

McGill University
INTERNATIONAL ECONOMICS (**ECON-724**)
Winter 2021 (January 7th to April 15th)
COURSE OUTLINE

Professor N.V. Long
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CLASS TIMES: Tuesday and Thursday, 10 a.m. to 11:30 a.m. (First lecture: Thursday, January 7th, 2021, at 10:00 a.m.; via ZOOM.)

(I) COURSE DESCRIPTION

Objectives: This course aims at providing students with (a) an overview of major theoretical and policy issues in open-economy macro-economics and (b) analytical concepts and techniques that are necessary for understanding existing models and for constructing new models that address those issues. Some empirical studies in open economy macroeconomics will also be discussed. The core of this course is theoretical, because it is believed that students who have a critical understanding of good theories will be able to analyze new situations that will inevitably arise in the international economic environment.

For reading materials, we use a combination of chapters in textbooks, journal articles and recent working papers.

We study the monetary side of international economics, and open economy macroeconomics. We examine issues such as devaluation, exchange rate determination, choice of exchange rate regimes, currency crises, dynamics of the current accounts, international financial markets, sovereign risk, global linkages and economic growth.

Lecture notes: these can be downloaded from <https://mycourses2.mcgill.ca> after each lecture.

Mathematical requirements: Students are assumed to be familiar with standard calculus techniques.

A useful website: mathworld.wolfram.com; derivative-calculator.net
e.g., type: $\sin(\sqrt{e^x+a})/2$ and click "Go" to get its derivative.

Lectures: Lectures will be presented at (remote) Zoom Meetings, via Mycourses2@mcgill.ca. (10 a.m. to 11:30 a.m., Tuesdays and Thursdays). Each lecture will be automatically recorded and can be accessed one day after the lecture, until the course ends. At the end of each lectures, students can ask questions using Zoom's chat feature.

Lecture notes and lecture slides: These can be downloaded from the website mycourses2@mcgill.ca one day after each lecture.

The recorded lectures, the lecture notes, and the lecture slides **must not be made available** to anyone who is not enrolled in this course.

(II) ASSESSMENT METHOD

Your final grade is a weighted average of your grades in the following three components: Assignments, Midterm Exam, and Essay. There will be no final exam.

Assignments: 15% . There will be 3 assignments, each of which is worth 5%. Assignment questions are available on Mycourses2@mcgill.ca TWO WEEKS before the due date.

Midterm exam: 35%. This will be a take-home exam. The questions will be made available on 23 February 2021 on Mycourses2@mcgill.ca. You must upload your answers to mycourses2@mcgill.ca before Monday 1 March 2021.

Essay: 50%. Due date of essay: 5 April 2021. Essay topics will be made available on 8 March 2021.

Your essay must be typed (double spaced) and must not exceed 10 pages.

Notes on the essay: You will be asked to write a commentary on a specific research paper (in international economics) written by a team of economists. In your essay, you should address the following questions. What are the research questions that the authors investigate in their paper? Are they important questions? What are the key assumptions of the model and the main results? Are the results novel and significant discoveries? Are you aware of any alternative models that explore the same (or similar) issues? Do you have any suggestions that you think the authors should take up in their future revision of the paper under review? (The research paper that you comment on **must be chosen from set of five research papers that I will upload** to Mycourses2@mcgill.ca on March 8, 2021)

(III) READING LIST

This list includes important journal articles, and chapters in the reference books listed below.

This list includes journal articles, recent working papers, and chapters in the reference books listed below.

Reference books

- Obstfeld M. and K. Rogoff, Foundations of International Macroeconomics, MIT Press, 1996 (HF 1359 O27 1996). (A hard copy is in the library; you can also borrow from the library an electronic copy of the book.)

- Turnovsky, Stephen J., Methods of Macroeconomic Dynamics, second edition, MIT Press, Cambridge, Mass. 2000

- Stokey, Nancy L. and Robert E. Lucas, Recursive Methods in Economic Dynamics, Harvard University Press, Cambridge, Mass. 1989

Topic 1: Some Basic Concepts and Current Issues

- Obstfeld M. and K. Rogoff, Foundations of International Macroeconomics, Chapter 1, pp 1-22.

- Caballero, R., E. Farhi, and P.-O. Gourinchas (2008), "An Equilibrium Model of Global Imbalances and Low Interest Rates," American Economic Review, 98(1): 358-393.

- Caballero, R., E. Farhi, and P.-O. Gourinchas (2015), "Global Imbalances and Currency Wars at the ZLB." NBER Working Paper Number 21670, October 2015.

- Obstfeld, M. (2012), "Does the Current Account Still Matter?" American Economic Review, 102(3):1-23.

- Chinn, M. and H. Ito (2019), "A Requiem for 'Blame it on Beijing': Interpreting Rotating Global Current Account Surpluses". NBER Working Paper number 26226 (<http://www.nber.org/papers/w26226>), September 2019.

Topic 2: Devaluation in a Popular Model of the Open Economy

- Dornbusch, R. (1975), Exchange Rate and Fiscal Policy in a Popular Model of the Open Economy, *American Economic Review*, Vol. 65: 859-871

Topic 3: Exchange Rate Dynamics: The Dornbusch Overshooting Model

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

Topic 4: Speculative Attacks: First Generation Model

- Salant, Stephen and Dale Henderson (1978), Market Anticipations of Government Gold Policies and the Price of Gold, *Journal of Political Economy*, Vol. 86, 627-48

- Krugman, Paul (1979), A Model of Balance of Payments Crises, *Journal of Money, Credit, and Banking*, Vol. 11:311-25

-Flood, Robert and Peter M. Garber (1984), Collapsing Exchange Rate Regimes: Some Linear Examples, *Journal of International Economics*, Vol. 17, 1-13

-Flood, Robert and Peter M. Garber, and Charles Kramer (1996), Collapsing Exchange Rate Regimes: Another Linear Example, *Journal of International Economics*, Vol. 41, 223-34

-Flood, Robert P. and Nancy P. Marion (2000), Self-fulfilling risk predictions: an application to speculative attacks, *Journal of International Economics*, Vol. 50, 245-268.

-Obstfeld, M. (1986a), Rational Self-fulfilling Balance of Payments Crises, *American Economic Review*, Vol. 76, 72-81

-Obstfeld, M. (1986b), Speculative Attacks and the External Constraint in a Maximizing Model of Balance of Payments, *Canadian Journal of Economics*, vol. 19, 1-22

-Obstfeld, M. (1986c), Capital Controls, the Dual Exchange Rate, and Devaluation, *Journal of International Economics*, Vol.20, 1-20.

-Willman, A. (1988), The Collapse of the Fixed Exchange Rate Regime with Sticky Wages and Imperfect Substitution between Domestic and Foreign Bonds, *European Economic Review*, Vol. 32: 1817-33.

Topic 5: Speculative Attacks: Second Generation Models

- Obstfeld, M. (1996), Models of Currency Crises with Self-fulfilling Features, *European Economic Review* 40, 1037-47

- Calvo, G. A. and E.G. Mendoza (1996), Mexico's Balance of Payment Crisis: A Chronicle of a Death Foretold, *Journal of International Economics*, Vol.41, 235-64

- Cole, H. and T. Kehoe (2000), Self-fulfilling Debt Crisis, *Review of Economic Studies*, 67(1), 91-116.

Topic 6: Speculative Attacks: Third Generation Models (Bank Balance Sheet Mismatch, Financial Vulnerability, Short-term Capital Flows) and the Economics of the Sudden Stop.

-Krugman, Paul (1999), Balance Sheets, the Transfer Problem, and Financial Crises. *International Tax and Public Finance*, Volume 6, pp. 459-472. (Also in Peter Isard, Assaf Razin and Andrew Rose, eds., *International Finance and Financial Crises: Essays in Honor of Robert P. Flood, Jr.* Boston: Kluwer Academic, 31-44.)

-Chang, Robert, and Andres Velasco, (2001), "A Model of Financial Crises in Emerging Markets," *Quarterly Journal of Economics* 116(2): 489-517.

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

-Chang, Robert, and Andres Velasco, (2000b), "Banks, Debt Maturity, and Crises," *Journal of International Economics* 51: 169-194.

- Calvo, G., Izquierdo, A., and Mejia, L. (2004), On the Empirics of Sudden Stops: The Relevance of Balance Sheets Effects, NBER Working Paper No. 10520.

- Calvo, G., Izquierdo, A., and Loo-Kung, R. (2012), Optimal Holdings of International Reserves Self-Insurance Against Sudden Stop, NBER Working Paper No. 18219.

-Jeanne, O. and Ranciere, R. (2011), The Optimal Level of International Reserves for Emerging Market Countries: A New Formula and Some Applications, *Economic Journal*, September 2011, 905-929.

Topic 7: Dynamics of Small Open Economies: The Infinitely-lived Representative Agent Approach

-Obstfeld, M. and K. Rogoff (1996), Chapter 2 of *Foundations of International Macroeconomics*, MIT Press, 1996

-Turnovsky, Stephen J., *Methods of Macroeconomic Dynamics*, second edition, Chapters 11 and 16.

-Stokey, Nancy L. and Robert E. Lucas, *Recursive Methods in Economic Dynamics*, Chapters 2, 3, and 4

Topic 8: The Life Cycle, Tax Policy, and the Current Account: The Overlapping Generations Approach.

-Obstfeld, M. and K. Rogoff (1996), Chapter 3 of *Foundations of International Macroeconomics*, MIT Press, 1996

-Barczyk, Daniel (2016), 'Ricardian equivalence revisited: deficits, gifts and bequests. *Journal of economic dynamics and control*, Vol. 63, pp. 1-24.

Topic 9: The Real Exchange Rate and the Terms of Trade

-Obstfeld, M. and K. Rogoff (1996), Chapter 4 of *Foundations of International Macroeconomics*, MIT Press, 1996

Topic 10: Uncertainty and International Financial Markets

-Obstfeld, M. and K. Rogoff (1996), Chapter 5 of *Foundations of International Macroeconomics*, MIT Press, 1996

Additional References (optional reading):

-Epstein, L. and S. Zin (1989), " Substitution, Risk Aversion, and the Temporal Behavior of Consumption and Asset Returns: A Theoretical Framework." *Econometrica* 57 (July 1989): 937-969.

-Weil, P. (1990), "Nonexpected Utility in Macroeconomics". *Quarterly Journal of Economics* 105 (Feb. 1990): 29-42.

Topic 11: Imperfections in International Capital Markets: Sovereign Risk

-Obstfeld, M. and K. Rogoff (1996), Chapter 6 of *Foundations of International Macroeconomics*, MIT Press, 1996.

-Arellano, Cristina (2008), "Default Risk and Income Fluctuations in Emerging Economies," *American Economic Review*, Vol. 98(3), pp. 690-712.

-Bianchi, Javier (2011), "Overborrowing and Systemic Externalities in the Business Cycle", *American Economic Review*, Vol.101, December, pp. 3400-3426.

-Cole, H., D. Neuham, and G. Ordoñez, (2016), *Debt Crises: For Whom the Bell Tolls*. NBER Working Paper 22330, National Bureau of Economic Research.

- Cole, Harold, Timothy Kehoe, (2000). "Self-fulfilling Debt Crises", Review of Economic Studies, Vol. 67(1),91-116.

-de-Cordoba, Gonzalo, Pau Pujolas, and José Torres (2017). "Fiscal Discipline and Default," Review of Economic Dynamics, Vol. 24, pp 1-13.

Topic 12: Global Linkages and Economic Growth

-Obstfeld, M. and K. Rogoff (1996), Chapter 7 of Foundations of International Macroeconomics, MIT Press, 1996

Topic 13: Exchange Rate Dynamics: A New Keynesian Approach

- Obstfeld M. and K. Rogoff, (1995) Exchange Rate Dynamics Redux, Journal of Political Economy, 624-60

-Lane, P. (2001), The New Open Economy Macroeconomics: A Survey, Journal of International Economics, vol. 54, 2001, 235-66.

-Galí, J. and T. Monacelli, (2005), "Monetary Policy and Exchange Rate Volatility in a Small Open Economy," Review of Economic Studies, 72 (252), 707-734.

Topic 14: Structural Transformation and Trade Imbalances

-Alvarez-Cuadrado, F., N. V. Long, and M. Poschke (2018), Capital Labor Substitution, Structural Change, and the Labor Income Share, Journal of Economic Dynamics and Control, Volume 87(C), 206-231.

-Alvarez-Cuadrado, F., N. V. Long, and M. Poschke (2017), Capital Labor Substitution, Structural Change, and Growth. Theoretical Economics, Volume 12, pp. 1229-1266.

-Huang, Zongye (2015), Structural Transformation and Trade Imbalances, Chapter 2 of his Ph.D. Thesis, Essays on Structural Transformation, Trade, and Economic Growth, McGill University.

Topic 15: Financial Frictions, Asset Bubbles, Trade and Capital Flows

-Amtras, P. and R. Cabarelo (2009), Trade and Capital Flows: A Financial Frictions Perspective. Journal of Political Economy 117(4), pp. 701-744.

-Kunieda, Takuma and Akihisa Shibata (2016), Asset Bubbles, Economic Growth, and A Self-Fulfilling Financial Crisis. Journal of Monetary Economics 82, 70-74.

(IV) TWO STATEMENTS REQUIRED BY THE UNIVERSITY IN ALL COURSE OUTLINES

1. Language Statement

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. This right applies to all written work that is to be graded, from one-word answers to dissertations.

2. Academic Integrity Statement [approved by Senate on 29 January 2003]:

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 www.mcgill.ca/students/srr <<http://www.mcgill.ca/integrity/>> for more information).

Important Notice: Work submitted for evaluation as part of this course may be checked with text matching software within myCourses.

