

Updated: August 23, 2016

AEM 4545/ECON 3545

International Finance and Macroeconomics

Fall 2016

Professor Eswar Prasad

This course will examine the determinants of international capital flows and their consequences for growth and volatility. Basic analytical models in open economy macroeconomics and international finance, including those related to exchange rate dynamics, will be covered. The course will analyze the challenges created by rising global financial integration for monetary policy, financial regulation, and other policies. Emerging market perspectives on these issues will be emphasized, with a special focus on the economies of China and India. In particular, the course will focus on the roles of domestic financial sector development and international financial integration, and the interaction between them, in the process of economic development. The course will also discuss growth prospects for emerging markets, the myriad domestic and external challenges that they face in sustaining high growth, and the implications for the world at large. Students will be required to write an independent research paper.

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| Prerequisites: | Intermediate-level courses in macroeconomics, international economics, and econometrics/statistics. |
| Lecture hours: | Wednesdays, 10:10 a.m. – 12:35 p.m. B-51, Warren Hall |
| Grading: | Letter grade only. Grade will be based on assignments, research paper, and class participation |
| Credits: | 3 |
| Teaching Assistant: | Isha Agarwal (ia233) |
| TA's Office Hours: | Wednesdays & Thursdays, 3:00–4:00 pm. |
| Course Support: | Erika Rose (ear245) 201 Warren Hall |
| Professor's Office Hours: | By appointment (through Erika Rose) |

COURSE SCHEDULE

Lecture 1: August 24

Lecture 2: August 31

Topic: The New World Economic Order

Emerging Markets: Resilience and Growth Amidst Global Turmoil: Chapters 4-6.

Bosworth, Barry, and Susan Collins, 2008, "Accounting for Growth: Comparing China and India," *Journal of Economic Perspectives*, Vol. 22:1, pp. 45-66.

Gordon, James, and Poonam Gupta, 2004, "Understanding India's Services Revolution," IMF Working Paper No. 04/171.

Kochhar, Kalpana, Utsav Kumar, Raghuram Rajan, Arvind Subramanian, and Ioannis Tokatlidis, 2006. "India's Pattern of Development: What Happened, What Follows?" *Journal of Monetary Economics*, Vol. 53, pp. 981-1019

Kose, M. Ayhan, and Eswar Prasad, 2010, "Emerging Markets Come of Age," *Finance & Development*, December 2010.

Prasad, Eswar, 2009, "Is China's Growth Miracle Built to Last?" *China Economic Review*, Vol. 20:1, pp. 103-123.

Prasad, Eswar, 2011, "Rebalancing Growth in Asia," *International Finance*, Vol. 14:1, pp. 27-66.

Sharma, Ruchir, 2013, "The Rise of the Rest of India," *Foreign Affairs*, September/October 2013.

We will have guest presentations about data resources available at Cornell to work on topics related to international finance and open economy macro. Some data issues (and potential pitfalls) will also be discussed.

Lecture 3: September 7

Topic: Balance of Payments, Exchange Rates

The Dollar Trap: Chapter 5, pages 63-67. Chapter 4.

Callen, Timothy, 2007, "PPP Versus the Market: Which Weight Matters," *Finance and Development*, Vol. 44:1.

Catao, Luis, 2007, "Why Real Exchange Rates," *Finance and Development*, Vol. 44:3, pp. 46-47.

Mankiw, Gregory, N., 2002, *Macroeconomics*, fifth edition, Worth Publishers.

Section 5.3, pp. 127-141. [On reserve at the library]

Lecture 4: September 14

Topic: Monetary Policy, Exchange Rate Regimes

Goodfriend, Marvin, and Eswar Prasad, 2007, “A Framework for Independent Monetary Policy in China,” *CESifo Economic Studies*, Vol. 53:1, pp. 2-41.

Goldstein, Morris, and Nicholas Lardy, 2008, “China’s Exchange Rate Policy: An Overview of Some Key Issues,” in *Debating China’s Exchange Rate Policy*, eds. M. Goldstein and N. Lardy (Washington, DC: Peterson Institute for International Economics).

McKinnon, Ronald, 2007, “Why China Should Keep its Exchange Rate Pegged to the Dollar: A Historical Perspective from Japan,” *International Finance*, Vol. 10:1, pp. 43-70.

Prasad, Eswar, Thomas Rumbaugh, and Qing Wang, 2005, “Putting the Cart Before the Horse? Capital Account Liberalization and Exchange Rate Flexibility in China,” *China and the World Economy*, Vol. 13:4, pp. 3-20.

Prasad, Eswar, 2007, “Exchange Rate Flexibility in China: Why It Really Matters and How to Make Progress,” Testimony at the Senate Finance Committee Hearing on “Risks and Reform: The Role of Currency in the U.S.–China Relationship”, March 28. Posted at <http://prasad.aem.cornell.edu>.

Prasad, Eswar, 2010, “After the Fall: Central Banking in the Aftermath of the Financial Crisis,” *Finance & Development*, Vol. 47:2, pp. 22-26.

Reinhart, Carmen M., and Kenneth S. Rogoff, 2004, “The Modern History of Exchange Rate Arrangements: A Reinterpretation,” *Quarterly Journal of Economics*, Vol. 119:1, pp. 1-48.

Lecture 5: September 21

Topic: Growth Prospects, Reforms, and Risks in China’s Economy

Guest Lecturer: Dr. James Daniel, Assistant Director and Head of China Division, Asia-Pacific Department, International Monetary Fund

Before class, read the 2016 IMF Staff Report on China, available online at: <https://www.imf.org/external/pubs/ft/scr/2016/cr16270.pdf>

Lecture 6: September 28

Topic: Capital Controls, Capital Account Liberalization

The Dollar Trap: Chapters 3, 4, 10.

Bhagwati, Jagdish, 1998, "The Capital Myth: The Difference between Trade in Widgets and Dollars," *Foreign Affairs*, Vol. 7:3, pp. 7-12.

Kose, Ayhan, and Eswar Prasad, 2004, "Liberalizing Capital," *Finance and Development*, Vol. 41:3, pp. 50-51.

Kose, Ayhan M., Eswar Prasad, Kenneth Rogoff, and Shang-Jin Wei, 2007, "Financial Globalization: Beyond the Blame Game," *Finance and Development*, Vol. 44:1, pp. 9-13.

Lane, Philip R., and Sergio L. Schmukler, 2007, "The International Financial Integration of China and India," World Bank Policy Research Working Paper 4132.

Prasad, Eswar, 2009, "Some New Perspectives on India's Approach to Capital Account Liberalization," *Brookings India Policy Forum*, Volume 5 (2008/09).

Prasad, Eswar, and Shang-Jin Wei, 2005, "China's Approach to Capital Inflows: Patterns and Possible Explanations," International Monetary Fund Working Paper No. 05/79

Rodrik, Dani, 1998, "Who Needs Capital-Account Convertibility?" Essays in International Finance, No. 207 (Princeton, NJ: Princeton University Press).

Stiglitz, Joseph, 2004, "Capital-Market Liberalization, Globalization, and the IMF," *Oxford Review of Economic Policy*, Vol. 20:1, pp. 57– 71.

Lecture 7: October 5

Topic: Finance and its Role in Growth

Allen, Franklin, Jun, Qian, and Meijun Qian, 2005, "Law, Finance, and Economic Growth in China," *Journal of Financial Economics*, Vol. 77, pp. 57-116.

Chamon, Marcos, and Eswar Prasad, 2010, "Why are Saving Rates of Urban Households in China Rising?" *American Economic Journal – Macroeconomics*, Vol.2:1, pp. 93-130.

Dobson, Wendy, and Anil Kashyap, 2006, "The Contradiction in China's Gradualist Banking Reforms," *Brookings Papers on Economic Activity*, pp. 103-148.

Elliot, J. Douglas and Kai Yan, 2013, "The Chinese Financial System: An Introduction and Overview," John L. Thornton China Center, Brookings Institution.

Prasad, Eswar, and Raghuram Rajan, 2008, "Next Generation Financial Reforms for India," *Finance and Development*, Vol. 45:3, pp. 23-27.

October 12

No lecture meeting

Lecture 8: October 19**Topic: International Transmission of Business Cycles and Financial Cycles**

Emerging Markets: Resilience and Growth Amidst Global Turmoil: Chapters 8-9.

Kose, M. Ayhan, Christopher Otrok, and Eswar Prasad, 2008, "How Much Decoupling? How Much Converging?" *Finance and Development*, Vol. 45:2.

Dervis, Kemal, 2012, "Convergence, Interdependence and Divergence," *Finance and Development*, Vol. 49:3.

Lecture 9: October 26**Topic: The Battle Among Reserve Currencies**

The Dollar Trap: Chapters 12-15.

Kroeber, Arthur, 2011, "The Chinese Yuan Grows up Slowly: Fact and Fiction about China's Currency Internationalization," Policy Paper. Washington: New America Foundation.

Lardy, Nicholas, and Patrick Douglass, 2011, "Capital Account Liberalization and the Role of the Renminbi," Working Paper 11-6. Washington: Peterson Institute for International Economics.

Prasad, Eswar and Lei Ye, 2012, "Will the Renminbi Rule," *Finance & Development*, Vol. 48:1, pp. 26-29.

Prasad, Eswar and Lei Ye, 2012, "The Renminbi's Role in the Global Monetary System," Brookings Institution Report.

Yu, Yongding, 2012, "Revisiting the Internationalization of the Yuan," ADBI Working Paper No. 366.

Lecture 10: November 2**Topic: Currency Wars, Monetary Policy Spillovers, and Global Governance**

The Dollar Trap: Chapters 7-9, 11.

Lecture 11: November 9**Topic: Prospects for the World Economy**

Huang, Yasheng, and Tarun Khanna, 2003, "Can India Overtake China?" *Foreign Policy* July-August, pp. 74-81.

Perkins, Dwight, and Thomas Rawski, 2007, "Forecasting China's Economic Growth Over the Next Two Decades," Harvard University manuscript.

Prasad, Eswar, 2009, "Is China's Growth Miracle Built to Last?" *China Economic Review*, Vol. 20:1, pp. 103-123.

Pritchett, Lant, and Lawrence H. Summers, 2014, "Asiaphoria Meets Regression to the Mean," NBER Working Paper No. 20573, Cambridge, MA: NBER.

Sharma, Ruchir, 2012, "Broken BRICS: Why the Rest Stopped Rising," *Foreign Affairs*, November/December 2012.

More readings to be added later.

Lecture 12: November 16

Topic: Growth and Reforms in India

Guest Lecturer: Dr. Paul Cashin, Assistant Director and Head of India Division, Asia-Pacific Department, International Monetary Fund

Before class, read the 2016 IMF Staff Report on India, available online at:
<https://www.imf.org/external/pubs/ft/sr/2016/cr1675.pdf>

Additional Reading: Taming Indian Inflation, Paul Cashin and Rahul Anand, 2016

November 23

Thanksgiving holiday

Lecture 13: November 30

Topic: TBD

BACKGROUND READINGS & REFERENCE MATERIALS**Required:**

Gaining Currency: The Rise of the Renminbi, Eswar Prasad, Oxford University Press, October 2016.

The Dollar Trap: How the U.S. Dollar Tightened its Grip on Global Finance, Eswar Prasad, Princeton University Press, 2014.

Emerging Markets: Resilience and Growth Amidst Global Turmoil, M. Ayhan Kose and Eswar Prasad, Brookings Institution Press, 2010.

Recommended:

China's Efforts to Expand the International Use of the Renminbi, Eswar Prasad, Brookings Institution Report, February 2016.

Collapse and Revival: Understanding Global Recessions and Recoveries, M. Ayhan Kose and Marco Terrones, 2015.

Dealing with China, Hank Paulson, Twelve (Hachette Group), 2015.

Markets Over Mao: The Rise of Private Business in China, Nicholas R. Lardy, Peterson Institute Press, 2014.

An Uncertain Glory, Amartya Sen and Jean Dreze, Allen Lane, 2013.

Why Growth Matters: How Economic Growth in India Reduced Poverty and the Lessons for Other Developing Countries, Jagdish Bhagwati and Arvind Panagariya, Public Affairs, 2013.

Taming Indian Inflation, Paul Cashin and Rahul Anand, 2016

Suggested for Broader Perspectives:

India After Gandhi: The History of the World's Largest Democracy, Ramachandra Guha, HarperCollins, 2007.

On China, Henry Kissinger, Penguin Books, 2012 (original edition, 2011).

COURSE ASSIGNMENTS AND REQUIREMENTS

Common Points about Formatting, Submission of Assignments

1. All text should be double-spaced (except footnotes and references, which should be single-spaced).
2. Use 12-point font for text (important: assignments with smaller font size won't be accepted), at least 1" margins on all sides.
3. Follow formatting instructions for tables and figures.
4. Put on the subject line "4545: Assignment I" or whatever the relevant document is.
5. Email the documents in pdf format to Isha Agarwal (ia233) and Erika Rose (ear245).
6. Put your name at the top right corner of each assignment.

Indicative Grade Allocation

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|---|-----------|
| Assignment I (Macro Data: Basic): | 5 percent |
| Assignment II (GDP Comparisons): | 5 percent |
| Assignment III (Trade, Exchange Rate): | 5 percent |
| Assignment IV (Capital Flows): | 5 percent |
| Assignment V (Critique of News Article) | 5 percent |
| [Top four grades of assignments I-V will be used to determine final grade (20 percent)] | |

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| Assignment VI (Data Note): | 10 percent |
| Assignment VII (Research Note): | 15 percent |
| Assignments VIII-X (Research Proposal, First Draft, Final Draft): | 55 percent (10+15+30) |

Assignment Schedule

| Number | Description | Handed out | Due date / time |
|--|----------------------|------------|--------------------|
| I. | Macro Data: Basic | Aug. 24 | Aug. 29 / 10 a.m. |
| II. | GDP Comparisons | Aug. 31 | Sept. 5 / 10 a.m. |
| III. | Trade, Exchange Rate | Sept. 7 | Sept. 12 / 10 a.m. |
| IV. | Interest Rates | Sept. 14 | Sept. 19 / 10 a.m. |
| V. | News Note | Sept. 21 | Sept. 26 / 10 a.m. |
| VI. | Data Note | Sept. 28 | Oct. 3 / 10 a.m. |
| VII. | Research Note | Oct. 5 | Oct. 14 / 5 p.m. |
| VIII. | Research Proposal | Oct. 19 | Oct. 28 / 5 p.m. |
| [Special sessions on Oct. 26, Oct. 27 @ 8:00-9:30 p.m. to present proposals] | | | |
| IX. | First Draft | Nov. 2 | Nov. 11 / 5 p.m. |
| X. | Final Draft | Nov. 16 | Dec. 5 / 5 p.m. |