

University of Pennsylvania
Department of Economics

Enrique G. Mendoza
egme@sas.upenn.edu

Econ 252
International Finance

Fall 2018, M/W 2:00-3:30PM, Room: McNeil 169

Teaching Assistants

Cuimin Ba (cuiminba@sas.upenn.edu, Room 141 PCPE)

Office hours: Th. 11:00am-12:30pm

Sergio Villalvazo (vservgio@sas.upenn.edu , Room 500 PCPE)

Office hours: Wed. 11am-12:30pm

Course description

A formal study of International Macroeconomics with emphasis on financial crises and policy responses. 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. We use these theoretical foundations to examine financial crises that have affected advanced and emerging economies since the mid-1990s, the “global imbalances” phenomenon characterized by the large external deficits of the United States since the late 1990s, the global financial crisis that started with the U.S. crash in 2008, and the sovereign debt crises in the Eurozone. Preparation of a policy essay and discussions of current international policy issues are also part of the curriculum.

The foundations of International Macroeconomics are covered using a set of notes and other material available from the course 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 financial 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.

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).

Guest students visiting Penn must email Prof. Mendoza (egme@sas.upenn.edu) with information on the courses that would match the prerequisites (institution where taken, course name, textbooks, grades, etc.) and obtain written permission to register.

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 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.

Homepage

Click [here](#) to access the main webpage for the course. Please navigate through the links to find the class notes, course materials, problem sets, important announcements, and links to institutions and researchers. Canvas will be used mainly for posting grades.

Office hours: Monday. 4:00-5:30PM, Room 538 PCPE

Grading

Grades are based on an in-class mid-term exam (30%, **set for Monday, Nov. 5, 2018**), a policy essay (30%, final version **due Dec. 10, 2018**, proposal due **Oct. 31, 2018**), three problem sets (30%, **due Sept. 26, Oct. 17 and Oct. 31**), 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 must focus on the experience of one of the countries that went through a financial crisis since the 1990s. Each essay will be written jointly by two students and must be divided into three parts: Part 1 documents the basic facts of the crisis that hit the particular country 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 about the particular country or other reference material. In addition, parts 2 and 3 must present 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 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*). A one-page proposal outlining the structure and contents of the essay must be submitted for approval by **Oct. 31, 2018**. *Only papers with an accepted proposal will be graded.* The paper is due **Dec. 10, 2018**.

Etiquette and Ethics:

- (a) **Proprietary materials for course participants only:** The midterm exam, problem sets, answer keys, class notes, policy essays and any other material created for this class are copyrighted and are not be shared with anyone who is not registered for the course, either electronically (e.g. Course Hero) or by other means.
- (b) **Classroom:** Attendance is required and adherence to Penn’s Code for Academic Integrity is expected. 5 mins. maximum tolerance for late arrivals. Laptops and tablets for taking notes are allowed, cellphones should be silenced and put away during class.

Class Notes and Downloadable Reference Books

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

Macroeconomics in the Global Economy by Jeffrey Sachs and Felipe Larrain.

Part of the Notes follow this book, but starting with the analysis of money they differ significantly. Purchasing the book is not required. The book is out of print but can be found on low cost resale and for download online.

International Macroeconomics by Stephanie Schmitt-Grohe, Michael Woodford & Martin Uribe (not to be confused with *Open Economy Macroeconomics*, a graduate textbook by two of these authors). This is an unpublished new book made available in PDF by the authors. It is excellent reference material.

Course Outline

- 1 Introduction: Financial Globalization and Global Imbalances (Promises & Facts)**
(Presentation slides, “Commanding Heights” Episode 3)
 - A. Historical perspective on financial globalization
 - B. Stylized facts of global imbalances
 - C. The case for globalization v. the outcomes of globalization

- 2 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

- 3 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

- 4 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

5 Sustainable Exchange Rates and Currency Crises in General Equilibrium

(Class notes)

- A. Sustainable fixed exchange rate in general equilibrium
- B. Balance-of-Payments Crises in general equilibrium
- C. Effects of a temporary currency peg

6 Additional Foundations for Studying Financial crises

(presentation slides, Mendoza (2016, 2017).

- A. Stylized facts of Credit Booms and Sudden Stops
- B. Borrowing Constraints and Fisherian Amplification
- C. Macroprudential financial regulation
- D. Public debt sustainability (the debt Crisis of the United States)

Video documentaries & movies

“Commanding Heights” (Great PBS three-episode documentary based on Daniel Yergin’s book, an analysis of the push for economic globalization and the 1990s Crises in Emerging Markets, <https://www.pbs.org/wgbh/commandingheights/hi/index.html> has the original website but video formats are outdated, it can be watched free in YouTube, Ch. 3 is at <https://www.youtube.com/watch?v=bSGAJTJzgLA>)

“House of Cards” (Not the Netflix show, but an entertaining/informative documentary from CNBC about the U.S. housing boom and crash, <https://www.cnn.com/house-of-cards/>, video available for rent at IMDb)

“Too Big to Fail” (Nice account of the critical period of the U.S. crisis in 2008-09, HBO movie based on Andrew Sorkin’s book, <https://www.hbo.com/movies/too-big-to-fail> , available for rent)

“The Big Short” (Movie directed by Adam McKay providing a nice account of the period leading up to the U.S. 2008 crash, based on the book by Michael Lewis, <https://dvd.netflix.com/Movie/The-Big-Short/80075560> , available for rent)

“The Warning” (Great PBS documentary from the Frontline series about the late 1990s U.S. financial deregulation, free at <https://www.pbs.org/wgbh/frontline/film/warning/>)

“Money, Power, & Wall Street” (Another great PBS Frontline documentary, this one covers the U.S. financial crisis starting with its origins in financial innovation and deregulation since the 1990s, the crisis period, and the policy response, free at <https://www.pbs.org/wgbh/frontline/film/money-power-wall-street/>)

Some Optional Readings 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.

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

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

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

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