

University of Pennsylvania
Department of Economics

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Econ 252
International Finance
Fall 2014, T/Th 12:00PM-1:30PM, Room: McNeil 286-7

Teaching Assistants

Juan Hernández (juanhern@sas.upenn.edu, McNeil 359)

Office hours (preliminary): Tu.,Fr. 1:30-3:00PM W.,Th.,Fr. 8:00-9:30AM

Hanna Wang (hannaw@sas.upenn.edu, McNeil 526)

Office hours (preliminary): M. 8:00-11:00AM Tu.,W.,Th. 3:00-4:30PM

Course description

A formal study of International Macroeconomics with emphasis on financial crises and policy responses in open economies. We focus in particular on the capital markets crises that affected many developed and emerging economies since the mid-1990s, the “global imbalances” phenomenon characterized by the large external deficits of the United States in the last two decades, and the global financial crisis that started with the U.S. crash in 2008 and continues today with the sovereign debt crises in the Eurozone. Topics covered include: macroeconomic equilibrium in open economies with and without money, theories of current account and exchange rate determination, the effects of exchange rate adjustments, macroeconomic policy under fixed and floating exchange rates, currency crises, and financial contagion. Preparation of a policy essay and discussions of current international policy issues are also part of the curriculum.

The lectures cover the foundations of international macroeconomics using a set of notes and other material available from the website. The objective is to build an analytical foundation for the preparation of the policy essay and for understanding and debating key macro issues in the world economy. We examine alternative hypotheses about the causes and dynamics of global capital markets crises and alternative proposals for dealing with them. These include issues related to capital-market imperfections, domestic economic policy, and the contagion of crises across countries. The course also examines the challenges financial crises pose to governments and international organizations in their efforts to contain them and prevent their recurrence.

Background

The course is designed to be self-contained, in the sense that a conscious effort to keep up with the coursework, the lecture notes and other material and readings distributed for the lectures should suffice. The course does require the skills acquired in the pre-requisite courses, including intermediate level Micro and Macro and multivariate calculus. This is a policy-oriented course, but at the same time it is a highly analytical course in which students are expected to develop and defend policy arguments using formal macroeconomic principles.

Prerequisites

ECON 101 (Int. Micro Theory) and 102 (Int. Macro Theory), MATH 104 (Calculus 1) and either 114 (Calculus 2) or 115 (Calculus 2 with probability). A student who receives credit for ECON 252 may not receive credit for ECON 50. Wharton students can satisfy the ECON 101 prerequisite with BEPP 250 HONORS (the regular BEPP 250 does not count as a substitute).

Homepage

The course homepage is located at <http://www.sas.upenn.edu/~egme/econ252/index.html>
Please access it for links to the class notes, course materials, problem sets and announcements.

Office hours: Tue. 3:00-4:30PM

Grading

Grades will be based on an in-class mid-term exam (30%, **planned for Thursday, Nov. 6, 2014**), a policy essay (30%, **due Dec. 12, 2014**), three problem sets (30%, **due Sept. 22, Oct. 6 and Oct. 27**), and class attendance and participation (10%).

Policy Essay

The policy essay is an exercise in researching and writing a “policy” or “action” paper similar to those used to guide decision making in financial institutions, government agencies and international organizations. The essay has to focus on the experience of one of the countries that went through a capital markets crisis since the 1990s. Each essay will be written jointly by two students (larger or smaller teams will not be allowed), and must be divided into three parts. Part 1 documents the basic facts of the crisis that hit the particular country under study using macroeconomic data. Part 2 must present a diagnosis (i.e., an analysis of the causes and consequences of the crisis). Part 3 must present policy recommendations to deal with the crisis. The analysis in parts 2 and 3 must be explicitly based on the analytical principles studied in the course and on readings of the particular country case or other reference material. In addition, parts 2 and 3 must ponder opposing views of the crisis: A “domestic” perspective from the viewpoint of the government, or the domestic banks, or the unions, etc., and a “foreign” perspective from the viewpoint of the IMF, or “Wall Street”, or the U.S. government, etc. One author of each pair will choose to take one of the opposing views, and the two authors should meet to discuss their viewpoints, expose them in Part 2, and articulate their positions in Part 3.

Authors will choose the country and view for their essay by signing up (first-come, first-served) on a list posted in my office door during the first month of the course. Each essay must be a maximum of 10 double-spaced pages in a standard 12 point font with 1 inch margins (*including cover page, main text, and all figures and tables*). The list will also name the teaching assistant assigned to each essay. Your assigned TA will be available to help you with questions and suggestions as you make progress. A one-page proposal outlining the structure and contents of the essay must be submitted for approval by **Oct. 30, 2014**. *Only papers with an accepted proposal will be graded.* The paper is due on the first day of the final exam period **Dec. 12, 2014**.

Outline and Readings

Class Notes: The lectures of the first part of the course follow the notes available at:

http://www.sas.upenn.edu/~egme/econ252/files/Lecture_NotesEcon252forPDF.pdf

Please read them carefully. Part of them is based on the book *Macroeconomics in the Global Economy* by Jeffrey Sachs and Felipe Larrain (S&L, Prentice-Hall 1993). This book is not needed, but can be found in re-sale at Amazon (a PDF is publicly available at booksee.org). The book is not a substitute for the notes, and in particular it has a very different treatment of the macroeconomics of money.

1 Macroeconomic equilibrium in a small open economy without money

(Class notes, Sachs & Larrain Chs. 4-7)

- A. The Households Saving Decision
- B. The Firms Investment-Output Decisions
- C. The Current Account
- D. The Government Sector

2 Equilibrium in the Small Open Economy with Money

(Class notes, Sachs & Larrain Chs. 8-11)

- A. Interest Rates and Prices in a Monetary Economy
- B. Money and the Households Budget Constraint
- C. The Demand for Money: A Transactions Costs Approach
- D. The Money Supply Process
- E. Money Supply and the Consolidated Government Budget Constraint
- F. Equilibrium in the Money Market
- G. Money, Exchange Rates and Prices

3 Inflation, Unsustainable Policies and Balance-of-Payments Crises

(Class notes, Sachs & Larrain Ch. 12)

- A. Government Deficits and Inflation
- B. Balance-of-Payments Crises: The Collapse of Fixed Exchange Rates
- C. The Inflation Tax and Seigniorage
- D. Real and Monetary Effects of Currency Crises

4 Evaluation of the theory and overview of recent research.

- A. The Role of Banking Fragility: Implicit Fiscal Deficits
- B. Financial Vulnerabilities and Self-Fulfilling Crises
- C. The Syndrome of Exchange-Rate-Based Stabilizations
- D. Borrowing Constraints and Fisherian Multipliers
- E. The U.S. Global Imbalances: Is Globalization to Blame?
- F. Fiscal sustainability and sovereign default

5 Case Studies

The Mexican Crash of 1994 (IMF Pre-1994 tape on Mexico, Calvo and Mendoza, *American Ec. Review* May 1996, *Journal of Intn'l Econ*, Nov.1996)

The 1990s Crises in Emerging Markets (“Commanding Heights” video documentary)

The U.S. Crash of 2008 (“House of Cards” video documentary, “Too Big to Fail” HBO movie based on Andrew Sorkin’s book, “The Big Short” book by Michael Lewis)

A Few Suggested References for Policy Essays

David Driscoll, “What Is the International Monetary Fund?” Revised September 1998,
Paul Krugman, “The Confidence Game,” *New Republic*, October 5, 1998.

Jeffrey Sachs, “Global Capitalism: Making it Work,” *Economist*; and “IMF is a Power Unto Itself,” *NY Times*, December 11, 1997.

Enrique Mendoza, "Why Should Emerging Economies Give Up National Currencies: A Case for 'Institutions Substitution'," NBER WP 8950, 2002, National Bureau of Economic Research.

IMF, "A Guide to Progress in Strengthening the Architecture of the International Financial System," April 28, 1999.

Barry Eichengreen, Toward a New International Financial Architecture: A Practical Post-Asia Agenda (Institute for International Economics, 1999).

Robert E. Rubin, "Reform of the International Financial Architecture: Weighing Risks", *Vital Speeches of the Day*, New York, May 15, 1999, 65(5), pg. 445.

Anna J. Schwartz, "Time to Terminate the ESF and the IMF," National Bureau of Economic Research study no. 48, August 26, 1988.

Martin Feldstein, "A Self-Help Guide for Emerging Markets," Foreign Affairs 78, No. 2 (March/April, 1999), pp. 93-110.

Barry Eichengreen, "Capital Controls: Capital Idea or Capital Folly," ms. (Nov. 1998).

Barry Eichengreen and Michael Mussa, "Capital Account Liberalization and the IMF," Finance and Development (December 1998).

IMF, Chapter IV: Exchange Rate Arrangements and Economic Performance in Developing Countries, *World Economic Outlook* 1997.

IMF, *World Economic Outlook: International Financial Contagion*, May 1999

IMF, *World Economic Outlook and International Capital Markets: Interim Assessment*, December 1998.

Timothy Lane, *et al.* IMF-Supported Programs in Indonesia, Korea, and Thailand: A Preliminary Assessment, at <http://www.imf.org/external/pubs/ft/op/op178/index.htm>

I. Fisher, "The Debt-Deflation Theory of Great Depressions," *Econometrica*, 1933

J. Sachs and S. Radelet, "The East Asian Financial Crisis: Diagnosis, Remedies, Prospects," *Brookings Papers on Economic Activity*, 1998(1), pp. 1 – 74; "On their feet again", *The Economist*, August 21, 1999.

G. Calvo, "The Russian Virus: Contagion When Wall Street is the Carrier", 1999.

G. Calvo and E. Mendoza, "Globalization, Contagion, and the Volatility of Capital Flows", in Capital Inflows to Emerging Markets, ed. by S. Edwards, NBER, Cambridge MA 1999

G. Calvo and E. Mendoza, "Petty Crime and Cruel Punishment: Lessons from the Mexican Debacle," American Economic Review, Papers & Proceedings, May 1996.

Paul Krugman, The Return of Depression Economics, Norton, 1999, Chapter 9.

Paul Krugman, "Saving Asia: It's Time to Get Radical," Fortune, September 1998; together with open letter to Mahatir and "Curfews."

Michael Lewis, The Big Short, Norton 2010

Enrique Mendoza, "Why Should Emerging Economies Give Up National Currencies: A Case for 'Institutions Substitution'," NBER WP 8950, 2002, Nat. Bureau of Economic Research.

Carmen Reinhart and Kenneth Rogoff, This Time Is Different: Eight Centuries of Financial Folly, Princeton U. Press, 2011

Michael Siconolfi, et al., "Markets Under Siege – Swept Away: How Russia Set Off Wave That Swamped Markets World Wide – Flight From Risk Send Bonds Diverging Madly, Ruined A Host of Financial Bets – Selling Whatever Can Be Sold", Wall Street Journal, New York: September 22, 1998.

Nicolas Dunbar, *Inventing Money*, Wiley, 2000.