

Economics 662 – Fall 2004
International Monetary Economics
Course website: <http://www2.hawaii.edu/~noy/662.html>

Tuesday-Thursday 1:30-2:45 (Webster 103)

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Email is by far the best way to contact me for appointments, emergencies, questions or clarifications.

Course Description

The study of international economics is usually divided into two parts: trade (micro-analysis) and finance (monetary/open macroeconomics). This course studies the latter. We first define the field and introduce the major concepts of macroeconomics as they relate to open economies (output, exchange rates, etc.). We then develop intertemporal models that help us evaluate policies that affect the determination of output, unemployment, price levels, and exchange rates. We continue with a number of selected topics in international finance based on the class and the instructor's interests and preferences. Throughout, we also analyze the current state of the empirical literature.

Lectures should only be considered a supplement to the readings. The lectures are designed to cover the most fundamental issues and provide a foundation for the readings. The exam may include topics covered by the required readings that were not dealt with in class (required readings are indicated by an asterisk).

Readings

Required Textbook

[OR] Obstfeld, Maurice, and Kenneth Rogoff. *Foundations of International Macroeconomics* (Cambridge, Mass.: MIT Press, 1996).

[Available on reserve at Sinclair library.]

Optional Book

[GR] Grossman, Gene and Kenneth Rogoff (eds.), *Handbook of International Economics*, Vol. III (Amsterdam: North Holland, 1995).

[Available on reserve at Sinclair library.]

Class Requirements

A. Presentations

Each student will present at least two papers (from the reading list). The presentation should include both the main arguments and ideas of the paper, the methodology used, a technical description of results and your own critique. This information should also be included in a handout provided to the class before the lecture. A presentation should last about 30-45 minutes. If you want, your presentation can be posted online ahead of time.

B. Exam

A take-home exam will cover the first part of the course. You will have 24 hours to do the exam (date: TBA)

C. Final paper

The final paper will discuss a topic of your choice (out of the topics we choose in the latter half of the course). It will describe the major contributions on the topic, the current state of the literature, and will propose at least one possible extension/addition to that literature.

Grading

Exam	30%
Final Paper	30%
Presentations	30% (15% each)
Participation	10%

Grades awarded will include +/- notation

Disability Needs

If you feel you need reasonable accommodations because of the impact of a disability, please, (1) contact the KOKUA program at 956-7511 or 956-7612 (rm. 013 at QLCSS) and (2) discuss with me any specific needs related to your documented disability.

THIS IS NOT A FINAL READING LIST! I WILL UPDATE THIS LIST AS WE PROGRESS.

1. THE INTERTEMPORAL APPROACH TO THE CURRENT ACCOUNT

*OR, Chapters 1-2.

Mercereau, Benoît and Jacques Miniane (2004). "Challenging the Empirical Evidence from Present Value Models of the Current Account." IMF WP/04/106.

Svensson, L., and A. Razin (1983). "The Terms of Trade and the Current Account: The Harberger-Laursen-Metzler Effect." *Journal of Political Economy*, 91, 97-125.

*Tornell, Aaron, and Philip Lane (1998). "Are windfalls a curse? A Non-Representative Agent Model of the Current Account." *Journal of International Economics*, 44, 83-112.

2. NON-TRADED GOODS AND THE REAL EXCHANGE RATE

*OR, Chapter 4.

*Goldberg, Penny K. and Michael Knetter (1997). "Goods Prices and Exchange Rates: What have we Learned?" *Journal of Economic Literature* 35, 1243-72.

Taylor, M.P. (1995). "The Economics of Exchange Rates." *Journal of Economic Literature* 33(1), 13-47.

3. FISCAL POLICY IN THE OPEN ECONOMY

*OR, Chapter 3.

Asdrubali, Pierfederico, Bent Sorensen and Oved Yosha (1996). "Channels of Interstate Risk Sharing: United States 1963-90." *Quarterly Journal of Economics*, 111, 1081-110.

Bertola, G., and A. Drazen (1993). "Trigger Points and Budget Cuts: Explaining the Effects of Fiscal Austerity." *American Economic Review*, 83, 11-26.

*Caballero, Ricardo J. and Arvind Krishnamurthy (2004). "Fiscal Policy And Financial Depth." Mimeo, MIT.

*Frenkel, J. and A. Razin (1986). "Fiscal Policies in the World Economy." *Journal of Political Economy*, 94, 564-594.

4. MONEY AND THE OPEN ECONOMY

*OR, chapters 9-10

Corsetti, Giancarlo and Paolo Pesenti (2001). "Welfare and Macroeconomic Interdependence," *Quarterly Journal of Economics*, 421-445.

Dornbusch, Rudiger (1976). "Expectations and Exchange Rate Dynamics." *Journal of Political Economy*, 24, 1161-1176.

Obstfeld, Maurice (2002). "Exchange Rates and Adjustment: Perspectives from the New Open Economy Macroeconomics." NBER WP 9118.

Obstfeld, Maurice and Ken Rogoff (1995). "Exchange Rate Dynamics Redux." *Journal of Political Economy*, 102.

*Obstfeld, Maurice and Kenneth Rogoff (2000). "New Directions in Stochastic Open Economy Models." *Journal of International Economics*, 48, 117-153

*Philip Lane (2001). "The New Open Economy Macroeconomics: A Survey." *Journal of International Economics*, 54, 235-266.

5. BALANCE OF PAYMENTS CRISES - THEORY

OR, pp. 558-67, 576-78, 648-653.

*Aghion, Philippe, Philippe Bacchetta, Abhijit Banerjee. (2001). "Currency Crises And Monetary Policy In An Economy With Credit Constraints." *European Economic Review*, (45)7, 1121-1150.

*Allen, Franklin, and Douglas Gale. (1998). "Optimal Financial Crises." *Journal of Finance*, 53, 1245-1284.

Arellano, Cristina and Enrique Mendoza (2002). "Credit Frictions and 'Sudden Stops' in Small Open Economies: An Equilibrium Business Cycle Framework for Emerging Markets Crises." NBER WP 8880.

Calvo, Guillermo (1987) "Balance of Payments Crises in a Cash-in-Advance Economy." *Journal of Money, Credit and Banking*, 19, 19-32.

Calvo, Guillermo. (1998). "Capital Flows and Capital-Market Crises: The Simple Economics of Sudden Stops." *Journal of Applied Economics* 1, 35-54.

*Chang, Roberto and Andres Velasco (2001). "A Model of Financial Crises in Emerging Markets." *Quarterly Journal of Economics*, 489-518.

*Corsetti, Giancarlo, Paolo Pesenti, and Nouriel Roubini. (1999). "Paper Tigers? A Model Of The Asian Crisis." *European Economic Review*, 43, 1211-1236.

Dooley, Michael (2000). "A Model of Crises in Emerging Markets." *Economic Journal*, 110, 256-272.

Flood, Robert P., and Peter M. Garber, 1991, "The Linkage Between Speculative Attacks and Target Zone Models of Exchange Rates." *Quarterly Journal of Economics*, 106, 1367–72.

*Krugman, Paul (1979). "A Model of Balance of Payment Crisis." *Journal of Money, Credit and Banking*, 11, 311-325.

Krugman, Paul (1998). "What Happened to Asia." mimeo.

*Krugman, Paul, "Fire-Sale FDI," Chapter 2 in *Capital Flows and the Emerging Economies*, S. Edwards (ed.).

Morris, Stephen and Hyun Song Shin (1998). "Unique Equilibrium in a Model of Self-Fulfilling Currency Attacks." *American Economic Review* 88, 587-97.

*Obstfeld, Maurice (1994). "The Logic of Currency Crises." *Cahiers économiques et monétaires* 43, 189-213. [Paper available from Obstfeld's homepage].

6. MISCELLENOUS TOPICS IN INTERNATIONAL MACROECONOMICS

Aizenman, J. and S. Turnovsky, "Reserve Requirements on Sovereign Debt in the Presence of Moral Hazard – on Debtor or Creditors?" *Economic Journal*.

Hellmann, Thomas, Kevin Murdock and Joseph Stiglitz (2001). "Liberalization, Moral Hazard in Banking, and Prudential Regulation: Are Capital Requirements Enough?" *American Economic Review*, 90.

*Lewis, K.K. "Puzzles in international financial markets" in GR.

Lewis Karen (1999). "Trying to Explain Home Bias in Equities and Consumption." *Journal of Economic Literature* 37, 571-608.

*Obstfeld, Maurice and Kenneth Rogoff (2000). "The Six Major Puzzles in International Macroeconomics: Is there a Common Cause?" in Ben Bernanke and Kenneth Rogoff (eds.), *NBER Macroeconomics Annual 2000*. Also NBER WP 7777.

ELECTIVE TOPICS

Currency Unions

Alesina, Alberto, and Robert Barro, "Currency Unions," mimeo, Harvard University.

Corsetti, Giancarlo, and Paolo Pesenti. (2002). "Self-Validating Optimum Currency Areas." NBER WP 8783.

Dixit, Avinash (2001). Games of monetary and fiscal interactions in the EMU, *European Economic Review*, 45(4), 589-613

Glick, Reuven and Andrew K. Rose (2002). "Does a currency union affect trade? The time-series evidence." *European Economic Review*, 46(6), 1125-1151.

Mundell, Robert (1961). "A Theory of Optimum Currency Areas." *American Economic Review* 51(4), 657-665.

Exchange Rate Regimes

Calvo, Guillermo and F. Mishkin (2003). "The Mirage of Exchange Rate Regimes for Emerging Market Countries." *Journal of Economic Perspectives* 17(4).

Calvo, Guillermo and Carmen M. Reinhart, 2002, "Fear of Floating," *Quarterly Journal of Economics*, 117(2), 379-408.

Chang, Roberto, and Andres Velasco. (2000b). "Financial Fragility and the Exchange Rate Regime." *Journal of Economic Theory* 92, 1-34.

Fischer, Stanley "The bi-polar view"

Jeanne O. and A. K. Rose (1999). "Noise Trading and Exchange Rate Regimes," NBER WP # 7104.

Levy-Yeyati, Eduardo and Federico Sturzenegger (2003). "To Float or to Fix: Evidence on the Impact of Exchange Rate Regimes on Growth." *American Economic Review*, 93(4). 1173-1193.

Krugman, Paul (1991). "Target Zones and Exchange Rate Dynamics." *Quarterly Journal of Economics*, 106, 669-82.

Reinhart, Carmen M., and Kenneth S. Rogoff, 2004, "The Modern History of Exchange Rate Arrangements: A Reinterpretation," *Quarterly Journal of Economics*, 119(1), 1-48.

Balance Of Payments and Banking Crises - Empirics

Arteta, Carlos, and Barry Eichengreen (2002). "Banking Crises in Emerging Markets: Presumptions and Evidence." In: M. Blejer and M. Skreb (eds.) *Exchange Rate and Financial Vulnerability in Emerging Markets*.

Demirgüç-Kunt, Asli, and Enrica Detragiache. (1998). "The Determinants of Banking Crises in Developing and Developed Countries." *IMF Staff Papers*, 45, 81-109.

Frankel, Jeffrey, and Andrew Rose. (1996). "Currency Crashes in Emerging Markets. An Empirical Treatment." *Journal of International Economics* 41, 351-366.

Forbes, Kristin (2002). "Cheap Labor Meets Costly Capital: The Impact of devaluations on Commodity Firms". *Journal of Development Economics* 69(2), 335-365.

Glick, Reuven and Michael Hutchison (forthcoming). "Capital Controls and Exchange Rate Instability in Developing Economies," *Journal of International Money and Finance*.

Hutchison, Michael and Ilan Noy (forthcoming). "How Bad are Twins? Output Costs of Currency and Banking Crises". *Journal of Money, Credit and Banking*.

Kaminsky, Graciela and Carmen M. Reinhart (1999). "The Twin Crises: The Causes of Banking and Balance of Payments Problems." *American Economic Review*, 89, 473-500.

Milesi-Ferretti, Gian Maria, and Assaf Razin. (2000). "Current Account Reversals and Currency Crises: Empirical Regularities." In *Currency Crises*, edited by P. Krugman.

Tornell, Aaron and Frank Westermann (2002). "Boom-Bust Cycles: Facts and Explanations". *IMF Staff Papers* (September).

The New International Financial Architecture

Jeanne, Olivier (2000). "Foreign Currency Debt And The Global Financial Architecture." *European Economic Review* 44(4), 719-727.

Jeanne Olivier and Charles Wyplosz "The International Lender of Last Resort: How Large is Large Enough?" NBER Working Paper No. W8381, July 2001.

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

Sovereign risk and financial integration

OR page 349-388, 407-17, 419-22

Bulow, J. and K. Rogoff (1989). "A Constant Recontracting Model of Sovereign Debt." *Journal of Political Economy* 97, 155-78.

Bulow, J. and K. Rogoff (1989). "Sovereign Debt: Is to Forgive to Forget?" *American Economic Review* 79, 43-50.

Eaton and Gersovitz (RES, 48 (April) 1981, 289-309).

Eaton and Raquel Fernandez (1995), GR chapter XX.

Kletzer, K. (1984). "Asymmetric Information and the LDC Borrowing with Sovereign Risk." *Economic Journal*, 287-307.

Kletzer, Kenneth and Brian Wright (2000). "Sovereign Debt as Intertemporal Barter." *American Economic Review* 90, 621-639.

Dollarization

Berg, Andrew and Eduardo Borensztein, 2000, "The Pros and Cons of Full Dollarization." IMF WP/00/50.

Edwards, Sebastian (2001). "Dollarization: Myths and Realities," *Journal of Policy Modeling*, 23.

Jeanne, O. (2003). "Why do Emerging Market Economies Borrow in Foreign Currency." IMF WP/03/177.

Reinhart, Carmen M., Kenneth S. Rogoff and Miguel A. Savastano (2003). "Addicted to Dollars." NBER WP 10015.

Uribe, Martin (1997). "Hysteresis in a Simple Model of Currency Substitution," *Journal of Monetary Economics*, 40(1), 185-202.

History of the International Financial System

Boughton, James M. (2004). "The IMF and the Force of History: Ten Events and Ten Ideas That Have Shaped the Institution." IMF WP/04/75.

Dooley, M., Folkerts-Landau, D and P. Garber (2004). "The Revived Bretton Woods System." NBER WP 10332.

Eichengreen, Barry J., (1996). *Globalizing Capital: A History of the International Monetary System* (Princeton: Princeton University Press).

Eichengreen, Barry J., (2004). "Global Imbalances and the Lessons of Bretton Woods." NBER WP 10497.

Lothian, James R. and Mark P. Taylor (1996) "Real Exchange Rate Behavior: The Recent Float From The Perspective Of The Past Two Centuries." *Journal of Political Economy* 104, 488-509.

Obstfeld, Maurice, Jay C. Shambaugh and Alan M. Taylor (2004). "Monetary Sovereignty, Exchange Rates, And Capital Controls: The Trilemma In The Interwar Period." NBER WP 10393.

More on Exchange Rates

OR. Chapter 5

Cheung, Yin-Wong, Menzie Chinn, and Antonio Garcia Pascual (2003). Empirical Exchange Rate Models of the Nineties: Are Any Fit to Survive? IMF WP/04/73.

Chinn, M.D. and R.A. Meese, 1995, "Banking on Currency Forecasts: How Predictable is Change in Money," *Journal of International Economics* 38, 161–178.

Engels, C. and J. Hamilton, 1990, "Long Swings in the Exchange Rate: Are They in the Data and Do Markets Know It?" *American Economic Review* 80, 689–713.

Engels Charles (1999). "Accounting for US Real Exchange Rate Changes," *Journal of Political Economy* 107, 507-538.

Engels Charles and K. West (2003). "Exchange Rates and Fundamentals." ECB WP 248.

Froot, K. and K. Rogoff, (1995). "Perspectives on PPP and Long-Run Real Exchange Rates," in GR.

Kilian, L. and M.P. Taylor (2003). "Why is it so Difficult to beat the Random Walk Forecast of Exchange Rates." *Journal of International Economics* 60, 85–108.

Mark, N., (1995). "Exchange Rates and Fundamentals: Evidence on Long Horizon Predictability," *American Economic Review* Vol. 85, 201–218.

Rogoff, Kenneth (1996). "The Purchasing Power Parity Puzzle." *Journal of Economic Literature*.

Taylor, Alan M. and Mark P. Taylor (2004). The Purchasing Power Parity Debate." NBER WP 10607.