

Discipline Specific Elective 12 (DSE-12): Open Economy

Semester	Course title & Code	Credits	Duration (per week)			Eligibility Criteria	Prerequisite
			Lecture	Tutorial	Practical/ Practice		
V/VII	Open Economy Macroeconomics – ECON042	4	3	1	0	Class 12th Pass	Intermediate Macroeconomics II (ECON011)

Learning Objectives

The Learning Objectives of this course are as follows:

- The course is designed with the objective of introducing the students to the standard macroeconomic issues in an open economy framework using the Mundell-Fleming model and the exchange rate overshooting model.
- It further exposes them to the models of banking and currency crises which try to make sense of the risks and vulnerabilities in an interdependent economy.
- The course would give an exposure to contemporary concerns in the global economy and the challenges it poses to policy making.

Learning outcomes

The Learning Outcomes of this course are as follows:

- The student would get a good exposure towards the process of macroeconomic policy- making in an open economy and the challenges involved.
- The course would facilitate learning the art of building macro-models in an open economy context. It would also enable the student to relate it to the contemporary issues.
- The student would learn to appreciate contemporary issues by relating the real world data to the theory in this regard.

Syllabus

UNIT I: Introduction to Open Economy Macroeconomics (10 hours)

Intertemporal long run budget constraint, how much can a country borrow, external wealth, external assets and liabilities, net international investment position, financial flows and valuation effects, Feldstein Horioka Puzzle, Harberger-Laursen- Metzler effect, Foreign Exchange Market. An overview of the spot and forward markets, swaps, options and derivatives. Uncovered and Covered Interest Parity. Covered Interest Arbitrage.

UNIT II: Macro-modelling of the Open Economy (20 hours)

Mundell-Fleming model (with Flexible Prices). Dornbusch's exchange rate overshooting model with stability conditions. Monetary Approach to Balance of Payments. PPP and long run monetary approach, Balassa –Samuleson effect and non-tradables, Fisher effect. Portfolio and macroeconomic equilibrium in an open economy. 3 equation model for the open economy. Currency crises (first, second and third generation models). Optimum currency areas and monetary union.

UNIT III: International Monetary System and Policy Co-ordination (15 hours)

Classic specie price flow mechanism and the Gold Standard. Fixed exchange rate system under Bretton Woods. Triffin dilemma and the collapse of the Bretton Woods, SDRs, international consistency condition. Financial trilemma. International liquidity and demand for international reserves. Government policies to- wards capital market, exchange and capital controls. Central bank intervention, sterilization.

Prospects of Macroeconomic policy co-ordination in an open economy, Policy reaction function, Hamada diagram

Recommended readings

- Feenstra, Robert and Taylor, Alan (2020) International Macroeconomics, 3rd ed., Worth Publishers
- Feenstra, Robert and Taylor, Alan (2014) International Economics, 3rd ed., Worth Publishers
- Pugel, T International Economics, 16th ed., McGraw-Hill Education
- Gandolfo, Giancarlo (2016) International Finance and Open Economy Macroeconomics, Springer.
- Krugman, P., Obstfeld, M. and Melitz (2018) International Economics - Theory and Policy, 11th ed., Pearson Education.
- Carlin, Wendy and Soskice, David (2015) Macroeconomics: Institutions, Instability and the Financial System
- Wickens, Michael(2012) Macroeconomic Theory. Princeton University Press.
- Sorenson, Peter B and Whitta-Jacobson, Hans Jorgen(2010) Introducing Advanced Macroeconomics: Growth and Business Cycles. McGraw Hill Education

Note: Examination scheme and mode shall be as prescribed by the Examination Branch, University of Delhi, from time to time.