

Syllabus
ITRN 503
Investment and Macroeconomics for International Commerce
Spring 2003

Thursday 4.30pm – 7.10 pm
Arlington Room 251

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Contacts:

Office Hours: By appointment (BUT I am normally available at Arlington between 4.00 and 4.30 on Thursday if there is something urgent. I am always ready to help with anything by telephone or e-mail.)

PLEASE inform me at once of any change in your GMU e-mail address since I will use that extensively for communications.

Course Goals: The objective of the course is to provide a basic foundation allowing students to gain an understanding of the macroeconomic aspects of world commerce. This commerce is influenced by the financial decisions of businesses and the fiscal, monetary and trade policies of governments. It is also important for a full appreciation of international commerce and policy that the interactions between government and business are understood. The objective is not to be doctrinaire in terms of the macroeconomic theory covered but to indicate to students the various theories and approaches that have evolved.

Course Content: A part of the course is concerned with straightforward macroeconomic theory and how this is important for an understanding how international trade has developed and how government economic policy can influence it. The course also provides considerable background material, in the form of case studies, that highlight the relevance of macroeconomics in the appreciation of how national economies have performed in the twentieth century both in their own right and in relation to their trading activities. Trade in this context embraces all types of economic activity including foreign investment and the service sector. The case study approach also forces students to become familiar with the standard sets of economic statistics used in trade policy assessment and to appreciate some of their limitations.

Texts: Michael Ruckstad, *Macroeconomic Decision Making in the World Economy* and various cases as enumerated below. (It HAS been ordered from the bookshop – I have seen it there – and there may be ‘used’ copies available.)

In addition to this there will be additional material given out during the semester.

It would also be useful to have a standard text that covers basic macroeconomics. I have found in the past that students find this helpful to follow up basic ideas and concepts brought up in the case studies. Further, from experience I have found that different people have different needs from these texts and to make a strong recommendation is not always helpful (each book has its own style and method of presentation). I normally suggest that students spend a little time in a library and look over the numerous options available and make their own choice. Having said that!

The popular introductory economics book (and it should be since the author got a \$1million in advanced royalties) is: G. Mankiw: *Principle of Economics* (Dryden). This would also be of use for microeconomics.

Specifically on macroeconomics there is: W. Baumol and A. Binder: *Macroeconomics* (Dryden) personally I find it has too many diagrams and the visual presentation is not very attractive, and D. Hyman: *Macroeconomics* (Irwin) which is a little more advanced.

Anyone interested in pure international economics may find the following useful:

Appleyard and Field: *International Economics* (McGrw-Hill).

Pedagogy: Instruction will be in part by the case method, which requires everyone to come to each class fully prepared to discuss the issues raised by the assigned reading material. The quality of learning depends in large measure on everyone's preparation for and participation in the case discussions.

Examinations: There will be one mid-term and one final examination.

Grading: Grades will depend on contributions to class discussion and short exercises (30%), on the mid-term (30%) and the final (40%) examinations.

NOTE:

Should for any reason a session be cancelled (weather, illness, etc), I build in a little slack in terms of the substance for each component. If there are no cancellations then I will add a little more material into the latter component – advanced notice will be given.

OUTLINE OF COURSE IN DETAIL

INTRODUCTION (January 23)

Introduction and administration. Outline of course, rationale, students' role, course assessment, reading material, faculty/student contact.

THEME #1 (January 30)

Cases: **An Introduction to Macroeconomics**

Reading: Refer back to any standard 101 text that is available and refresh ideas on the basis of macroeconomic and trade theory.

Introduction to macroeconomics. This is particularly designed to assist those with no prior background in economics or with only a very basic grounding. Defining macro, meso and micro economics. Identifying common schools of thought in macroeconomics. The links between the domestic and the international economy. Circular flow of income concepts. Basic revision and simple extensions to Economics 101. Useful basic microeconomics to understand the macro economy. The key figures in macroeconomic thought. Definitions. It runs over some of the very basic concepts in both macro and microeconomics that are required to fully understand the macroeconomics. These include such things as supply and demand, elasticities, rational behavior, and so on.

Questions:

1. How is consumption determined in a Keynesian framework?
2. In what general ways can government intervene in the economy?
3. What are the benefits of trade?

THEME #2 (February 6)

Cases: **An Introduction to Macroeconomics** **How to Read Data Exhibits**

This component also looks at the types of data available to analyze macroeconomic problems. It considers the problems involved in the data. It looks at leading indicators and aggregate measures of key parameters. It looks at key macro economic linkages in a Keynesian framework. Basically it is concerned with the tool kit of macroeconomics.

Questions:

1. Is it possible to aggregate individuals' demand curves?
2. What is the difference between optimum and equilibrium?
3. What are the problems of developing National Income Accounts?

4. What is the circular flow of income?

THEME #3 (February 13)

Cases: **Money and the Determination of Income** **The U.S. Financial Crisis of 1931**

These materials introduce the underlying economic concepts of the money creation process, the banking system, and how the money supply affects aggregate demand. We also explore the monetary policies, tools and role of the Federal Reserve System during the early years of the Great Depression. There will also be some discussion on how monetary controls differ now as compared to that period.

Questions:

1. What is money?
2. How is money created?
3. Evaluate the goals of the Federal Reserve in the 1920s and in the 1930s.
4. How did the money supply change between 1929 and 1933 and why? Did the Fed's action create the Depression?
5. What actions might you yourself have taken as a member of the Fed? When? Why?

THEME #4 (February 20)

Cases: **A Keynesian Cure for Depression** **Data on U.S. Economy (through 1941)**

This session focuses on Keynesian macroeconomic concepts that will be useful in the rest of the course. "The Means to Prosperity," an article written in 1933 by John Maynard Keynes, lays out the fundamentals of the Keynesian prescription for meeting the problems of the Great Depression. The article was a prelude to Keynes's masterwork, The General Theory of Employment, Interest and Money, which was published three years later and which established Keynes as the most influential western economist of the mid-twentieth century. Because of the power of Keynesian ideas on a generation of economists and policy makers (especially in the U.S. and the U.K.), this statement of his analysis has an importance beyond the context of its composition in 1933.

Questions:

1. Evaluate the Keynesian diagnosis. What were Keynes's assumptions about the nature of unemployment, the relation between savings and investment, and the role of government?
2. How might Roosevelt go about implementing a full-scale Keynesian program? How much, roughly, would such a program cost?

Cases: **The Tax Cut of 1964**

Data on U.S. Economy (through 1970s)

In this session we examine the intellectual, political, and economic underpinnings of the landmark tax legislation begun by John F. Kennedy and carried through Congress by his successor, Lyndon B. Johnson. Our aim is to examine the economic thinking that grew out of the Depression experience and reached its climax in the 1964 legislation.

Questions:

1. What are the assumptions of Kennedy, Heller, Keyserling, and other players regarding the proposed acts in individual and corporate income taxes?
2. How well did Kennedy manage the political process required for passing his proposal?
3. Evaluate the tax cut package actually passed in 1964. By what criteria should its success be measured? (Use the exhibits to support your conclusion.)

THEME#5 (February 27)

Cases: **The Reagan Plan**

In 1981 President Reagan is a new manager confronting a set of problems that seem more intractable than ever. This case allows for an analysis of Reagan's program and especially the assumptions that underlie particular policy measures. We also introduce concepts in supply-side economics.

Questions:

1. Evaluate the situation facing President Reagan in February 1981.
2. How was the Reagan strategy supposed to work, in theory? Does it address the causes of U.S. economic problems?
3. What assumptions--economic, social, political and international--did the President make in his speech? To what extent are they valid?

MID-TERM EXAMINATION (March 6)

SPRING BREAK (March 13)

THEME#6 (March 20)

Cases: **Kennedy and the Balance of Payments,
An Introduction to the Balance of Payments**

Our objective in this session is to introduce balance of payments analysis, an important tool in many international cases. A technical note and exercise provide analytical tools. The case setting is the Kennedy Administration's attempt to achieve satisfactory tradeoffs among the competing goals of world political and military leadership, commercial and industrial supremacy, and avoidance of balance of payments deficits.

Questions:

1. Calculate and analyze the U.S. payment balances for 1960 using the work sheet and Exhibits 1 and 2 on pp. 475-479.
2. What are Kennedy's balance of payments problems and how are they reflected in the statistics?
4. What policy options are available to Kennedy?

THEME#7(March 27)

Cases: **Nixon's New Economic Policy: 1971
Data on U.S. Economy (through 1970s)**

This is the first of two sessions covering the U.S. economic situation and strategy from 1969 to 1978. Richard Nixon has become President and must assess the situation he inherited. His diagnosis is that inflation is the principal problem. Do the exhibits confirm this diagnosis? If so, what are the causes and consequences of this inflation? Why are some of his advisers confused? What are Nixon's options in the Spring 1971?

Here we see Richard Nixon's hand forced, as he simultaneously takes action on the foreign and domestic economic fronts. August 15, 1971 marks the end of the dollar's convertibility to gold and to growth without inflation.

Questions:

1. Evaluate the economic situation Nixon confronted upon taking office in 1969. How effective were the policies implemented at that time?
2. What is stagflation? What accounts for it?
3. Evaluate Nixon's August 15th actions. Are they appropriate?

THEME#8 (April 3)

Cases: The Decline of the Dollar: 1978
Exchange Rate Determination

In this session we examine factors that affect the exchange rate for a nation's currency; important economic concepts will be introduced that will be useful in the rest of the course. What, in fact, determines the value of one currency against another? What is the meaning of a "strong" or "weak" currency? What should a major industrial power such as the United States strive for? All these questions confront the American government in 1978, as it tries to decide whether to "strengthen" the dollar by more active intervention.

Questions:

1. What were the primary forces accounting for the decline of the dollar during 1977 and 1978? How flexible was the exchange rate system during this period?
2. Why did the Carter administration face an "inescapable dilemma" between a strong dollar and a "robust economy," while Germany and Japan had both a strong economy and a strong currency?
3. As an adviser to the Carter administration, be prepared to evaluate the strengths and weaknesses of the options available to the President for dealing with decline of the dollar in late October of 1978.

THEME#9 (April 10)

Case: Europe 1992

The case looks at the efforts in the early 1990s within the European union to remove the barriers to trade that still remained. The EU had until that time been slow to harmonize national policies and relatively high barriers still existed to trade within the Union. The session looks at some of the problems of trying to integrate the economies of the EU and at some of the successes and failures. It goes on to consider the issue of the importance of having some form of common currency structure within an economic union.

Questions:

1. What were the objectives of the 1992 Single Market initiative?
2. What were the main impediments to free trade in the EU prior to 1992?
3. How do the main policy making institutions of the EU differ from those of the US?

Case: The Single European Currency.

(Note additional material will be provided on this prior to the class)

This looks at the rationale behind and actions taken to allow for the introduction of the Euro. It looks at issues of the advantages and problems of a single currency and the conditions required for its introduction. It considers matters as optimal currency areas.

Questions.

1. Is the Single European Currency an economic or a political measure/
2. What are the problems of having a single currency?
3. How does the existence of a Single Currency for the EU affect non-member countries?
4. What is the role of the central bank when there is a Single Currency?

THEME#10 (April 17)

Case: Mexico: Crisis of Confidence

The economic performance of Mexico led in the to it becoming a member of the OECD in the mid-1990s but prior to that (and also after!) it went through a number of economic crisis. In particular in the early 1980s it, like many other developing countries, found itself in difficulties regarding debt liabilities. It had enjoyed a period of growth due to petroleum exports. The subsequent problems were in part due to the links the economy had to larger international markets.

Questions:

1. What were the underlying weaknesses of the Mexican economy in 1981?
2. What actions should an agency take in the circumstances of 1991?
3. What options were open to the new government of Mexico at the end of 1981?

THEME#11 (April 24)

Case: Privatization in the United Kingdom

Deregulation of US Domestic Air Transportation (To be handed out separately)

The session will initially look at the link between microeconomic issues of public ownership and the use of privatization as a macroeconomic policy instrument. The situation in the UK represented a dramatic shift in the way in which public ownership was viewed that went well beyond the boundaries of that country. It will also consider the implications of excessive regulation of the private sector on the performance of the larger economy, taking US domestic airline deregulation as an example.

Questions:

1. Why should industries be owned by the state?
2. What are the macroeconomic gains from privatization in the short term and in the longer term?

3. What sort of regulation should accompany privatization?
4. What were the implications of deregulating US domestic air transportation on the US economy?

THEME#11 (May 1)

The state of the US macro economy and the global economy. This class will be concerned with looking at how the US economy is performing at the end of the twentieth century and into the twenty-first. Material, mainly data and other economic indicators will be handed out to students the week prior to this class.

Questions:

1. Did the end of the twentieth century see the end of a pre-longed period economic growth?
2. What sort of structure does the US economy require to continue its growth over the next decade?
3. What should be the policy of the Federal Reserve over the next year or so?
4. How important will international trade be to the US economy in the future?
5. Can the US continue to be the World's leading economic power?
6. How should the US handle the expansion of economies such as China's?

FINAL EXAMINATION (May 8)