

McGill University
Department of Economics
Class Time: Tue/Thu 10.05-11.25
Class Room: Leacock 520

Instructor: Dhanoos (Dee) Sutthiphisal
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Office Hours: Tue/Thu 9.00-10.00
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**ECON 453D2: INTERNATIONAL ECONOMICS – FINANCE
HONORS**

WINTER 2005

Course Objectives

This course is the second part of the one-year, 6-credit Econ 453D sequence. It 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 Tuesday Feb 1. The second midterm is on Thursday March 10. 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.

In addition to the three exams, you may volunteer to turn in a term paper on a topic in international finance. This option will allow you to replace one of your midterm score with your score from the presentation. However, for you to have this option, by Tuesday February 15, I must receive your e-mail stating your intention to have this option as well as a priority ranking of the topics that you would prefer to write on. (See instructions for the term paper on the last page of the syllabus.)

Textbooks

The required textbook for this course is Paul Krugman and Maurice Obstfeld, *International Economics: Theory and Policy*, Sixth Edition (Addison-Wesley, 2003). Henceforth, "KO."

Students might also find Richard Caves, Jeffrey Frankel and Ronald Jones' *World Trade and Payments: An Introduction*, Ninth Edition (Addison-Wesley, 2002), helpful.

Class Notes, Readings and Problem Sets

Class notes, readings and problem sets (with solutions) will be posted on the Class Web. 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, the required readings will be helpful in answering essay 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.stern.nyu.edu/globalmacro), Paul Krugman's web site (www.wws.princeton.edu/~pkrugman).

For students interested in conducting empirical research in international economics, Carlos Vegh's web site (www.econ.ucla.edu/cvegh/resources.htm) provides excellent links to many useful resources. As for economic information specific to Canada, go to Statistic Canada (www.statcan.ca).

Office Hours and Final 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 two-part review session for the final. The first part of the final review will be held on Tuesday April 12. We will discuss when and where I will give the second part of the review session after the second midterm.

E-mail Policies

In addition to office hours, please feel free to ask me questions via e-mail. In addition to office hours, please feel free to ask me questions via e-mail. However, you must state course number/title in your e-mail subject and your name in the content. (This is because I will not open an email with a suspicious subject heading to avoid computer virus. The course number/title will also be helpful for me in answering your questions since I teach two courses this semester.) 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 announcement, you need to update your email address in Minerva.

Exam Policies

The midterm scores and grades will be put in front of my office door within a week after the midterm. (They will be listed by the last 3 digits of your student ID.) Solutions to the midterm questions will be posted on the Class Web or distributed in class within 2 weeks after the midterm. 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 paper (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 paper will be reviewed. There will not be a partial re-grading, and you may receive a lower grade after the appeal.

The deadline for submitting the grade appeal is as follows. If you submit your grade appeals within TWO WEEKS from the day of you receive the grade for each midterm exam/term paper, you will receive the grade for the course based on any of the four schemes below that gives you the highest grade. On the other hand, if you submit your grade appeal later than the two-week deadline but within a year after you take the final, your course grade will be assigned based on Scheme 4 only.

Grade Assignment for Econ 453D2

For Schemes 1, 2 and 3, you will receive a letter grade for each exam and the term paper. Your grade for each exam is based on a class distribution, whereas your grade for the term paper is based on your own performance.

<u>Scheme 1</u>		<u>Letter</u>	<u>Numeric</u>	<u>Course Grade</u>
		<u>Grade</u>	<u>Grade</u>	<u>Lower Bound</u>
Term Paper	0%			
Midterm 1	25%	A	4.0	3.75
Midterm 2	25%	A-	3.7	3.35
Final	50%	B+	3.3	3.05
		B	3.0	2.75
		B-	2.7	2.35
		C+	2.3	2.05
		C	2.0	1.75
		D	1.0	0.75
		F	0.0	0.00
<u>Scheme 2</u>				
Term Paper	25%			
Midterm 1	25%			
Midterm 2	0%			
Final	50%			
<u>Scheme 3</u>				
Term Paper	25%			
Midterm 1	0%			
Midterm 2	25%			
Final	50%			

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

<u>Scheme 4</u>		<u>Letter</u>	<u>% Total Score</u>
		<u>Grade</u>	<u>Lower Bound</u>
Term Paper	0%		
Midterm 1	25%	A	85%
Midterm 2	25%	A-	80%
Final	50%	B+	75%
		B	70%
		B-	65%
		C+	60%
		C	55%
		D	50%
		F	0%

Again, if you submit your grade appeals within the two-week deadline, the grade you receive will be from the scheme that yields the highest grade. For example, suppose you receive 50 out of 100 for the term project, 80 out of 200 for the first midterm, 100 out of 200 for the second midterm and 80 out of 100 for the final; and the curves give you a B- from the term project, a C for the first midterm, a B for the second midterm and an A for the final. Scheme 3 is obviously better than Schemes 1 and 2, and it will give you: $2.7 \times 0.25 + 3 \times 0.25 + 4.0 \times 0.75 = 3.425 < 3.75 \rightarrow$ an A-. Scheme 4 gives you $(80/200) \times 0.25 + (100/200) \times 0.25 + (80/100) \times 0.50 = 62.5\% \rightarrow$ a C+. Hence, your course grade would be an A-. In contrast, if you submit your grade appeals later than the three-week deadline, you will get a C+ for the course (based on Scheme 4).

Grade Assignment for Econ 453D Sequence

To receive credits for this one-year, 6-credit Econ 453 sequence, you must take BOTH Econ 453D1 in Fall 2004 (professor Benchekroun) AND this Econ 453D2 in Winter 2005. Your final grade for the Econ 453D sequence is determined by the average grade that you receive from the two courses.

Course Schedule (Dates for topics to be covered are tentative and subject to changes.)

1. Introduction

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

Dates: Thu Jan 6

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: Tue Jan 11

Required: KO, Chapter 12.

"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: "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: Thu Jan 13 & Tue Jan 18

Required: KO, Chapter 13.

4. Money, Interest Rates, and Exchange Rates

Key Issues: How monetary policies affect exchange rates.

Dates: Thu Jan 20, Tue Jan 25 & Thu Jan 27

Required: KO, Chapter 14.

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

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

Midterm: TUE FEB 1.

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: Thu Feb 3, Tue Feb 8 & Thu Feb 10

Required: KO, Chapter 15.

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

Optional: 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: Tue Feb 15 & Thu Feb 17

Required: KO, Chapter 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: Tue Mar 1, Thu Mar 3 & Tue Mar 8 (Midterm Break during Feb 21-27.)

Required: KO, Chapter 17.

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

Midterm: THU MAR 10

8. 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.

Dates: Tue Mar 15

Required: KO, Chapter 18.

9. Macroeconomic Policy and Coordination under Floating Exchange Rates

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

Dates: Thu Mar 17 and Tue Mar 22

Required: KO, Chapter 19.

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: 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 Regime is Right for All Countries or At All Times," *NBER Working Paper* No. 7338.

10. 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

Required: KO, Chapter 20.

"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).

Optional: KO, Chapter 21.

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

11. 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: KO, Chapter 22.

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.

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

Optional: "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.

Review: **TUE APR 12** (Part 1 of two-part final review). The schedule for Part 2 will be announced in class.

Instruction for Term Paper

You can write a research paper on a topic of your choice or one of the topics suggested below. The paper should be concise and succinct: no more than 10 pages. It should be typed, double-spaced, 12-pt font, 1.25-inch margin on both sides. The grade for the paper will be given based on both its content and how well it is written. In your analysis, you might want to consider the following issues.

1. What are the relevant theories?
2. What are the assumptions that you need to make?
3. What would be the data that support your arguments?
4. Is the policy recommendation applicable to both developed and developing countries?
5. Is there any “unintended” consequence from the policy recommendation?

Due Dates

If you choose your own topic other than those suggested below, you must email me the topic you select by Tuesday February 15.

A short outline of the paper must be sent to me via e-mail by 5PM of Tuesday March 1. The objective of the paper outline is to describe your research questions and how you would proceed to answer them. I will give you my feedback between Monday March 14 and Thursday March 17. If you turn it in before the due date, you may schedule a meeting with me before March 14. However, you need to give me 5 days in advance.

I would also be pleased to give you my comment on your draft as long as you send it to me by Tuesday March 29. (Since it would take me a week to read through your draft, you would not be able to incorporate my comment in the final version of the paper if you give me the draft after March 29.)

The complete paper is due on Thursday April 12 by 5PM. Any complete paper that is turned in after the due date will receive no credit. **THE FINAL VERSION OF YOUR PAPER MUST BE SUBMITTED TO TURNITIN.COM.** I take academic integrity seriously. You would be turned in to McGill authority if I found an evidence of plagiarism in the term paper.

Suggested Topics

1. Should countries be allowed to default on their debts?
2. Should developing countries adopt capital controls on capital inflows and outflows as a means of stemming speculative attacks?
3. Should firms be allowed to borrow external debts denominated in foreign currencies?
4. Are fixed exchange rate regimes preferred to adopting a common currency? What is the optimal exchange rate regime?
5. Should Canada, the U.S. and Mexico have a monetary union?
6. What hurts most: exchange or interest rate volatility?
7. Whether and how could the previous financial crises have been prevented? (Pick one crisis to discuss in details.)
8. If money is neutral in the long run, do international macroeconomic policies have any impact on a country's long run economic growth?