

**The Johns Hopkins University**  
**Department of Economics**

**180.642: International Monetary Economics**

Fall 2003

Wednesday 1-3pm

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<http://www.econ.jhu.edu/courses/642/ime642.htm>

## **Course Outline**

This course is a graduate-level introduction to current research in open-economy macroeconomics and international finance. We begin by discussing in depth the intertemporal approach to the current account, the main building block of modern international macroeconomics. Building on the basic model we will discuss several empirical approaches in order to develop an understanding of how thorough theoretical modeling informs empirical testing of economic hypotheses. We then go on to study current account and exchange rate determination, international risk sharing, and the international transmission of business cycles. The focus shifts next to monetary issues in the open economy where we study models with flexible prices and a few selected issues on monetary policy in the open economy.

## **Evaluation**

The course grade will be determined by a short term paper (30%) and a comprehensive final exam (70%). The paper should identify an interesting research area, discuss relevant literature, highlight unsolved problems, and suggest a plan of attack. The proposed research can be of either empirical or theoretical nature. It need not have an entirely original research component, but mere literature surveys will not be acceptable. Students are encouraged to develop their own topics or chose from a list provided by the instructor.

## **Textbooks**

There is no required textbook for the course. Generally useful texts are:

Frenkel, Jacob A. and Assaf Razin (1996): *Fiscal Policies in the World Economy*. Cambridge, MA: The MIT Press. 3<sup>rd</sup> Edition.

- Grossman, Gene M. and Kenneth Rogoff (eds.) (1995): *Handbook of International Economics, Vol. III*. Amsterdam: North Holland.
- Mark, Nelson C. (2001): *International Macroeconomics and Finance*. Blackwell Publishers. Malden, MA.
- Obstfeld, Maurice and Kenneth Rogoff (1996): *Foundations of International Macroeconomics*. Cambridge, MA: The MIT Press.
- Van der Ploeg, Frederick (ed.) (1994): *The Handbook of International Macroeconomics*. Cambridge, Ma: Basil Blackwell.

Useful websites for international macroeconomists:

<http://www.econ.yale.edu/~corsetti/euro/>

[http://www.geocities.com/brian\\_m\\_doyle/open.html](http://www.geocities.com/brian_m_doyle/open.html)

<http://www.geocities.com/monetaryrules/mpoe.htm>

## **Syllabus and Reading List**

(Highly recommended readings are indicated by a ' \* ')

### **1. The Intertemporal Approach to the Current Account**

#### 1.1. The Basic Theoretical Framework

Dornbusch, Rudiger (1983): "Real Interest Rates, Home Goods, and Optimal External Borrowing". *Journal of Political Economy*, 91, 141-153.

Frenkel and Razin (1996), ch. 6, 7.

Obstfeld, Maurice (1982): "Aggregate Spending and the Terms of Trade: Is There a Laursen-Metzler Effect?" *Quarterly Journal of Economics*, 97 (May), 251-270.

\* Obstfeld, Maurice and Kenneth Rogoff (1995): "The Intertemporal Approach to the Current Account". In: Gene M. Grossman and Kenneth Rogoff (eds.): *Handbook of International Economics*, Volume 3, North Holland, Amsterdam.

\* Obstfeld and Rogoff (1996), ch. 1, 2, and 4.

Razin, Assaf (1995): "The Dynamic Optimizing Approach to the Current Account: Theory and Evidence". In: Peter B. Kenen (ed.): *Understanding Interdependence: The Macroeconomics of the Open Economy*. Princeton University Press, Princeton, NJ. Chapter 3.

\* Rogoff, Kenneth (1996): "The Purchasing Power Parity Puzzle". *Journal of Economic Literature*, 34 (June), 647-688.

Sachs, Jeffrey (1981): "The Current Account and Macroeconomic Adjustment in the 1970s". *Brookings Papers on Economic Activity*, 1, 201-282.

## 1.2. Empirical Issues

- Bergin, Paul R. and Steven M. Sheffrin (2000): "Interest Rates, Exchange Rates, and Present Value Models of the Current Account". *The Economic Journal*, 110 (April), 535-558.
- \* Glick, Reuven and Kenneth Rogoff (1995): "Global vs. Country-Specific Productivity Shocks and the Current Account". *Journal of Monetary Economics*, 35, 159-192.
- Ghosh, Atish R.(1995): "Capital Mobility Amongst the Major Industrialized Countries: Too Little or Too Much?" *Economic Journal*, 105, 107-128.
- Gruber, Joseph W. (2001): "A Present Value Test of Habits and the Current Account". Mimeo, Johns Hopkins University.
- \* Nason, James M. and John H. Rogers (2003): "The Present-Value Model of the Current Account Has Been Rejected: Round Up the Usual Suspects". Forthcoming: *Journal of International Economics*.
- \* Sheffrin, Steven M. and Wing T. Woo (1990): "Present-Value Tests of the Current Account". *Journal of International Economics*, 29, 237-253.

## **2. Uncertainty and International Financial Markets**

### 2.1 Risk Sharing

- Canova, Fabio and Morten O. Ravn (1996): "International Consumption Risk Sharing". *International Economic Review*, 37:3 (August), 573-602.
- \* Cole, Harold L. and Maurice Obstfeld (1991): "Commodity Trade and International Risk Sharing: How Much Do Financial Markets Matter?" *Journal of Monetary Economics*, 28, 3-24.
- \* Kehoe, Patrick J. and Fabrizio Perri (2002): "International Business Cycles with Endogenous Incomplete Markets". *Econometrica*, 70(3), pp. 907-928.
- \* Kim, Jinill and Sunghyun Kim (2003), "Spurious Welfare Reversals in International Business Cycle Models". *Journal of International Economics*, 60(2), pp. 471-500.
- Kollmann, Robert (1995): "Consumption, Real Exchange Rates, and the Structure of International Asset Markets". *Journal of International Money and Finance*, 14, 191-211.
- \* Lewis, Karen K. (1996): "What Can Explain the Apparent Lack of International Consumption Risk Sharing?" *Journal of Political Economy*, 104:2 (April), 267-297.
- \* 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*. Cambridge: MIT Press.
- Schmitt-Grohé, Stephanie and Martin Uribe (2003): "Closing Small Open Economy Models". Forthcoming, *Journal of International Economics*.

Tesar, Linda L. (1993): "International Risk-Sharing and Non-Traded Goods". *Journal of International Economics*, 35, 69-89.

\* Tesar, Linda L. (1995): "Evaluating the Gains from International Risk Sharing". *Carnegie-Rochester Conference Series on Public Policy*, 42, 95-143.

Van Wincoop, Eric (1994): "Welfare Gains from International Risksharing". *Journal of Monetary Economics*, 33, 175-200.

## 2.2. International Portfolio Diversification

Baxter, Marianne, Urban J. Jerman, and Robert G. King (1998): "Nontraded Goods, Nontraded Factors, and International Non-diversification". *Journal of International Economics*, 44:2 (April), 211-29.

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

Obstfeld and Rogoff (1996), ch. 5

Stockman, Alan C. and Harris Dellas (1989): "International Portfolio Nondiversification and Exchange Rate Variability". *Journal of International Economics*, 26 (May), 271-289.

Svensson, L. E. O. (1988): "Trade in Risky Assets". *American Economic Review*, 78:3 (June), 375-94.

## **3. International Real Business Cycles**

### 3.1. Empirical Issues

\* Backus, David and Patrick J. Kehoe (1992): "International Evidence on the Historical Properties of Business Cycles". *American Economic Review*, 82, 864-888.

Costello, Donna M. (1993): "A Cross-Country, Cross-Industry Comparison of Productivity Growth". *Journal of Political Economy*, 101, 207-222.

### 3.2. Small Open Economy Models

Correia, Isabel, Joao C. Neves, and Sergio Rebelo (1995): "Business Cycles in a Small Open Economy". *European Economic Review*, 39 (June), 1089-1113.

Finn, Mary G. (1990): "On Savings and Investment Dynamics in a Small Open Economy". *Journal of International Economics*, 29, 1-21.

Mark (2001), ch. 5.

\* Mendoza, Enrique G. (1995): "The Terms of Trade, the Real Exchange Rate, and Economic Fluctuations". *International Economic Review*, 36, 101-137.

\* Schmitt-Grohé, Stephanie (1998): "The International Transmission of Economic Fluctuations". *Journal of International Economics*, 44, 257-287.

Tesar, Linda L. (1991): "Savings, Investment and International Capital Flows". *Journal of International Economics*, 31, 55-78.

### 3.3. Two-Country Models

- \* Backus, David K., Patrick J. Kehoe, and Finn E. Kydland (1992): "International Real Business Cycles". *Journal of Political Economy*, 100:4 (August), 745-775.
- Backus, David K., Patrick J. Kehoe, and Finn E. Kydland (1994a): "Dynamics of the Trade Balance and the Terms of Trade: The J-Curve". *American Economic Review*, 84, 84-103.
- Backus, David K., Patrick J. Kehoe and Finn E. Kydland (1994b): "Relative Price Movements in Dynamic General Equilibrium Models of International Trade". In: Frederick Van Der Ploeg (ed.): *The Handbook of International Macroeconomics*, Cambridge, Ma: Basil Blackwell.
- \* Baxter, Marianne (1995): "International Trade and Business Cycles". In: Gene M. Grossman and Kenneth Rogoff (eds.): *Handbook of International Economics, Vol. III*. Amsterdam: North Holland.
- \* Baxter, Marianne and Mario J. Crucini (1995): "Business Cycles and the Asset Structure of Foreign Trade". *International Economic Review*, 36:4, 821-854.
- Betts, Caroline M. and Timothy J. Kehoe (2001): "Tradability of Goods and Real Exchange Rate Fluctuations". Federal Reserve Bank of Minneapolis Staff Report #265
- Canova, Fabio and Jane Murrin (1998): "Sources and Propagation of International Output Cycles: Common Shocks or Transmission?" *Journal of International Economics*, 46, 133-166.
- \* Stockman, Alan C. and Linda L. Tesar (1995): "Tastes and Technology in a Two-Country Model of the Business Cycle: Explaining International Comovements". *American Economic Review*, 85:1 (March), 168-185.

## **4. Nominal Exchange Rate Determination**

### 4.1. Empirical Issues

- \* Clarida, Richard and Jordi Galí (1994): "Sources of Real Exchange Fluctuations: How Important Are Nominal Shocks?" *Carnegie-Rochester Conference Series on Public Policy*, 41, 1-56.
- Cushman David O., and Tao Zha (1997): "Identifying Monetary Policy in a Small Open Economy under Flexible Exchange Rates". *Journal of Monetary Economics*, 39(3), 433-448.
- \* Eichenbaum, Martin and Charles L. Evans (1995): "Some Empirical Evidence on the Effects of Shocks to Monetary Policy on Exchange Rates". *Quarterly Journal of Economics*, 110:4, 975-1009.
- Kim, Soyoung (2001): "International Transmission of U.S. Monetary Policy Shocks: Evidence from VAR's". *Journal of Monetary Economics*, 48(2), 339-372.
- Mark (2001), ch. 4.

Mussa, Michael (1986): "Nominal Exchange Rate Regimes and the Behavior of Real Exchange Rates". *Carnegie-Rochester Conference Series on Public Policy*, 25, 117-214.

Rogers, John H. (1999): "Monetary Shocks and Real Exchange Rates". *Journal of International Economics*, 49(2), 269-288.

#### 4.2. Flexible Price Models

Grilli, Vittorio and Nouriel Roubini (1992): "Liquidity and Exchange Rates". *Journal of International Economics*, 32, 339-352.

Lucas, Robert E. (1982): "Interest Rates and Currency Prices in a Two-Country World". *Journal of Monetary Economics*, 10, 335-360.

Mark (2001), ch. 6.

\* Obstfeld and Rogoff (1996), ch. 8.

Schlagenhauf, Don E. and Jeffrey M. Wrase (1995): "Liquidity and Real Activity in a Simple Open Economy Model". *Journal of Monetary Economics*, 35, 431-461.

\* Stockman, Alan C. (1980): "A Theory of Exchange Rate Determination". *Journal of Political Economy*, 88:4 (August), 673-698.

#### 4.3. Price Level Determination in the Open Economy

Bergin, Paul (2000): "Fiscal Solvency and Price Level Determination in a Monetary Union". *Journal of Monetary Economics*, 45, 37-53.

Canzoneri, Matthew B., Robert E. Cumby, and Behzad Diba (2001): "Fiscal Discipline and Exchange Rate Regimes". *Economic Journal*, 111, No. 474.

Corsetti, Giancarlo and Bartosz Mackowiak (2002): "Fiscal Imbalances and the Dynamics of Currency Crises". Forthcoming, *Journal of International Economics*.

Dupor, Bill (2000): "Exchange Rates and the Fiscal Theory of the Price Level". *Journal of Monetary Economics*, 45, 613-630.

Kareken John and Neil Wallace (1981): "The Indeterminacy of Equilibrium Exchange Rates". *Quarterly Journal of Economics*, 96 (May), 207-222.

### **5. A Smorgasbord of Useful Topics**

Bergin, Paul R. (2003): "Putting the 'New Open Economy Macroeconomics' to a Test". *Journal of International Economics*. 60(1), pp. 3-34.

Bergin, Paul R. and Reuven Glick (2003): "A Theory of Endogenous Non-Tradability and its Implications for Intertemporal Trade". Mimeo, UC Davis.

Devereux, Michael and Charles Engel (2003): "Monetary Policy in the Open Economy Revisited: Exchange Rate Flexibility and Price Setting Behavior". Forthcoming: *Review of Economic Studies*.

Lubik, Thomas A. and Frank Schorfheide (2003): “Do Central Banks Respond to Exchange Rate Movements? A Structural Investigation” Mimeo, Department of Economics, Johns Hopkins University.

Sutherland, Alan (2002): “A Simple Second-Order Solution Method for Dynamic General Equilibrium Models”. Mimeo. University of St. Andrews.

Velasco, Andrés (1996): “Fixed Exchange Rates: Credibility, Flexibility, and Multiplicity”. *European Economic Review*, 40, pp. 1023-1035.