Wilfrid Laurier University
Waterloo, Ontario
IP623: Special Topics in International Economic Relations
WINTER 2017

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Course Objectives

After reviewing the basic elements of fiscal and monetary policy and their effects on inflation and unemployment, the course explores the operation of such policies in an increasingly interdependent world. Exchange rate arrangements are the most common expression of the interdependence of monetary policies between countries. However, the critical role of central

banks and monetary policy also led inflation control to become the new international monetary order for a time. The global financial crisis has raised questions about the wisdom of this choice.

"LEGAL STUFF"

Wilfrid Laurier University uses software that can check for plagiarism. Students may be required to submit their written work in electronic form and have it checked for plagiarism.

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<u>*Special needs:*</u>
Students with disabilities or special needs are advised to contact Laurier's Special Needs Office for information regarding its services and resources. Students are encouraged to review the Calendar for information regarding all services available on campus.

Term Grades

Item	Title	% of Total
Assignment # 1: **Due: February 10th , 2017**	Monetary Policy Game	**25**
Exam	**Feb 20th, in class – 2 hours**	**25**
Assignment # 2: **Due: March 20th , 2017**	Evolving Central Bank Independence <u>NOTE: Country names required</u> <u>by FEB 6</u>	**25**
Assignment # 3: **Due: April 12th , 2017**	**Post-Crisis Economic Memo** <u>**NOTE: Country name required**</u> <u>**by March 27**</u>	**25**

Details about the assignments, and the exam, are provided following the course schedule. <u>All assignments are due on the due dates listed above by 4PM latest.</u> Any missed presentation will be subject to a deduction of 10% from the grade (i.e., the maximum is out 90 instead of being out of 100) unless there is a documented medical reason.

Topics Covered – Required Readings

Note: I have tried to keep readings to a minimum. Note taking in class will be a very useful complement to these readings unless you wish to read several more papers than the minimal list shown below! Readings are NOT listed in order of importance. The week before each lecture I will post on My Learning Space a PDF version of the slides used in the lectures.

1. *The Conduct of Monetary and Fiscal Policy: Theory, Practice & MoPoS*

   a. Clarida, Gali and Gertler (1999) - technical
   b. Kydland and Prescott (1977) - technical
   c. Goodfriend (2007)
   d. Taylor (1993, 1998, 2007)

2. *Central Banks: Independence, Transparency and Governance*

   a. Cukierman, Webb, and Neyapti (1992)
   b. Crowe and Meade (2007)
   c. Siklos (2016)
   d. Cargill (2013)
   e. Dincer and Eichengreen (2014)

3. *The Eurozone Crisis*

   a. Jonung and Drea (2010)
   b. Shambaugh (2012)
   c. De Grauwe (2016)
   d. IEO (2016)

4. *Economic and Financial Crises Through the Ages*

   a. Reinhart and Rogoff (2008)
   b. Bordo (2008)
   c. Lombardi, Siklos, and St. Amand (2016), Lombardi, St. Amand, and Siklos (2016)
   d. Mishkin (2011)
   e. Schularick and Taylor (2012)

Assigned Readings

Bordo, M. (2008), "An Historical Perspective on the Crisis of 2007-2008", NBER working paper 14569, December.

Cargill, T. (2013), "A Critical Assessment of Measures of Central Bank Independence", *Economic Inquiry* 51 (January): 260-272.

Clarida, R., J. Gali, and M. Gertler (1999), "The Science of Monetary Policy: A New Keynesian Perspective", *Journal of Economic Literature* 37 (December): 1661-1707.

Cukierman, A., S.B. Webb, and B. Neyapti (1992), "Measuring the Independence of Central Banks and Its Effect on Policy Outcomes", *The World Bank Economic Review* 6 (3): 353-398.

De Grauwe, P. (2016), "The Legacy of the Eurozone Crisis and How to Overcome It", *Journal of Empirical Finance* (forthcoming).

Crowe, C. and E. Meade (2007), "The Evolution of Central Bank Governance Around the World", *Journal of Economic Perspectives* 21 (Fall): 69-90, http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.21.4.69

Dincer, N. and B. Eichengreen (2014), "Central Bank Transparency and Independence: Updates and new Measures", *International Journal of Central Banking* (March): 189-253.

Goodfriend, M. (2007), "How the World Achieved Consensus on Monetary Policy", *Journal of Economic Perspectives* 21 (Fall): 47-68.

Independent Evaluation Office of the International Monetary Fund (2016), "The IMF and the Crises in Greece, Ireland, and Portugal", Evaluation Report.

Jonung, L. and E. Drea (2010), "It Can't Happen, It's a Bad Idea, It Won't Last: U.S. Economists on the EMU and the Euro, 1989-2002", *Econ Journal Watch* 7 (January): 4-52, http://ideas.repec.org/a/ejw/journl/v7y2010i1p4-52.html.

Kydland, F., and E. C. Prescott (1977), "Rules Rather Than Discretion: The Inconsistency of Optimal Plans", *Journal of Political Economy* 85 (June): 473-492.

Lombardi, D., S. St. Amand, and P. Siklos (2016), "Long-term Bond Yields When Policy Rates Are At the Effective Lower Bound: International Evidence", working paper, September.

Lombardi, D., P. Siklos, and S. St. Amand, and (2016), "Monetary Policy Spillovers: A Global Empirical Perspective", working paper, October.

Mishkin, F. (2011), "Monetary Policy Strategies: Lessons from the Crisis", NBER working paper 16755, February.

Reinhart, C., and K. Rogoff (2008), "This Time is Different': A Panoramic View of Eight Centuries of Financial Crises", NBER working paper 13882, April.

Schularick, M., and A. Taylor (2012), "Credit Booms Gone Bust: Monetary Policy, Leverage Cycles, and Financial Crises, 1870-2008", *American Economic Review* 102 (2): 1029-1061.

Shambaugh, J. (2012), "The Euro's Three Crises", available from http://www.brookings.edu/~/media/Files/Programs/ES/BPEA/2012_spring_bpea_papers/2012_spring_BPEA_shambaugh.pdf.

Siklos, P. (2016), "Evolution Not Revolution in Central banking: From Autonomy to Transparency", in *Development and Current Practice of Central Banks* (forthcoming).

Taylor, J. (1993), "Discretion Versus Policy Rules in Practice", Carnegie-Rochester Conference on Public Policy 39: 195-214.

Taylor, J. (1998), "Monetary Policy and the Long Boom", Review of the Federal Reserve Bank of St. Louis (November/December): 3-12.

Taylor, J. (2007), "The Explanatory Power of Monetary Policy Rules", NBER working paper 13685, December.

A Few Additional References You Might Find Interesting (not required reading)

Part 1:

Paul Romer (2016), "The Trouble With Macroeconomics", unpublished, https://paulromer.net/.
Michael Woodford (2012), "Principled Policy Making in an Uncertain World", unpublished, Institute for New Economic Thinking.
Michael Woodford (2012a), "What's Wrong With Economic Models?", unpublished, Institute for New Economic Thinking.
John Kay (2011), "The Map is Not the Territory: An Essay on the States of Economics", unpublished, Institute for New Economic Thinking.
John Taylor (2016), "Central Bank Models: Lessons from the Past and Ideas for the Future", unpublished, Stanford University.

Alternative to MoPos: https://sffed-education.org/chairthefed/default.html?startover=1

Part 2:

John Taylor (2016), "Independence and the Scope of the Central Bank", Riksbank.

Donato Masciandaro and Davide Romelli (2016), "Peaks and Troughs: Economics and Political Economy of Central Bank Independence Cycles", Bocconi University.

Part 4:

Moritz Schularick (2010), 140 Years of Financial Crises: Some Policy Lessons From History", unpublished.
J. Voth (2014), "Fear, Folly, and Financial Crises: Some Policy Lessons From History", unpublished.

Other Relevant Readings (for reference and general interest only)

Ahamed, L. (2009), *The Lords of Finance* (New York: The Penguin Press).

Bernanke, Ben S. (2015), *The Courage to Act* (New York: W.W. Norton).

Blinder, Alan S. (2013), *After the Music Stopped* (New York: Penguin Press).

Blinder, A. (2008), *The Quiet Revolution* (New Haven: Yale University Press).

Blinder, A. S. (1999), *Central Banking in Theory and Practice* (Cambridge, Mass.: Cambridge University Press).

Brunnermeier, M., H. James, and J.-P. Landau (2016), *The Euro and the Battle of Ideas* (Princeton, N.J.: Princeton University Press).

Eichengreen, B. (2002), *Financial Crises* (Oxford: Oxford University Press).

Issing, O. (2008), *The Birth of the Euro* (Cambridge: Cambridge University Press).

James, H. (2012), *Making the European Monetary Union* (Cambridge, Mass.: Harvard University Press).

Siklos, P. (2002), *The Changing Face of Central Banking* (Cambridge: Cambridge University Press)

Class Schedule

Class No.	Week	Class Day/ Time	Topic[+]
1	Jan 13th*	Friday 9:30-12: 00	**Note different class date – location the same** 1
2	Jan 16th	Monday 9:30-12:00	1
3	Jan 23rd	Monday 9:30-12:00	**1:** *Playing the MoPoS game:* *Introduction and Q&A – alphabetical order*
4	Jan 30th	Monday 9:30-12:00	2
5	Feb 1th	Wednesday time TBA	**Note different day: time TBA** *Jonathan Ostry Seminar: Title TBA*
6	Feb 6th	Monday 9:30-12:00	**Assignment #1 presentations[§]** **- reverse alphabetical order**
	Feb 13th	Monday 9:30-12:00	Replaced by Ostry Lecture – but also extra office hours
-	Feb 20th	Reading Week	
7	Feb 27th	Monday 9:30-12:00	**EXAM**
8	Mar 6th	Monday 9:30-12:00	*Assignment #2 presentations[§]* **- Random order**
9	Mar 13rd	Monday 9:30-12:00	3
10	Mar 20th	Monday 9:30-12:00	4
11	Mar 27th	Monday 9:30-12:00	4
12	Mar 28th	Tuesday 1:00-2:20	**Memo preparation/questions** **– in office consultations or via email**
13	Apr 10th	Monday 9:30-12:00	*Assignment #3 presentations[§]*

[§] 10 minutes per student, excluding Q&A. Reporting of results. Only electronic versions of assignments are acceptable (to psiklos@balsillieschool.ca). The presentation is worth 10% of the grade.

Assignment # 1: Monetary Policy Game

The objective: You are asked to generate some scenarios for the policy interest rate based on different assumptions about the economy (see below) and come up with a decision about the interest rate setting for monetary policy.

1. *Read MoPoS – A Monetary Policy Simulation Game (http://www.snb.ch/en/mmr/reference/mopos/source/mopos.en.pdf)* [**]
2. *Familiarize yourself with the basic operations of the game. A zip file is available from MY Learning Space with where a copy of the game is stored. A separate Guide I've prepared – based on an older Excel version - is also available on My Learning Space. Focus all discussions in your analysis on a **2 to 5 years ahead horizon (or 8 to 20 quarters)**.*
3. *After you have started click on the simulation button and choose Advanced Mode. All simulations to be performed below should be done using ANY one simulation files of your choice.*
4. Choose the **Taylor rule strategy**: each time you simulate the economy save the data for the interest rate, real GDP, the price level, the estimated gap, and inflation, in a separate spreadsheet for plotting and analysis. This applies to all of the exercises to be performed below.
   i. Run the simulation with the **default parameters**;
   ii. In the parameter page **change the weights in the Taylor rule**: try changing the weights on the inflation and output parameters. Use a smaller and then a larger weight relative to the default. Make sure to save the data results each time!
   iii. Change the Taylor rule weights back to the default. Next, **change the inflation persistence parameter of the Phillips curve**. Try two different levels of inflation persistence.
   iv. What happens to the economy (i.e., interest rates, and inflation) when there is low growth (1% per year) for the foreseeable future?
5. Draw some general conclusions about the challenges of conducting monetary policy relying on the in class discussion and course materials.
6. Next, use the above results, or any other simulations you care to imagine, as background to come up with a *press release of the kind the Bank of Canada publishes* (e.g., http://www.bankofcanada.ca/2016/12/fad-press-release-2016-12-07/).

Submit your answers in an Excel spreadsheet and discuss your results in a Word document not exceeding **5** pages (double spaced, 12 pt font). Only essential charts (or Tables) should be in the report and no more than 3 pages (additional material is relegated to the spreadsheet). The press release is a separate **1 page** (maximum) document. 80% of the grade is for simulation work, the remaining 20% is for the press release.

Assignment # 2: Evolving Central Bank Independence[**]

NOTE: Country names required by FEB 6

1. Go to http://www.bis.org/cbanks.htm. This page provides links to central banks around the world with websites.

2. Select **5** countries. Try to vary the selection of countries so that they are not all advanced economies (for the member countries in the euro area there is only ONE central bank, the European Central Bank). Obviously, the legislation should be available online and in English (most, but not all, websites have an English language page even though the home page may not be in English). Send me a list of the countries selected. Choices are on a first come, first served, basis to avoid an overlap of countries chosen.

3. Calculate the indicator of CB independence based on the Bade-Parkin criteria (see page 3 of Parkin (2013)[1] or Siklos (2016)).

4. Estimate the (annual) inflation rates from the World Economic Outlook data base of the IMF: http://www.imf.org/external/data.htm) since the current legislation has been in place for each of the four countries in your sample, and for five years previous (this will depend on when the last legislation was enacted. What is the simple correlation between annual inflation and CB type during the following sub-periods: five years before the legislation was passed, since the legislation was passed; 2000-2007 and 2008-2015? Did the Global Financial Crisis lead to major changes in legislation? Did the crisis affect the CBI score?

5. Using graphical analysis, evaluate the following, reproduced from Parkin (2013): "*They found that only type 4 central banks deliver significantly lower inflation. It was not possible to separate types 1, 2, and 3. So ... they concluded that "there is strong evidence that central banks which are independent of central governments both in policy making and in the appointment of directors deliver a low rate of inflation but not necessarily low variability of monetary policy. ... [and] ... monetary policies do not appear to differ significantly as between 'independent' central banks and government-dominated central banks where the 'independent' central bank has a directorate entirely appointed by government.*"

6. Based on your findings do you agree with Cargill (2013) that the mis-classification problems associated with measures of CB independence are large?

[**]**NOTE: Please provide your index and figures in a spreadsheet. Explanations are to be provided in a separate Word file of no more than 5 double-spaced pages (12 pt font).**

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[1] Available from http://economics.uwo.ca/epri/workingpapers_docs/wp2013/Parkin_01.pdf.

Assignment # 3: Post-Crisis Policy Memo
NOTE: Country name required by March 27

For this exercise, intended as a kind of capstone exercise, you are asked to write a report that evaluates the state of monetary and fiscal policy and the appropriateness of the current and intended stance of the government and the central banks. Is the central bank putting financial stability above the aims the aims of monetary policy? Is this appropriate? Explain and argue your position. What are some of the main forces that policy makers should be aware that currently govern the policy mix? Should alternatives be considered?

The report should not exceed 10 pages, 12 pt font, 1" margins, with no more than 5 additional pages of charts, tables, and references. You are not required to generate any new evidence but you should make your case based on existing reviews and analyses of the country in question. Note that it is critical that all material be correctly referenced, including data sources. It should be written at the level of the well-informed reader. Jargon is to be avoided as well as unnecessary complexity.

There are plenty of sources of reports of this kind written at the more specific or general levels. Some examples include country (or region) reports from the IMF, or commentary by some think tanks (e.g., CIGI, C.D. Howe Institute). Use these as models for your memo.