

ECON 797L

Open Economy Macroeconomics

<http://courses.umass.edu/econ797l>

University of Massachusetts

Spring 2009

Tuesday 6:00-8:30 PM

Ninth Floor Conference Room

Office hours: TuTh., 11 AM – 12PM (or by appointment)

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Overview

This is a graduate level course on open economy macroeconomics and students will be assumed to have some background in the area in addition to familiarity with basic mathematical tools of comparative static and dynamic analysis. Apart from covering the main theoretical topics, we will familiarize ourselves with some of the recent econometric studies of the models reviewed. After a quick tour of some core ideas, we will; (1) compare and contrast alternative theories of the linkages between macroeconomic variables such as output, the monetary base, inflation, portfolio allocation, employment, and income distribution in an open economy, (2) explore the effects of various policies under different exchange rate regimes, (3) study selected open economy issues from a developmental perspective, and (4) attempt a broad survey of some of the recent time series techniques that have come to dominate empirical work in the area. Understanding the economic intuition behind the models as well as thinking critically about the underlying assumptions and how well they fit actual open economies will be a major focus. Students will be challenged to think about the relevance of the various theories and models to contemporary policy issues in the global economy.

Needless to point out that this course is being offered at a very interesting time. Proposals for a new Bretton Woods are in the air. What alternative forms of global financial architecture could conceivably be geared towards more equitable growth? Global imbalances are beginning to unwind just as the US consumption engine sputters. Have some of the rapidly growing “emerging economies” truly de-coupled from their reliance on the industrialized economies? As the US investment-savings gap closes, will the dollar adjust smoothly enough to maintain its status as the premier reserve and vehicle currency or are we in for a “wile coyote moment?” The US Fed’s balance sheet has nearly doubled over the last 5 weeks as the Treasury gets ready to implement another massive fiscal stimulus package. What does this mean for the rest of the world? Does the real exchange rate have a role as a development policy tool? Is the global economy entering into another round of beggar-thy-neighbor policies? How easy would it be to re-direct China’s investment- and export-led strategy into a domestic demand led strategy once demand from the industrialized world weakens, and what are the likely implications for Chinese and global income distribution?

As we build our theoretical toolkit we will pursue these kinds of broad questions along with country-specific case studies. Student interest can influence the depth of coverage of individual topics so be sure to speak up!

Note: Please note that I will not cover models of international financial crises in any detail. That topic falls under the purview of the international finance course. (However, you will, by the end of the semester, have a better understanding of why the Fed's balance sheet has ballooned in the last five weeks since the AIG bailout.)

Class Website

The class website (URL: courses.umass.edu/econ797L) will contain the syllabus (and any updates) plus announcements, assignments, and other useful information (e.g., links to readings and related websites).

Work Requirements and Grading

There will be one **midterm** exam and a take home **final exam**. 4-6 problem sets will be distributed to provide practice and to help fix ideas. The midterm and paper will account for 30% and 40% of the grade, respectively. Satisfactory problem set completion and in-class presentations on selected topics will account for the other 30%. The problem sets will partly cover new material or extensions not covered in class.

Books and Articles

Required textbook:

Gandolfo, G., *International Finance and Open Economy Macroeconomics* (Springer, 2001).

Note: I have not been able to find a textbook that covers a majority of the topics that I plan to cover in a satisfactory manner. I have, therefore, opted for Plan B, which involves one core textbook that I will use to cover most of the topics during the first half of the semester, and chapters from other textbooks that I will use to pursue selected topics later on (I will provide scanned copies of these chapters).

Supplementary textbooks:

Rodseth, A., *Open Economy Macroeconomics* (Cambridge University Press, 2000).

Robert A. Blecker, *Taming Global Finance: A Better Architecture for Growth and Equity* (Washington: Economic Policy Institute, 1999).

Taylor, Lance, *Income Distribution, Inflation, and Growth: Lectures on Structuralist Macroeconomic Theory* (Cambridge, MIT Press, 1991)

Agenor, P-R. and Montiel, P, *Development Macroeconomics*, (Princeton University Press, 2008)

Dornbusch, Rudiger, *Open Economy Macroeconomics* (New York: Basic Books, 1980).

Recommended background reading:

This is meant only for students who have not taken undergraduate international finance/open economy macroeconomics.

Caves, Richard E., Jeffrey A. Frankel, and Ronald W. Jones, 2006, *World Trade and Payments: An Introduction* 10th Edition (New York: Harper Collins).

Krugman, P. and Obstfeld, M., *International Economics: Theory and Policy* (Addison-Wesley, 2007).

Van Hoose, D. and Daniels, J., *International Money and Finance* (South Western Publishing, 2002).

Course Outline and Readings

Note: The list of readings is work in progress. For each topic, the two or three most important readings will be highlighted. The other readings are for your own benefit should you be interested in further pursuing specific topics. Most of these readings will be put on reserve or made electronically available in one form or another.

* denotes required readings (this list is especially subject to change!)..

A. Basic Concepts, Parity Conditions, Balance of Payments Accounting, and a Brief Overview of the Global Financial Architecture

*Gandolfo, chaps. 2-6

R. Blecker, *Taming Global Finance*, chap. 2.

Supplementary Readings:

Marrewijk, C. 2004. "An Introduction to International Money and Foreign Exchange Markets," Working Paper Number 2004-02, The University of Adelaide.

Christopher J. Neely, 1999 "An Introduction to Capital Controls" FRB St. Louis Review 81(6), Nov/Dec.

Taylor, Alan and Taylor, Mark, "The Purchasing Power Parity Debate," *Journal of Economic perspectives*, 18(4), Fall 2004, pp. 135-158.

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(3), June, 488--509.

Pakko, Michael R. and Patricia S. Pollard, 2003, "Burgernomics: A Big Mac™ Guide to Purchasing Power Parity", Federal Reserve Bank of St. Louis Review 85 (6) pp. 9--27.
URL: <http://research.stlouisfed.org/publications/review/03/11/pakko.pdf>

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

B. Flow Approaches to Exchange Rates, the Balance of Payments, and Income Determination

1. The partial equilibrium elasticities approach and the Marshall-Lerner condition

*Gandolfo, chap. 7

2. The Keynesian approach to output adjustment and absorption

*Gandolfo, chaps. 8-9

Dornbusch, R., 1980. *Open Economy Macroeconomics*, chs. 3-4.

3. The Mundell-Fleming approach under fixed and flexible exchange rates

*Gandolfo, chs. 10-11

Frenkel J. and Razin, A. 1987. "The Mundell-Fleming Model: A Quarter Century Later," *IMF Working Paper Number WP/87/46*, Washington, DC.

Mundell, Robert. 1962. "The Appropriate Use of Monetary and Fiscal Policy for Internal and External Balance," *IMF Staff Papers* 9, pp. 70-79.

Mundell, Robert. 1963. "Capital Mobility and Stabilization Policy under Fixed and Flexible Exchange Rates," *Canadian Journal of Economics and Political Science*, pp. 475-85.

Fleming, Marcus. 1962. "Domestic Financial Policies Under Fixed and Under Floating Exchange Rates," *IMF Staff Papers* 9, November, pp. 369-379.

Agenor and Montiel. 2008. Ch. 2

4. The Dependent Economy Model

*Dornbusch, R., 1980. *Open Economy Macroeconomics*, ch. 6.

Agenor and Montiel. 2008. Ch. 2

Rodseth 2000. Ch. 7

C. Stock Approaches to External Adjustment

1. The monetary/monetarist approach

*Gandolfo, ch. 12

*R. Dornbusch, R. (1976), Expectations and Exchange Rate Dynamics, *Journal of Political Economy*, 84:1161-76

Whitman, Marina v. N. 1975. "Global Monetarism and the Monetary Approach to the Balance of Payments," *Brookings Papers on Economic Activity*, 3:1975, pp. 491-536

Laidler, David, 1981. "Some Policy Implications of the Monetary Approach to Balance of Payments and Exchange Rate Analysis," *Oxford Economic Papers*, 33, July, 70-84.

Asea, Patrick K., and Max Corden, 1994, "The Balassa-Samuelson Model: An Overview," *Review of International Economics* 2

Canzoneri, Matthew B., Robert E. Cumby, and Behzad Diba, 1996, "Relative Labor Productivity and the Real Exchange Rate in the Long Run: Evidence from a Panel of OECD Countries," NBER Working Paper Series, Working Paper 5676, July.

Frankel, Jeffrey A., 1979, "On the Mark: A Theory of Floating Exchange Rates Based on Real Interest Differentials," *American Economic Review* 69, Sep. 1979, 610--22.

Frenkel, Jacob and Harry Johnson, 1976, "The Monetary Approach to the Balance of Payments: Essential Concepts and Historical Origins," in Jacob Frenkel and Harry

Johnson (eds), *The Monetary Approach to the Balance of Payments* (Toronto: University of Toronto Press, 1976, p.25)

2. Portfolio adjustment in a partial equilibrium framework

*Gandolfo, ch. 13

D. Stock-Flow Consistent Approaches

1. The Mundell-Fleming approach

*Rodseth, chs. 2, 3, 6

Taylor, Lance, "Exchange rate indeterminacy in portfolio balance, Mundell–Fleming and uncovered interest rate parity models," *Cambridge Journal of Economics*, 28(2), 2004, pp. 205-27.

2. The Portfolio Balance approach

*Gandolfo, ch. 13

3. The inter-temporal approach and the "new open economy macroeconomics"

*Obstfeld and Rogoff (1996), chs. 1 and 4.

Corsetti, G. 2007. "New Open Economy Macroeconomics," EUI Working Papers, RSCAS 2007/27.

4. Two good (dependent economy models)

*Rodseth, ch. 7

E. Neo-Kaleckian, Structuralist, and Post-Keynesian Perspectives on Growth and Income Distribution in Open Economies

*Robert A. Blecker, 1999. "Kaleckian Macro Models for Open Economies," in J. Deprez & J. Harvey, eds., *Foundations of International Economics: Post Keynesian Perspectives*, pp. 116-49.

Taylor, Lance, 1991. *Income Distribution, Inflation, and Growth: Lectures on Structuralist Macroeconomic Theory*, MIT press, ch. 7.

*A. P. Thirlwall, "The Balance of Payments Constraint as an Explanation of International Growth Rate Differences," *Banca Nazionale del Lavoro Quarterly Review*, No. 128 (March 1979), pp. 45-53.

Krugman, Paul R., and Lance Taylor. 1978. "Contractionary Effects of Devaluation," *Journal of International Economics* 8, pp. 445-56.

Díaz-Alejandro, Carlos F. 1963. "A Note on the Impact of Devaluation and the Redistributive Effect," *Journal of Political Economy* 71, pp. 577-80.

Robert A. Blecker, "International Competition, Income Distribution, and Economic Growth," *CJE*, vol. 13 (September 1989), pp. 395-412.

J. S. L. McCombie and A. P. Thirlwall, *Economic Growth and the Balance-of-Payments Constraint* (1994), chs. 1-3, 5-9.

J. S. L. McCombie and A. P. Thirlwall, "Growth in an International Context," *Foundations of International Economics: A Post Keynesian Perspective*, Deprez, J. and Harvey, J. (ed.), Routledge, 1999.

Skott, Peter, "Kaldor's Growth Laws and the Principle of Cumulative Causation," in *Growth, Employment, and Inflation*, Setterfield, Mark (ed.), MacMillan Press, 1999.

Robert Blecker, 1996. "The New Economic Integration: Structuralist Models of North-South Trade and Investment Liberalization", *Structural Change and Economic Dynamics* 7 (3): 321-45.

F. Special Topics (we will cover a few of these depending on student interest)

1. Open economy considerations in emerging economies

*Eichengreen, B., R. Hausmann, and U. Panizza, 2005. *The Pain of Original Sin*. Chicago and London: University of Chicago Press.

*Corden, W.M., 1984 "Booming Sector and Dutch Disease Economics: Survey and Consolidation," *Oxford Economic Papers* 36(3), November 359—380.

Broner, F., G. Lorenzoni, and S. Schmukler, 2004. "Why Do Emerging Economies Borrow Short Term?", *World Bank Policy Research Working Paper No. 3389*.

Mody, A., P. Gupta, and B. Eichengreen, 2006. "Sudden Stops and IMF Supported Programs", *IMF Working Papers* 06/101.

Krugman, P. 1987, "The Narrow Moving Band, the Dutch Disease, and the Competitive Consequences of Mrs. Thatcher," *Journal of Development Economics* 27, 41-55.

Epstein, Gerald A., and Herbert Gintis. 1992. "International Capital Markets and the Limits of National Economic Policy," in T. Banuri and J. Schor, eds., *Financial Openness and National Autonomy: Opportunities and Constraints*. Oxford: Oxford University Press.

2. Global current account imbalances: what does the future hold in store?

*Krugman, Paul, "Will there be a dollar crisis?" *Economic Policy*, July 2007

Lane, P. and G. Milesi-Ferretti, 2005. "A Global Perspective on External Positions", *IMF WP No. 05/161*.

Bergsten, C. and J. Williamson, 2004. *Dollar Adjustment: How Far? Against What?* Special Report 17. Washington, D.C.: Institute for International Economics.

Dooley, M., D. Folkerts Landau, and P. Garber, 2004. "The revived Bretton Woods System", *NBER WP No. 10332*.

3. Exchange rate policy as a tool of development policy

Ros, J. and Frenkel, R., 2005. "Unemployment and the Real Exchange Rate in Latin America," *World Development*, 34(4), pp. 631-46.

Razmi and Skott (?)

Blecker, R. and Razmi, A., 2008. "The Fallacy of Composition and Contractionary Devaluations: Output Effects of Real Exchange Rate Shocks in Semi-Industrialised Countries," *Cambridge Journal of Economics*, 32(1), January, 2008.

Blecker, R., 2005. "Financial Globalization, Exchange Rates, and International Trade," in *Financialization and the World Economy*, Epstein, J. (ed.), Edward Elgar: Northampton.

Levy-Yeyati, Eduardo, and Sturzenegger, Federico, 2007. "Fear of Appreciation," World Bank Policy Research Working Paper No. 4387, Washington, DC.

Eichengreen, B., 2007. The Real Exchange Rate and Economic Growth, Unpublished Manuscript, University of California at Berkeley, July.

Williamson, J. 2008. Exchange Rate Economics, Working Paper Number 08-3, Peterson Institute for International Economics, Washington DC, February.

4. The Choice of Exchange Rate Regime: Fixed, Flexible, or Intermediate?

*Mussa, Masson, et al., 2000. Exchange Rate Regimes in an Increasingly Integrated World Economy," IMF Occasional Paper 193.

*Rogoff, Husain, et al., December 2003. "Evolution and Performance of Exchange Rate Regimes," IMF Working Paper WP/03/243.

Williamson, J, "The Evolution of Thought on Intermediate Exchange Rate Regimes, *The ANNALS of the American Academy of Political and Social Science*, 579 (1), Jan. 2002.

Velasco, Andres June 2000. "Exchange-rate Policies for Developing Countries: What Have We Learned? What Do We Still Not Know?" UNCTAD G-24 Discussion Papers, No. 5.

Friedman, Milton. 1953. "The Case for Flexible Exchange Rates," in Milton Friedman, *Essays in Positive Economics*. Chicago: University of Chicago Press.

5. Reserve accumulation: costs and benefits

Rodrik, Dani, 2006. "The Social Cost of Foreign Exchange Reserves," *NBER Working Paper Number 11952*, Cambridge.

*Jeanne, Olivier, 2007. "International Reserves in Emerging Market Countries: Too Much of a Good Thing?" *Brookings Papers on Economic Activity*, 1.

6. Time series properties of macroeconomic variables. Some basic issues.

Mark, Nelson. 2001. *International Macroeconomics and Finance: Theory and Econometric Method*, ch. 2.

7. Exchange rate-based stabilization programs in developing countries

*Rodseth, ch. 7

Taylor, Lance, "Capital Market Crises: Liberalisation, Fixed Exchange Rates, and Market-Driven Destabilisation," *Cambridge Journal of Economics*, vol. 22, no. 6 (1998), pp. 663-76.

Agenor and Montiel. 2008. Ch. 12.

Supplementary book readings:

Argy, Victor, *International Macroeconomics: Theory and Policy* (New York: Routledge, 1994).

- Arestis, Philip, *Money, Pricing, Distribution and Economic Integration* (London: Macmillan and New York: St. Martin's, 1997).
- Baker, D., Epstein, G., and Pollin, R., *Globalization and Progressive Economic Policy* (Cambridge: Cambridge University Press, 1998).
- Deprez, Johan and John T. Harvey (eds.), *Foundations of International Economics: Post-Keynesian Perspectives* (New York: Routledge, 1999).
- Dani Rodrik, *Has Globalization Gone Too Far?* (Washington, DC: Institute for International Economics, 1997).
- Eichengreen, Barry, *Globalizing Capital: A History of the International Financial System* (Princeton: Princeton University Press, 1996).
- Eichengreen, Barry, *Toward a New Financial Architecture: A Practical Post-Asia Agenda* (Washington, DC: Institute of International Economics, 1999).
- Frenkel, Jacob A., and Assaf Razin, *Fiscal Policies and Growth in the World Economy*, 3rd Edition (Cambridge: MIT Press, 1996).
- Grossman, G. M., and K. Rogoff (eds.), *Handbook of International Economics*, vol. 3, (Amsterdam: North-Holland, 1995).
- Hallwood, C. P. and Ronald MacDonald, *International Money and Finance*, 3rd edition (Oxford: Blackwell, 2000).
- Hinkle, Lawrence E. and Peter J. Montiel, 1999, *Exchange Rate Misalignment: Concepts and Measurement for Developing Countries* (Oxford: Oxford University Press for the World Bank).
- Isard, Peter, *Exchange Rate Economics* (Cambridge: Cambridge University Press, 1995).
- Jones, R.. and P. Kenen, (eds), *Handbook of International Economics*, vol. 2 (Amsterdam: North-Holland, 1984)
- Krugman, Paul (ed.), *Currency Crisis* (Chicago: University of Chicago Press, 2000).
- Mark, Nelson C., *International Macroeconomics and Finance: Theory and Econometric Methods* (Blackwell Publishers, 2001).
- MacDonald, R. *Exchange Rate Economics* (Routledge, 2007).
- McCallum, Bennett T., *International Monetary Economics* (Oxford University Press, 1996).
- Obstfeld, Maurice, and Kenneth Rogoff, *Foundations of International Macroeconomics* (Cambridge: MIT Press, 1996).
- Peet, Richard, *The Unholy Trinity: The IMF, World Bank, and WTO* (Zed Books, 2003).
- Pentecost, Eric, *Exchange Rate Dynamics* (Edward Elgar, 1993).
- Rivera-Batiz, Francisco L., and Luis A. Rivera-Batiz, *International Finance and Open Economy Macroeconomics*, 2nd ed. (New York: Macmillan, 1994).
- Rodseth, Asbjorn, *Open Economy Macroeconomics* (Cambridge: Cambridge University Press, 2000).
- Rogoff, K. and Obstfeld, M., *Foundations of International Macroeconomics* (Cambridge: MIT Press).

Sarno, Lucio and Mark P. Taylor, *Exchange Rate Economics* (Cambridge: Cambridge University Press, 2003).

Stiglitz, Joseph, *Globalization and its Discontents* (New York: W. W. Norton, 2002).

Thirlwall, Anthony, *Trade, the Balance of Payments, and Exchange Rate Policy in Developing Countries*, (Northampton: Edward Elgar, 2003).

van der Ploeg, Frederick (ed.), *The Handbook of International Macroeconomics* (Cambridge: Blackwell Publishers, 1994)

Williamson, J., 1983, *The Open Economy and the World Economy* (New York: Basic Books).