

American University
SIS-627, Spring 2017
Tuesdays 5:30-8:00 PM

INTERNATIONAL FINANCE AND THE EMERGING MARKETS

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Office hours (SIS #220): Tuesdays and Wednesdays, 3:30-5:15 PM

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Course description

This course deals with the implications of financial globalization for emerging-market countries, and specifically with the issues involved in attracting direct investment and portfolio flows; the peculiarities of international capital movements such as “contagion” and “sudden stop” phenomena; the roles of credit rating agencies and the IMF in facilitating access to international lenders and investors; the dangers posed by currency and maturity mismatches; the effectiveness (or not) of controls on capital flows; and the relationship between capital flows, over-indebtedness and sovereign debt defaults.

Our readings consist of the latest empirical and policy writings on the various topics, rather than theoretical papers or classical works from earlier years, and they are drawn from a variety of authors around the globe that are doing state-of-the-art research. By the end of the course, you will have an in-depth understanding of the international financial problems that developing (and even “advanced”) countries should strive to avoid – and of the major policy implications that follow.

The learning objectives of this course, which will be tested in various ways, are the following:

- 1) Gaining familiarity with the essential vocabulary, analytical tools, theoretical concepts, practical applications, institutional features, and economic policy aspects of international finance relevant to the emerging markets.
- 2) Understanding and applying theories and models drawn from appropriate disciplines including political science, history, and economics to international affairs.
- 3) Demonstrating competency in articulating a research question and designing and executing a research project.

The expected learning outcomes are the ability to apply concepts and theories mainly from international economics and international finance to explain trends and illuminate policy issues in the global economy, particularly those of relevance to the emerging markets; and the sharpening of your presentation, analytical, and problem-solving skills, as demonstrated by your class presentations, multiple-choice examinations, and an original essay-writing project.

Course requirements and grading

I will start each class with an introductory lecture and then, starting with the third class, student will join in with their presentations of self-assigned readings. In order to reap the benefits from the course, you should plan on attending every class and on doing all of the required readings before coming to class. There is no need to purchase any books; all the required readings are posted on Blackboard.

The course requirements are (1) four student presentations of self-assigned readings, and discussion of classmates' presentations, which will count for 20% of the final grade; (2) two exams to take place as indicated on the class schedule below, which will weigh 25% each; and (3) one essay with a maximum length of 3,000 words written on one of the three topics specified at the end of this syllabus, to be uploaded to Blackboard (see "Assignment") by the date specified below, which will account for the final 30% of the final grade. The class presentations, exams and final paper must reflect your own work; they cannot be collaborative projects.

The final grade distribution will be curved to reflect the performance of the class. Top-scoring students will be assigned an "A" or "A-" letter grade; students scoring close to the mean/median will be assigned a grade in the "B+" to "B-" range; and those scoring substantially below that will get a lesser final grade.

Important Information for All Students

Standards of Academic Conduct: They are set forth in American University's Academic Integrity Code (AIC). By registering for this course, you acknowledge your awareness of the AIC, and you are obliged to become familiar with your rights and responsibilities as defined by the Code. Violations of the AIC will not be treated lightly, and disciplinary actions will be taken should violations occur. Please contact me if you have any questions about the academic violations described in the Code in general or as they relate to particular requirements for this course, and I encourage you to familiarize yourself with the AIC at www.american.edu/academics/integrity/code.cfm. Finally, please let me know if you become aware of any violations of the AIC by other students.

In the Event of an Emergency: AU will implement a plan for meeting the needs of all members of the university community. Should the university be required to close for a period of time, we are committed to ensuring that all aspects of our educational programs will be delivered to you. These may include altering and extending the duration of the traditional term schedule to complete essential instruction in the traditional format and/or use of distance instructional methods. Specific strategies will vary from class to class, depending on the format of the course and the timing of the emergency. I will communicate class-specific information to you via AU e-mail and/or Blackboard, and you are responsible for checking your AU email on a daily basis and for keeping yourself informed of any declared emergencies. Please refer to the AU Student Portal, the AU Web site www.american.edu/emergency and the AU information line at (202) 885-1100 for university-wide information.

AU provides numerous services to help students to be successful in their coursework: the Academic Support Center, the Counseling Center, Disability Support Services, the Writing Center and Writing Lab, and the Center for Diversity and Inclusion, most of which are located in the Mary Graydon Center (MGC).

Academic Support Center (x3360, MGC 243) offers study skills workshops, individual instruction, tutor referrals, Supplemental Instruction, and services for students with learning disabilities and ADHD. Writing support is available in the ASC Writing Lab or in the Writing Center. If you qualify for accommodations because of a disability, please notify me in a timely manner with a letter from the Academic Support Center or Disability Support Services so that we can make arrangements to address your needs.

Counseling Center (x3500, MGC 214) offers counseling and consultations regarding personal concerns, self-help information, and connections to off-campus mental health resources.

Disability Support Services (x3315, MGC 206) offers technical and practical support and assistance with accommodations for students with physical, medical, or psychological disabilities. If you qualify for accommodations because of a disability, please notify me in a timely manner with a letter from the Academic Support Center or Disability Support Services so that we can make arrangements to address your needs.

Writing Center (x2991, Battelle-Tompkins 228) offers free, individual coaching sessions to all AU students. In your 45-minute session, a student writing consultant can help you address assignments, understand the conventions of academic writing, and learn how to revise and edit your own work. The Center offers appointments on the hour from 11 AM to 9 PM Monday through Thursday; 11 AM to 4 PM Friday, and 3 to 6 PM on Sundays.

Center for Diversity and Inclusion (x3651, MGC 2nd fl.) is dedicated to enhancing LGBTQ, Multicultural, First Generation, and Women's experiences on campus and to advance AU's commitment to respecting and valuing diversity by serving as a resource and liaison to students, staff, and faculty on issues of equity through education, outreach, and advocacy.

Instructions for class presentations

Volunteer to make four (4) self-assigned, PowerPoint class presentations on assigned readings of your choice from among those highlighted with an asterisk in yellow (*), which should not be longer than a dozen slides and should not take more than 20 minutes to present, *and* to volunteer to make comments or ask questions on the presentations of your classmates, going through the following aspects to the extent possible:

- 1) What is original contribution that the author(s) claimed to be making?
- 2) What is the research question or hypothesis that the author(s) presented and set out to test empirically?

- 3) What is the nature or content of the model and/or the key equation(s) that the author(s) formulated? Which are the dependent and independent variables chosen for testing purposes?
- 4) What is the source and nature of the statistical data that the author(s) used for testing purposes? What are the advantages and shortcomings of these statistical series?
- 5) Which statistical technique(s) did the author(s) utilize, and what did they entail?
- 6) What is(are) the main result(s) that the author(s) obtained?
- 7) What new words, concepts or techniques did you learn? What is their meaning?
- 8) Do you feel that the author(s) made a useful or interesting contribution to knowledge, current problems or debates, or government policy choices or decisions? Please discuss.

For guidelines on the look of student PowerPoint presentations, please see the relevant PowerPoint file posted on Blackboard.

Schedule and readings

January 17: Background on financial globalization, Part 1

Required readings:

- 1) Frederic S. Mishkin, "Why We Shouldn't Turn Our Backs on Financial Globalization," IMF Staff Papers, March 2009.
- 2) William R. Cline, "Capital Market Integration," in The Evidence and Impact of Financial Globalization, ed. by Thorsten Beck et al. (London: Elsevier, 2013).
- 3) Giovanni Dell'Ariccia et al., "Reaping the Benefits of Globalization," in Macrofinancial Linkages: Trends, Crises and Policies, ed. by Christopher Crowe et al. (Washington, DC: IMF, 2010).
- 4) Dennis Reinhardt et al., "International Capital Flows and Development: Financial Openness Matters," Journal of International Economics, November 2013.

January 24: Background on financial globalization, Part 2

Required readings:

- 1) Dilek Aykut and M. Ayhan Kose, "Collateral Benefits of Financial Globalization," in The Evidence and Impact of Financial Globalization, op. cit.
- 2) Laura Alfaro et al., "Capital Flows in a Globalized World: The Role of Policies and Institutions," in Capital Controls and Capital Flows in Emerging Economies, ed. by Sebastian Edwards (Chicago: Univ. of Chicago Press, 2007).
- 3) John Bluedorn et al., "Capital Flows Are Fickle: Anytime, Anywhere," IMF Working Paper #WP/13/183, August 2013.

- 4) Gustavo Adler and Camilo E. Tovar, "Riding Global Financial Waves: The Economic Impact of Global Financial Shocks on Emerging Market Economies," in Latin America: New Challenges to Growth and Stability, ed. by Dora M. Iakova et al., (Washington DC: IMF, 2014).

January 31: Direct investment flows

Required readings:

- 1) Sebnem Kalemli-Ozcan and Carolina Villegas-Sanchez, "Role of Multinational Corporations in Financial Globalization," in The Evidence and Impact of Financial Globalization, op. cit.
- 2) Olivier Blanchard and Julien Acalin, "What Does Measured FDI Actually Measure?," Peterson Institute Policy Brief PB16-17, October 2016.
- 3) Nauro F. Campos and Yuko Kinoshita, "Structural Reforms, Financial Liberalization, and Foreign Direct Investment," IMF Staff Papers, June 2010. (*)
- 4) Torfinn Harding and Beata Javorcik, "Roll Out the Red Carpet and They Will Come: Investment Promotion and FDI Inflows," Economic Journal, December 2011. (*)
- 5) Jay Dixon and Paul A. Haslam, "Does the Quality of Investment Protection Affect FDI Flows to Developing Countries?," World Economy, August 2016. (*)

February 7: Bond and bank finance

Required readings:

- 1) Stijn Claessens and Neeltje van Horen, "Impact of Foreign Banks," The Journal of Financial Perspectives, March 2013.
- 2) Juan Carlos Gozzi et al., "Patterns of International Capital Raisings," Journal of International Economics, January 2010.
- 3) Luis Brandão-Marques et al., "Changes in the Global Investor Base and the Stability of Portfolio Flows to Emerging Markets," IMF Working Paper #WP/15/277, December 2015. (*)
- 4) Andrea F. Presbitero et al., "International Sovereign Bonds by Emerging Markets and Developing Economies: Drivers of Issuance and Spreads," IMF Working Paper #WP/15/275, December 2015. (*)
- 5) Erlend Nier et al., "Gross Private Capital Flows to Emerging Markets: Can the Global Financial Cycle be Tamed?," IMF Working Paper #WP/14/196, October 2014. (*)

February 14: Contagion effects

Required readings:

- 1) Matthew Pritsker, "Definitions and Types of Financial Contagion," in The Evidence and Impact of Financial Globalization, op. cit.
- 2) Gaston Gelos, "International Mutual Funds, Capital Flow Volatility, and Contagion," in The Evidence and Impact of Financial Globalization, op. cit.
- 3) Kristin J. Forbes, "The 'Big C': Identifying and Mitigating Contagion," in The Changing Policy Landscape, Federal Reserve Bank of Kansas City, 2013. (*)
- 4) Eliza Wua et al., "The Anatomy of Sovereign Risk Contagion," Journal of International Money and Finance, December 2016. (*)

February 21: Sudden stops

Required readings:

- 1) Alejandro Izquierdo, "Sudden Stops in Capital Flows," in The Evidence and Impact of Financial Globalization, op. cit.
- 2) Kristin J. Forbes and Francis E. Warnock, "Capital Flow Waves: Surges, Stops, Flights and Retrenchment," Journal of International Economics, November 2012. (*)
- 3) Barry Eichengreen and Poonam Gupta, "Managing Sudden Stops," draft, October 2016. (*)
- 4) Fernando Eguren Martin, "Exchange Rate Regimes and Current Account Adjustment: An Empirical Investigation," Journal of International Money and Finance, July 2016. (*)

February 28: Role of credit rating agencies

Required readings:

- 1) Fitch Ratings, "Sovereign Rating Criteria," July 2016.
- 2) Gaston Gelos et al., "Sovereign Borrowing by Developing Countries: What Determines Market Access?" Journal of International Economics, March 2011. (*)
- 3) Makram El-Shagi and Gregor von Schweinitz, "The Joint Dynamics of Sovereign Ratings and Government Bond Yields," Bundesbank Discussion Paper No 13/2016, June 2016. (*)
- 4) Marlene Amstad and Frank Packer, "Sovereign Ratings of Advanced and Emerging Economies After the Crisis," BIS Quarterly Review, December 2015. (*)

March 7: Mid-Term Exam: Multiple-choice questions

March 14: No class meeting: Spring Break

March 21: Role of the IMF

Required readings:

- 1) Shang-Jin Wei et al., “Does the Global Fireman Inadvertently Add Fuel to the Fire?”, Journal of International Money and Finance, June 2010. (*)
- 2) Koen van der Veer and Eelke de Jong, “IMF-Supported Programs: Stimulating Capital to Non-Defaulting Countries,” World Economy, April 2013. (*)
- 3) Mehmet C. Arabaci and Sencer Ecer, “The International Monetary Fund (IMF) and the Catalytic Effect: Do IMF Agreements Improve Access of Emerging Economies to International Financial Markets?,” World Economy, November 2014. (*)
- 4) Aitor Erce and Daniel Riera-Crichton, “Catalytic IMF? A Gross Flows Approach,” Federal Reserve Bank of Dallas Globalization and Monetary Policy Institute Working Paper #254, December 2015. (*)

March 28: Mismatches

Required reading:

- 1) Christoph Rosenberg et al., “Debt-Related Vulnerabilities and Financial Crises,” IMF Occasional Papers #240, 2005, Chapters I and II.
- 2) Morris Goldstein and Philip Turner, Controlling Currency Mismatches in Emerging Markets (Washington, DC: IIE, 2004), Chapters 1, 2 and 9.
- 3) Moody’s Investors Services, “Dramatic Growth in Local Currency Sovereign Debt Is Reducing Emerging Market Financial Vulnerabilities,” September 2015.
- 4) Nikola Tarashev et al., “International Capital Flows and Financial Vulnerabilities in Emerging Market Economies: Analysis and Data Gaps,” Bank for International Settlements, August 2016.
- 5) Salvatore Dell’Erba et al, “Debt Levels, Debt Composition, and Sovereign Spreads in Emerging and Advanced Economies,” Oxford Review of Economic Policy, Autumn 2013. (*)

April 4: Indebtedness and overindebtedness

Required readings:

- 1) Arturo C. Porzecanski, “Borrowing and Debt: How Do Sovereigns Get into Trouble?”, in Sovereign Debt Management, ed. by Rosa Lastra and Lee Buchheit (New York: Oxford Univ. Press, 2014).
- 2) Inter-American Development Bank, Living With Debt (Washington, DC: IADB, 2006), Chapter 3 (“How Does Debt Grow?”).

- 3) Carmen M. Reinhart, Kenneth S. Rogoff and Miguel A. Savastano, "Debt Intolerance," Brookings Papers on Economic Activity, Spring 2003. (*)
- 4) Luis A.V. Catão and Gian Maria Milesi-Ferretti, "External Liabilities and Crises," Journal of International Economics, September 2014. (*)

April 11: Sovereign defaults

Required reading:

- 1) Ugo Panizza et al., "International Government Debt," in The Evidence and Impact of Financial Globalization, op. cit.
- 2) Udaibir S. Das et al., "Restructuring Sovereign Debt: Lessons from Recent History," in Financial Crises: Causes, Consequences and Policy Responses, ed. by Stijn Claessens et al. (Washington DC, IMF: 2014). (*)
- 3) Christoph Trebesch and Michael Zabel, "The Output Costs of Hard and Soft Sovereign Default," European Economic Review, forthcoming in 2017. (*)
- 4) Arturo C. Porzecanski, "When Bad Things Happen to Good Sovereign Debt Contracts: The Case of Ecuador," Law & Contemporary Problems, Fall 2010.

April 18: Managing capital inflows

Required reading:

- 1) Roberto Cardarelli et al., "Capital Inflows: Macroeconomic Implications and Policy Responses," Economic Systems, December 2010.
- 2) Atish R. Ghosh et al., "When Do Capital Inflow Surges End in Tears?," American Economic Review, May 2016. (*)
- 3) Julián A. Caballero, "Do Surges in International Capital Inflows Influence the Likelihood of Banking Crises?," Economic Journal, March 2016. (*)
- 4) Nicolas E. Magud et al., "Capital Inflows, Exchange Rate Flexibility, and Credit Booms," Review of Development Economics, August 2014. (*)
- 5) Kristin Forbes et al., "Capital-Flow Management Measures: What Are They Good For?," Journal of International Economics, July 2015. (*)

April 25: Capital controls; Essay due by 5:30 PM uploaded via Blackboard

Required readings:

- 1) Mahir Binici et al., "Controlling Capital? Legal Restrictions and the Asset Composition of Financial Flows," Journal of International Money and Finance, June 2010.
- 2) Chikako Baba and Annamaria Kokenyne, "Effectiveness of Capital Controls in Selected Emerging Markets in the 2000s," IMF Working Paper #11/281, December 2011.
- 3) Bernardo S. de M. Carvalho and Márcio G.P. Garcia, "Ineffective Controls on Capital Inflows under Sophisticated Financial Markets: Brazil in the Nineties,"

- in Financial Markets Volatility and Performance in Emerging Markets, ed. by Sebastian Edwards and Márcio G.P. Garcia (Chicago: Univ. of Chicago Press, 2008).
- 4) Michael W. Klein, "Capital Controls: Gates versus Walls," Brookings Papers on Economic Activity, Fall 2012. (*)

May 9: Final Exam: Multiple-choice questions on material covered since Spring Break

Instructions for the essay assignment

Choose one of the three topics detailed below for your paper with a length of 3,000 words, which must demonstrate the application of concepts learned in class and *should make use* of articles from this syllabus plus at least 12 scholarly, academic or official sources that you have found on your own. You may cite relevant articles or other materials from newspapers, magazines, NGO websites and respectable blogs – but they do not count toward the aforementioned minimum.

Any and all footnotes, bibliography, tables or charts you come up with are excluded from the 2,000/3,000-word limits. Any articles or books you rely upon should be identified in brief via an in-line citation, as follows:

The recent history of debt defaults during the 1990s has provided some important lessons (Sturzenegger and Zettelmeyer, 2006).

The complete citations should be included in a bibliography at the end, where they are to be listed in alphabetical order by the last name of the author, followed by the year, title, publisher, month/day, and URL, if available. For example:

Sturzenegger, Federico and Jeromin Zettelmeyer (2006), Debt Defaults and Lessons from a Decade of Crises (Cambridge, MA: MIT Press).

Takáts, Előd (2010), "Cross-Border Bank Lending to Emerging Market Economies," in BIS Papers No. 54, December, 11-29, <http://www.bis.org/publ/bppdf/bispap54a.pdf>.

You must work on this essay all by yourself. All facts, opinions, quotations, and paraphrasing of material that are not your own must be credited to the original source, by way of an in-line citation to a source appearing in your bibliography *and to a specific page number*, in order to avoid even the appearance of plagiarism. For example:

As is well known, lending terms deteriorated substantially for all emerging-market banks during the crisis of 2008-09 (Takáts 2010, 22).

Footnotes should be used when you wish to expand on a point made in the text, and they should be numbered consecutively. For example:

¹² Lending terms deteriorated substantially for all emerging-market governments during the late 1990s (Takáts 2010, 22).

Please observe the following conventions:

(a) use Word software and activate its language (English U.S.) and spell-check features;

(b) specify single-line spacing;

(c) insert page numbering;

(d) pick a file name that consists of “[Last name] [First name] Essay.docx,” (e.g., Morris Ben Essay.docx);

(e) use the standard memo format of “To/From/Date/Subject”;

(f) make sure that your spelling, vocabulary, grammar, and punctuation are the best that they can be; and

(g) upload to Blackboard by the due date/time. Late and/or sloppy submissions will be penalized.

Essays which do not observe these conventions will be penalized.

Choice of Essay Topics:

1. Your boss, the newly appointed Minister of Finance, suggests that since funding is so plentiful and interest rates are so low in the international capital markets relative to conditions prevailing in the domestic financial market, this may be a great time to finance the 2018-19 budget deficits externally rather than domestically. Write her a memorandum explaining why “not all that shines is gold,” and how to go about funding the deficits abroad, if at all, in a way that adequately balances risks and opportunities.
2. Your boss, the new Economic Advisor to the President, has been charged with coming up with, and coordinating the implementation of, a plan of economic and other reforms to make the economy less vulnerable to “contagion effects” and the fallout from a “sudden stop” such as the country endured during late 2008-early 2009. Write him a memorandum detailing and justifying which structural and policy reforms should receive top government priority during the 2018-19 period.
3. Your boss, the President of the Central Bank, is leaning in favor of liberalizing the country’s regulatory and tax framework governing capital inflows starting in 2019, but is unsure whether to favor foreign direct investors relative to foreign portfolio investors and creditors – or whether to put out the welcome mat to any and all. Write her a memorandum arguing *against* a discriminatory, paternalistic approach to capital-account liberalization, and explaining how best to position the economy, and adjust the relevant macroeconomic policies and prudential regulations, for the inflows that may start to come.