

# ECON846: INTERNATIONAL MONETARY POLICY 2003

## I. COURSE CONTENT

The **objective** of this course is to examine selected **policy issues in international monetary economics**. The course assumes completion of an introductory or intermediate course in macroeconomics. **Emphasis is on strengthening analytical skills, especially the ability to present a cohesive economic argument** based upon **economic principles and understanding of policy issues from a global perspective** rather than advanced mathematical expertise or information per se. The lecture notes and reading for each topic are designed to cover a broad range of technical skills and provide considerable opportunities for debate and discussion.

## II. COURSE FORMAT AND ASSESSMENT

Course format is lecture-based with a fortnightly tutorial/group discussion based upon the assigned reading (see below). **All reading covered in the tutorials is examinable.**

**There will be a 2 hour examination in the last week of semester (same time and day) with a weight of 80 percent. The remaining 20 percent will be allocated to an essay (see below) drawn from tutorial topics. The essay is an integral component of the coursework. Failure to submit an essay will result in an F grade being awarded. (There are penalties for late essay submission, see below.)** No essay will be accepted after the exam date.

There is no single text for the course. A list of general and specific references is given below. Reading material marked with two asterisks is in the Reserve Section of the University library; items with one asterisk are available on three-day loan. **Journal (but not books) references can be downloaded from the University library website: [www.lib.mq.edu.au](http://www.lib.mq.edu.au). This website may also be used to download lecture notes but you will need your usernumber and password for the latter.**

### **III. LECTURE TOPICS**

**1. - 2. INTERNATIONAL MONETARY SYSTEM AND EXCHANGE RATE REGIMES.** Functioning of the present international monetary system; perceived weaknesses; role of International Monetary Fund; reform options.

**3. - 4. CONFIDENCE PROBLEM theory and applications.** Policy issues and reform options.

**5. -6. ADJUSTMENT PROBLEM theory and applications.** U.S. and Japan current account imbalances. Feldstein-Horioka puzzle and debate on capital mobility. Policy issues.

**7. --8. EXTERNAL DEBT theory and applications.** HIPC initiative.

**9. --10. LIQUIDITY PROBLEM theory and applications.** Policy issues and reform options.

**11.-12. MONETARY UNION AND OPTIMAL CURRENCY AREAS theory and applications** (European Monetary Union, East -Asian currency union). Roles of U.S. dollar, euro and SDR in international monetary system.

**13. REVIEW/CATCH-UP**

**14. EXAM**

## IV. REFERENCES

### 1. INTERNATIONAL MONETARY SYSTEM AND EXCHANGE RATE REGIMES

- \*\*Buire, A. (1995) “Reflections on the International Monetary System”, *Essays in International Finance*, No. 195, International Finance Section, Princeton University, January.
- \*\*Krugman, P. (1993) “What Do We Need to Know About the International Monetary System?” *Essays in International Finance*, No. 190, International Finance Section, July.
- \*Davidson, P. (1992-93) “Reforming the World’s Money” *Journal of Post-Keynesian Economics*, Vol. 15, Winter, 1992-93, 153-179.
- \*\*Ghosh, A. and others (2000) “Does the Exchange Rate Regime Matter for Inflation and Growth?” in P. King (ed.) *International Economics and International Economic Policy. A Reader*, McGraw Hill, United States, ch.21, 278-285.
- \*Horne, J. (2001) “Myths and Misconceptions of the Exchange Rate”, *Macquarie Economics Research Papers*, No. 5/2001, May.
- \*McKinnon, R. (1992-93) “Monetary and Exchange Rate Policies for International Financial Stability: A Proposal,” *Journal of Economic Perspectives*, Winter, 1988, 83-103.
- \*\*McKinnon, R. (1993) “The Rules of the Game: International Money in Historical Perspective”, *Journal of Economic Literature*, Vol. XXX1, March , 1- 44..
- \*Williamson, J. (1992-93) “On Designing an International Monetary System”, *Journal of Post-Keynesian Economics*, Vol. 15, Winter 1992-93, 181-191.

### 2. CONFIDENCE PROBLEM

- \*\*Krugman, P. (1979) “ A Model of Balance of Payments Crises” *Journal of Money, Credit and Banking*, Vol. 11, 311 – 25.

\*\*Cabalu, H (1999) “A Review of the Asian Crisis: Causes, Consequences and Policy Responses” *The Australian Economic Review*, Vol 32, 304 – 13.

\*\*Donovan, D (1999) “The IMF and the Asian Crisis: Handling Risk and Uncertainty” *Economic Papers*, 18, December, 20-25.

\*\*Radelet, S. and J. Sachs (2000) “The Onset of the East Asian Financial Crisis.” In King, op.cit, ch.28, 366-405.

\*\*Whitt, J. (2000) “The Mexican Peso Crisis” in King (ed. ), ch. 26, 335-359.

### **3. ADJUSTMENT PROBLEM**

\*\*Bayoumi, T. (1990) “Saving-Investment Correlations: Immobile Capital, Government Policy, or Endogenous Behavior?”, *I.M.F. Staff Papers*, 37, June, 360-87.

\*\*Corden, M. (1991) “Does the Current Account Matter? The Old View and the New”, *Economic Papers*, 10, 1-19.

\*\*Feldstein, M. and C. Horioka, (1980) “Domestic Saving and International Capital Flows,” *Economic Journal*, 90, June, 314-29

### **4. EXTERNAL DEBT.**

\*\*Bahram, N. (1990) “Lessons of the Debt Decade, *Finance and Development*, March, 9-13.

\*\*Cohen, D (1985) “How to Evaluate the Solvency of an Indebted Nation” *Economic Policy*, November, 140-156.

\*\*Eaton, J (1990) “Debt Relief and the International Enforcement of Loan Contracts” *Journal of Economic Perspectives*, Vol.4, No. 1, 43-56.

\*\*Katsela L (1985) “Discussion on Cohen”, op. cit, 157-166.

\*\*Green, J (1989) “ The External Debt Problem in Sub-saharan Africa” *IMF Staff Papers*, Vol. 36, December, 836-874.

## **5. INTERNATIONAL LIQUIDITY**

\*\*Buirra, A. *op. cit.* 6 –23.

\*\*Horne, J. and D. Nahm (2001) “International Reserves and Liquidity: a Reassessment”, *Kredit und Kapital*, 34, Heft 3, 356-392.

\*\*Lizondo, J. and D. Mathieson, (1987) “Stability of the Demand for International Reserves,” *Journal of International Money and Finance*, 6, Sept, 251-82.

## **6. MONETARY UNION AND OPTIMAL CURRENCY AREAS**

\*\*Eudey, G (2000) “Why is Europe Forming A Monetary Union?” in King (ed. ), ch. 24, 304-315.

\*\*Mundell, R (1961) “A Theory of Optimum Currency Areas”, *American Economic Review*, 51, September, 657-65.

\*\*Tavlas, G (2000) “The International Use of currencies: The U.S. Dollar and the Euro” in King , ch. 25, 325-330.

\*\*Beddoes, Z. (1999) “ From EMU to AMU? The Case for Regional Currencies”, *Foreign Affairs*, Vol. 78, 8 –13.

## **v. TUTORIAL EXERCISES AND ESSAY QUESTIONS**

### **PRINCIPLES AND INTERNATIONAL MONETARY SYSTEM (Week beginning August 11; Buirra (1995), pp. 1-6; 23-27); Ghosh and others (2000)**

- (a) Discuss critically the main perceived weaknesses of the present international monetary system, including Buirra’s argument. How have post-1995 developments affected Buirra’s argument? Would a return to fixed exchange rates for all countries resolve these weaknesses?
- (b) Explain and discuss critically the role and significance of the Nth country concept. What role was played by the Nth country problem in the breakdown

of Bretton-Woods? Has this problem been resolved for countries that have adopted flexible exchange rates?

- (c) Does the exchange rate regime matter for the functioning of the international monetary system? Examine and discuss critically the main findings of Ghosh and others (2000).

## **CONFIDENCE PROBLEM**

**(Week beginning August 25; reading; Radelet and Sachs (2000); Donovan (1999))**

- (a) Examine and discuss critically Radelet and Sach's analysis of the Asian crisis. What implications for a global confidence problem in the present international monetary system may be drawn from your discussion?
- (b) How might the role of the IMF be strengthened in addressing a global confidence problem? Compare and discuss critically the arguments of Donovan and Radelet and Sachs on this question.

## **ADJUSTMENT PROBLEM AND CURRENT ACCOUNT**

**(Week beginning September 15; reading; Buira, pp. 23- 29; Corden (1991))**

- (a) Examine and discuss critically Buira's analysis of the external adjustment process and role of the IMF. Does an adjustment problem exist under flexible exchange rates?
- (b) Examine and discuss critically Corden's analysis of situations when a persistent current account imbalance warrants a policy response. Which, if any scenario is relevant for Australia or the U.S. or Japan? What policy response would you recommend?

## **EXTERNAL DEBT**

**(Week beginning September 22; reading: Cohen; Katsela; Eaton)**

- (a) Compare and discuss critically the frameworks used by Cohen and Eaton for analysing external debt solvency. Which interpretation best fits HIPC countries?.
- (b) Examine and discuss critically Greene's analysis of the debt situation of low income African countries. To what extent does the HIPC initiative resolve these problems?

## **INTERNATIONAL LIQUIDITY**

**(Week beginning October 13; reading; Buira, pp. 6-23): Horne and Nahm, pp. 368-371.**

- (a) Examine and discuss critically the concept of adequacy of international liquidity and measures used to assess adequacy. How useful are Buira's estimates of demand for international reserves for this purpose?
- (b) Examine and discuss critically the problem of inequitable reserve distribution and Buira's policy solution. What role should the IMF play?

## **MONETARY UNION**

**(Week beginning October 20: reading, Eudey in King, ch. 24; Tavlas in King, ch.25)**

- (a) Examine and discuss critically Eudey's analysis of the benefits and costs of joining a monetary union. How relevant is the discussion for Asian countries?
- (b) What is the difference between the use of money in a single economy vis-a-viz a multi-country setting? What are the implications of this difference for predicting the future roles of the U.S. dollar, euro and S.D.R? Comment critically on the main conclusions reached in Tavlas (2000).

## **VI. ESSAY**

**Essay topic may be taken from any one of the above tutorial exercises. References are minimal: you are expected to develop your own.**

**Essay length should not exceed 2,000 words.**

**Deadline for submission: Monday 13 October, 2003, 8pm. Hand in essay (with attached signed sheet stating you have read, and understood University rules on plagiarism) in marked box in Econ Reference room.**

**Late essays will be penalised; one mark deducted for each day late without medical certificate.**

**Essay is part of coursework. Failure to submit an essay will result in an F grade being awarded.**