

International Monetary Economics

University of Copenhagen

2004 Course Project

Professor

John Kennes

Overview

The project is intended to give students an opportunity to work creatively and collaboratively on a number of key questions in international monetary economics. The project involves several activities that are to be supervised by the course professor. These activities are

1. Choosing the topic of each project and the co-authors. The allocation of projects and co-authors will be made by the professor using information supplied by students. (1 week)
2. Writing the project. (3000 words) The project is to be submitted to the professor by e-mail in an open source electronic format: Word or Tex file. (2 weeks)
3. Publication of the projects on the professor's website. (Names of the authors will be withheld)
4. Writing a referee report. (300 words) Each student is assigned one project to referee. (1 week)
5. Publication of the referee reports on the professor's website. (Names of the authors will be withheld)
6. Assignment of a grade. (2 weeks)
7. Projects of merit will be assigned to the Journal of Economic Homework (JEH) located at the professor's website: www.econ.ku.dk/kennes/

Notes

The maximum number of co-authors is three. Students expressing a desire to work with specific classmates or in smaller groups will be given the opportunity to do so. See **Signup Sheet**

Students will also be given some choice over the questions that they will address. The choice of questions is given in the section, **topics**. For the sake of brevity, the number of groups working on each topic will be limited. Students also have the alternative opportunity to choose their own question in consultation with the professor.

The projects are to be approximately 3000 words in length. The analysis can/should also incorporate helpful table, figures, formulas, etc. The referee reports will be 300 words in length.

The project is worth 25% of the students' final grades. The related referee reports are worth 5%.

Students shall provide the professor with their email addresses.

Important Dates

1. Distribution and collection of sign-up sheets. March 2 and 4
2. Allocation of topics: March 9
3. Submission of completed project: March 23
4. Allocation of projects for refereeing: March 25
5. Referee reports are to be submitted April 5.
6. Grade will be assigned on April 19.

Signup Sheet

The following information is needed to make the allocation of projects.

1) Pre-selection of co-authors

Name(s) / e-mail*

- 1) _____,
- 2) _____,
- 3) _____.

* Each person can be included on only one signup sheet

2) Each pre-selected group of less than three should answer the following question.

Can you work with an extra person(s)?

Yes _____, No _____ (check one)

- Students are strongly encouraged to choose Yes.
- The maximum group size is three.

3) State your favourite three topics from topics 1 to 6.

Topic 1 _____
Topic 2 _____
Topic 3 _____
Topic 4 _____
Topic 5 _____
Topic 6 _____

Use numbers (i), (ii) and (iii) to indicate your ranking of the top three topics. (leave the remaining three topics blank.

4) Do you prefer to work on topic 7? Yes _____, No _____

Proposed topic title: _____

5) Comments _____

Topics

TOPIC 1: (History)

1. The interwar decline of Britain is sometimes imputed to the 1924 return to gold standard at the overvalued pre-war parity. Explain how and why lasting overvaluation hurts.
2. Proposals to return the world to the gold standard are regularly put forward. Evaluate the pros and the cons of this idea.
3. Drawing lessons from history, determine the European Monetary System's strengths and weaknesses.
4. Is EMU robust? Write the cases for and against.

TOPIC 2: (Exchange Rate Regimes)

1. Why does a fixed exchange rate allow a country to adopt an inflation rate that differs from the one in the anchor currency country?
2. Dollarization is a good regime only for countries that display a chronic lack of fiscal discipline. Explain and comment.
3. It is often believed that a peg encourages residents (households, firms, banks) to borrow in foreign currency. Then, if the exchange rate is devalued, many residents face the risk of bankruptcy. Explain and comment.
4. Comment on the following assertion: 'Fixed exchange rate regimes are temporary arrangements'. What is the implication for Europe?

TOPIC 3: (The EMS)

1. Can other groups of countries also form a system like the EMS?
2. What lessons do you draw from the 1992-3 wave of speculative attacks? In particular, why did speculators attack some obviously not overvalued currencies (the Belgian and French francs, the Danish kronor) after other currencies were forced to leave ERM or to devalue?
3. After they join the European Union in 2004, the new members will have to operate for at least two years within EMS-2. What problems can you envision? What alternatives would you suggest?
4. By 1990, the EMS was seen as a major success. Can you provide your own evaluation of the system's performance over the period 1979-1990? (You may use the criteria of success that you wish, but be explicit about them).

TOPIC 4: (OCA theory)

1. You are given the task of designing a transfer system designed to cope with asymmetric shocks. Consider both how to collect and how to spend these resources.
2. Early evidence is that trade is increasing faster among EMU countries than among other European non-EMU countries. How can such evidence affect the debate on EMU membership in countries such as Norway, Sweden, Switzerland or the UK?

3. Evaluate the May 9, 2003 statement by the British Chancellor of the Exchequer, Gordon Brown, explaining why he recommends that Britain does not join Euroland, well not yet. (Source: <http://www.hm-treasury.gov.uk>).
4. Write a science-fiction story: a severe asymmetric shock occurs and leads to such economic hardship that the European Monetary Union is dissolved. Carefully explain each step in the process.

TOPIC 5 (EMU)

1. The Eurosystem asserts that, in its deliberations, it never pays attention to local (i.e. national) economic conditions. The reason is that there is a single monetary policy and that 'one size fits all'. Discuss this approach and imagine alternative approaches.
2. It is sometimes asserted that independence and accountability are substitutes, i.e. that more independence requires less accountability and *vice versa*. Discuss this assertion.
3. The convergence criteria are about nominal conditions (inflation, deficits and debts) but not about real conditions (GDP per capita, growth). This was understandable for the original founders but what does it mean for the upcoming wave of accession by countries from Central and Eastern Europe? Should the same criteria apply? Why or why not? Is the lack of real convergence problematic?
4. The British Chancellor of the Exchequer, Gordon Brown, has stated that Britain will join when five economic tests are passed. These five tests are:
 - i. Are business cycles and economic structures compatible so that we and others could live comfortably with euro interest rates on a permanent basis?
 - ii. If problems emerge is there sufficient flexibility to deal with them?
 - iii. Would joining EMU create better conditions for firms making long-term decisions to invest in Britain?
 - iv. What impact would entry into EMU have on the competitive position of the UK's financial services industry, particularly the City's wholesale markets?
 - v. In summary, will joining EMU promote higher growth, stability and a lasting increase in jobs?

Evaluate these tests.

TOPIC 6: (Financial markets and the Euro)

1. In which ways can the existence of different national financial systems complicate monetary policy in the euro area? What kind of measures could help the ECB?
2. How do you foresee the European banking system in 20 years? Describe the number of major banks, their ownership structure and the way they compete.
3. What, in your view, can reduce the home bias in equity holdings across Europe?
4. Finance is a major industry in the UK, accounting for some 5% of its GDP. Does this characteristic make membership to the euro area rather more or rather less appealing?

TOPIC 7: Come up with your own question.