Advanced International Economics
Economics 823
Spring Semester 2000
E. W. Nafziger
Mid-term Take-home Exam

Questions (1) and (2) taken together count 70 points, while question (3) counts 30 points, for a total of 100 points.

Hand in this take-home exam by 10:00 a.m., Friday, March 17, 2000, to me in Waters 312.

(1) Discuss the nature of, the reasons for, and ways to avoid crises similar to the 1997-99 Asian (i.e, Thai, Indonesian, Malaysian, and Korean) financial crisis.

[Note concerning substitutions allowed: (a) you are allowed to choose a single country among those experiencing the Asian crisis; (b) you are allowed to substitute any of these contemporary financial crises for the Asian crisis: Latin America, sub-Saharan Africa, or one country in either one of these two groups; or (c) you are allowed to substitute Russia, the former Soviet Union, or Eastern Europe.]

[If you select a single country: in Asia other than the four listed; in the former Soviet Union other than Russia; or in Eastern Europe, sub-Saharan Africa, or Latin America, be sure that the selection of the country will allow you to include discussion of some of the issues included in the reading. If you are uncertain, please discuss with the instructor.]

[Financial crisis in a country you choose may be broad enough to include issues such as debt crisis or exchange-rate crisis.]

(2) In light of recent financial, exchange-rate, or debt crises in developing economies, indicate the changes you recommend in the international financial system or architecture. You should relate what you recommend both to the financial crisis you discuss and other recent financial crises among developing economies. Discuss.

Length, method of citation, etc.: The question should be answered in no more than (equivelent to) roughly 12 typewritten single-spaced pages (not counting graphs and tables, which are to be limited to no more than 3-4 extra pages). Be sure to cite sources (see below).

Here are examples of how you should cite sources - from required readings: (Eichengreen, p. 13); from other students: (Conversation with Michael Jones, February 29, 2000); from the lecture: (Lecture, February 23, 2000). For sources outside the readings, list as (Smith 1999: 36-38) for author, year, and pages in text; in the references (not to be included in the 12 single-spaced limit), include author, title, publishing information if book (city, publishing company, year, and pages, if relevant)or journal

(name of journal, volume number, date, page numbers). See the American Economic Review for an example as to
how to cite. For material on the web, the bibliographical citation must be complete, for example, Partha Dasgupta, The Economics of the Environment, Proceedings of the British Academy, Volume 90, pp. 165-221, Copyright The British Academy, 1996, available at http://britac3.britac.ac.uk/pubs/keynes95/06sec5.html.

Feel free to hand in an earlier draft so that I can give you comments that will allow you to improve your paper (but give me a few days to respond), or ask questions about your progress at earlier stages of work on your paper.

Alternative: As an alternative you may write an original empirical or analytical work related to one of these crises. If you choose a topic of this sort, please discuss this with the instructor.

(3) Indicate and discuss how changes in assumptions about international trade and migration affect the ratio of skilled to unskilled wages (the skill premium) during the past two decades.

Length, method of citation, etc.: The question should be answered in no more than (equivalent to) roughly 5 typewritten single-spaced pages (not counting graphs and tables, which are to be limited to no more than 1-2 extra pages). Sources should be cited in the manner indicated above.

Advanced International Economics
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Final Take-home Exam
Due May 9, 2000

The four exam questions:

(1) The International Financial Institution Advisory (Meltzer) Commission of the US Congress's Joint Economic Committee indicates the following (in quotes) concerning the International Monetary Fund. Evaluate and discuss the Meltzer Commission's recommendations. http://www.house.gov/jec/imf/imfpage.htm and others have discussions of the Meltzer Commission.

"The frequency and severity of recent crises raise doubts about the system of crisis management now in place and the incentives for private actions that it encourages and sustains. The IMF has given too little attention to improving financial structures in developing countries and too much to expensive rescue operations. Its system of short-term crisis management is too costly, its responses too slow, its advice often incorrect, and its efforts to influence policy and practice too intrusive. . . . The IMF should continue as crisis manager under new rules that give member countries incentives to increase the safety and soundness of their financial systems. . . .

“The IMF should serve as quasi lender of last resort to emerging economies. However, its lending operations should be limited to the provision of liquidity (that is, short-term funds) to solvent member governments when financial markets close. Liquidity loans would have short maturity, be made at a penalty rate (above the borrowers recent market rate) and be secured by a clear priority claim on the borrowers assets. Borrowers would not willingly pay the penalty rate if financial markets would lend on the same security, so resort to the IMF would be reduced.”

“It would serve as a stand-by lender to prevent panics or crises. Except in unusual circumstances, where the crisis poses a threat to the global economy, loans would be made only to countries in crisis that have met pre-conditions that establish financial soundness. To the extent that IMF lending is limited to short-term liquidity loans, backed by pre-conditions that support financial soundness, there would be no need for detailed conditionality (often including dozens of conditions) that has burdened IMF programs in recent years and made such programs unwieldy, highly conflictive, time consuming to negotiate, and often ineffectual.”

“Four of the proposed pre-conditions for liquidity assistance that we recommend are: First, to limit corruption and reduce risk by increasing portfolio diversification, eligible member countries must permit, in a phased manner over a period of years, freedom of entry and operation for foreign financial institutions. Extensive recent history has demonstrated that emerging market economies would gain from increased stability, a safer financial structure, and improved management and market skills brought by the greater presence of foreign financial institutions in their countries. A competitive banking system would limit use of local banks to finance "pet projects," or lend to favored groups on favorable terms, thereby reducing the frequency of future financial crises.”

“Second, to encourage prudent behavior, safety and soundness every country that borrows from the IMF must publish, regularly and in a timely manner, the maturity structure of its outstanding sovereign and guaranteed debt and off-balance sheet liabilities. Lenders need accurate information on the size of short-term liabilities to assess properly the risks that they undertake.”

“Third, commercial banks must be adequately capitalized either by a significant equity position, in accord with international standards, or by subordinated debt held by non-governmental and unaffiliated entities. Further, the IMF in cooperation with the BIS should promulgate new standards to ensure adequate management of liquidity by commercial banks and other financial institutions so as to reduce the frequency of crises due to the sudden withdrawal of short-term credit.”

“Fourth, the IMF should establish a proper fiscal requirement to assure that IMF resources would not be used to sustain irresponsible budget policies. To give countries time to adjust to these incentives for financial reform, the new rules should be phased in over a period of five years. If a crisis occurred in the interim, countries should be allowed to borrow from the IMF at an interest rate above the penalty rate."

"Maintenance of stabilizing budget and credit policies is far more important than the choice of exchange rate regime. The Commission recommends that countries avoid pegged or adjustable rate systems. The IMF should use its policy consultations to recommend either firmly fixed rates (currency board, dollarization) or fluctuating rates. Neither fixed nor fluctuating rates are appropriate for all countries or all times. Experience shows, however, that mixed systems such as pegged rates or fixed but adjustable rates increase the risk and severity of crises."

"Long-term structural assistance to support institutional reform and sound economic policies would be the responsibility of the Bank and the regional banks. The IMF should cease lending to countries for long-term development assistance (as in sub-Saharan Africa) and for long-term structural transformation (as in the post-Communist transition economies). The Enhanced Structural Adjustment Facility and its successor, the Poverty Reduction and Growth Facility, should be eliminated. The IMF should write-off in entirety its claims against all highly indebted poor countries (HIPCs) that implement an effective economic development strategy in conjunction with the World Bank and the regional development institutions. In keeping with the greatly reduced lending role of the IMF, the Commission recommends against further quota increases for the foreseeable future. The IMFs current resources should be sufficient for it to manage its quasi lender of last resort responsibilities, especially as current outstanding credits are repaid to the IMF."

(2) What impact will the euro have on the US, especially the use of US dollar reserves by other countries? What impact will the euro have on the reserves of less-developed countries (LDCs)? Discuss.

(3) Discuss whether the US trade deficit is sustainable.

(4) Should WTO/GATT encourage regional trading blocs (under Article XXIV of GATT, which now allows free trade areas under certain conditions)? Are trading blocs a stumbling or building bloc to increasingly liberal international trade? Discuss. [You can write on this question, using material from just Jeffrey A. Frankel, *Regional Trading Blocs in the World Economy* (Washington D.C.: Institute for International Economics, 1997), or you can include material from Frankel and from Jeffrey A. Frankel and David Romer, Does Trade Cause Growth, American Economic Review 89(3) (June 1999): 379-99 as well. Let me note that this does not prevent you from using other sources as well.]

Alternative question to any one of the four above:

Jagdish Bhagwati's view of Japanese trade policy, in response to the contention of James Fallows, is the following (a two-paragraph quote from Bhagwati which includes his quote of Fallows): "'When foreign competitors ask Japan to embrace the principles of free trade, they run up against a broader Japanese discomfort with the very prospect of abiding by abstract principles,' revisionist James Fallows observed. Therefore, instead of futilely pressing Japan to conform to the rules of free trade, Fallows thinks that the U.S. should demand that Japan accept targeted quantities of U.S. goods.

But a simpler and wholly plausible explanation of the Japanese behavior in trade negotiations seems to be that, since the 1930s, they have not been allowed to trade by rules. Their export successes have always been met by demands for quantitative restraints. Other countries' political preferences, not the cultural afflictions of the Japanese, seem to have molded their attachment to quantities. If Japan is widely regarded as an unfair trader, it may be because the successful often appear to be predatory [plunderous]. . . . Many who are convinced that Japan does not offer market access have moved from the clearly false position that Japan has high trade barriers to the complex contention that Japanese institutions are so 'different' that they effectively impede imports."

Procedure, Citation, and Weight

The exam counts two units or 200 points.

Hand in this take-home exam by Tuesday, May 9, 2000, 11:50 a.m. to me in Waters 312.

Length, method of citation, etc.: Each question should be answered in no more than (equivalent to) roughly 12 typewritten double-spaced pages (not counting graphs and tables, which are to be limited to no more than 3-4 extra pages). Be sure to cite sources (see below).

Here are examples of how you should cite sources - from required readings: (Mann, p. 21); from other students: (Conversation with Michael Jones, April 17, 2000); from the lecture: (Lecture, April 10, 2000). For sources outside the readings, list as (Smith 1999: 36-38) for author, year, and pages in text; in the references (not to be included in the 12 double-spaced limit), include author, title, publishing information if book (city, publishing company, year, and pages, if relevant) or journal (name of journal, volume number, date, page numbers). See the American Economic Review for an example as to how to cite. For material on the web, the bibliographical citation must be complete, for example, Partha Dasgupta, “The Economics of the Environment,” Proceedings of the British Academy, Volume 90, pp. 165-221, Copyright © The British Academy, 1996, available at http://britac3.britac.ac.uk/pubs/keynes95/06sec5.html.

Feel free to hand in an earlier draft so that I can give you comments that will allow you to improve your paper (but give me a few days to respond), or ask questions about your progress at earlier stages of work on your paper.