Rates,” *Journal of Economic Perspectives* 9, pp. 73-96.

Reinhart, Carmen (2000). “The Mirage of Floating Exchange Rates,” *American Economic Review* (May), pp. 65-70.

Optional: KO, Chapter 19.

Rogoff, Kenneth (2001). “Why Not A Global Currency?” *American Economic Review* 91 (2), pp. 243-247.

Fischer, Stanley (2001). “Exchange Rate Regimes: Is the Bipolar View Correct?” *Journal of Economic Perspectives* 15 (2), pp. 3-24.

Frankel, Jeffrey A. (1999). “No Single Currency Regimes is Right for All Countries or At All Times,” *NBER Working Paper* No. 7338.

8.3. Optimum Currency Areas and the European Experience

Key Issues: The benefits and drawbacks of Europe's monetary union.

Dates: Thu Mar 24 & Tue Mar 29

Optional: KO, Chapters 20-21.

"Euro: Background," *Economist.com* (March 18, 2004).

"Irrational Pessimism," *The Economist* (December 6, 2001).

"What is Driving the Weakness of the Euro and the Strength of the Dollar?" *IMF World Economic Outlook* (May 2001), pp. 66-75.

"Grappling with the Strong Euro," *The Economist* (June 5, 2003).

"Tested by the Mighty Euro," *The Economist* (March 18, 2004).

Rose, Andrew (2000). "One Money, One Market: Estimating the Effects of a Common Currency on Trade," *Economic Policy* 30, pp. 7-46.

8.4. Developing Countries: Growth, Crisis, and Reform

Key Issues: Policy problems in developing countries and the role of IMF. Case studies include the Mexican Crisis (1994), the East Asian Crises (1997-98) and the Argentine Crises (2001-02).

Dates: Thu Mar 31, Tue Apr 5 & Thu Apr 7

Required: Summers, Lawrence H. (2000). "International Financial Crises: Causes, Preventions and Cures," *American Economic Review* 90, pp. 1-16.

Optional: KO, Chapter 22.

"Dollarization in Argentina," *Chicago Fed Letter* 142 (June 1999).

"Turkey in Turmoil," *The Economist: Global Agenda* (February 28, 2001).

Edwards, Sebastian (1997). "The Mexican Peso Crisis: How Much Did We Know? When Did We Know It?" *NBER Working Paper* No. 6334.

Krueger, Anne (1998). "Whither the World Bank and the IMF?" *Journal of Economic Literature* 13 (4), pp. 1983-2020.

Craig Burnside, Martin Eichenbaum, and Sergio Rebelo's "Understanding the Korean and Thai Currency Crises," *Chicago Fed: Economic Perspective* (2000, Vol. 3), pp. 45-60.

Rogoff, Kenneth (1999). "Institutions for Reducing Global Financial Instability," *Journal of Economic Perspectives* 13, pp. 21-42.