



INSTEP-WFU Cambridge

INTERNATIONAL ECONOMIC ISSUES

Prerequisites: *Introductory Micro and Macroeconomics with a g.p.a of 3.2 or higher in a relevant major.*

This course aims to provide students with the opportunity to explore a number of topical issues and current debates in the international economy. Since the onset of the global financial crisis many of these issues have moved centre stage in discussions of national and global macro-economic policy. The course is not a text-book course but rather aims to show students how basic economic analysis can be used to address and analyse important issues in macroeconomic policy. For each topic the course material is structured to acquaint students with the relevant economic theory, empirical evidence and implications for government policy. Knowledge of basic macro and micro-economics is advantageous for those taking this course. Detailed reading will be given prior to the sessions.

Sessions

1 & 2. WHY DO MACROECONOMISTS NEVER AGREE? A METHODOLOGICAL INQUIRY

This session outlines why macroeconomists often disagree with each other from methodological perspective This has become increasingly important since the failure of mainstream macroeconomics to explain the subprime crisis. Drawing on Thomas Kuhn's concept of the paradigm, it provides the conceptual framework in which post-war macroeconomic theoretical and policy debates may be analysed.

- Akerlof, G.A. and Shiller, R.J. (2009) *Animal Spirits*, Princeton: Princeton University Press (Part One Animal Spirits, chapter 6, "Why Do Economies Fall into Depression")
- Buchholz, T.G. (1989), *New Ideas from Dead Economists*, Penguin Press (Chapters, IX Keynes. "Bon Vivant as Savior", XII "The Wild World of Rational Expectations").
- Bird, A. "Thomas Kuhn", *The Stanford Encyclopaedia of Philosophy* (Fall 2013 Edition), Edward N. Zalta (ed.), URL = <<http://plato.stanford.edu/archives/fall2013/entries/thomas-kuhn/>>.
- McCombie, J.S.L. (2000), "Reflections on Economic Paradigms and Controversies in Economics, *Zargreb International Review of Economic & Business*, vol. 4(1), pp.1-25. (Mimeo)
- McCombie, J.S.L. (2012) "The End of the Consensus in Macroeconomic Theory? A Methodological Inquiry." Cambridge Centre for Economic and Public Policy, WP01-12
- Krugman, P. (2009) "How Did Economists Get it So Wrong?" *New York Times*, September 2, http://www.nytimes.com/2009/09/06/magazine/06Economic-t.html?pagewanted=all&_r=0
- Cochrane, J. (2009), "How did Paul Krugman Get it so Wrong?" <http://modeledbehavior.com/2009/09/11/john-cochrane-responds-to-paul-krugman-full-text/>

3 & 4. INTERNATIONAL ASPECTS OF THE SUBPRIME CRISIS.

The world entered into its severest recession in 2008 since the Great Depression. The banking system teetered on the edge of total collapse. The initial cause was the issue of subprime mortgages in the United States. How and why did this all come about and why did few economists or policy makers foresee the crisis? Why did many policy makers find the prevailing macroeconomics paradigm of little or no use for implementing policy to counter the crisis? How was the crisis transmitted to other countries?

(a) *What are Subprime mortgages and why did they become so toxic?*

- Buckley A., (2011) *Financial Crisis*, Financial Times, Prentice Hall (The best single introduction to the crisis and its policy implications)
- Ferguson, C. (2012) *Inside Job: The Financiers Who Pulled Off the Heist of the Century*, London: Oneworld Publications.
- "Subprime mortgage crisis" https://en.wikipedia.org/wiki/Subprime_mortgage_crisis
- Gottesman A.E., (2008), "Credit Crisis 101", *World Economics*.
- Coffee, J.C. (2009), "What Went Wrong? An Initial Inquiry into the Causes of the 2008 Financial Crisis", *Journal of Corporate Law*.
- Coval, J et al (2009), "The Economics of Structured Finance", *Journal of Economic Perspectives*, vol.23, pp.3-25.

(b) *The Debate over Fiscal Policy: Reinhart and Rogoff's (2010) "Growth in a Time of Debt": "Stylized Fact or Fiction"?*

This lecture continues to examine why economists disagree over the fundamentals of their subject. It starts with an examination of the case for and against fiscal stimulus and whether "fiscal consolidation" is of immediate concern. It then examines the debate started by the influential paper by Reinhart and Rogoff (2010) and the errors it contained which hit the headlines in the press and television the world over. It is shown that the controversy goes deeper than just the Excel errors in their paper.

- Blyth, M. (2013) *Austerity. A History of a Dangerous Idea*. Oxford: Oxford University Press.
- Gravelle, J.G. and Hungerford, T.L. (2013), "Can Contractionary Fiscal Policy be Expansionary? *Congressional Research Service*.
- **Reinhart C.M. and Rogoff, K. S. (2010), "Growth in a Time of Debt", *American Economic Review, Papers & Proceedings*, vol 100, 573-578.
- **Herndon, T., Ash, M and Pollin, R. (2013), "Does High Public Debt Consistently Stifle Economic Growth? A Critique of Reinhart and Rogoff." Political Economy Research Institute, University of Massachusetts Amherst, Working Paper, no. 322.
- **Irons, J and Bivens, J. (2010), "Government Debt and Economic Growth. Overreaching Claims of Debt 'Threshold' Suffer from Theoretical and Empirical Flaws. EPI Briefing Paper no. 271.
- Reinhart and Rogoff (2010) "Growth in a Time of Debt": Criticisms from the Op-eds and the Blogs, (pdf)

(c) *Should the subprime crisis have been anticipated? Three case studies.*

(i) **The Savings and Loans Crisis**

- Savings and loan crisis" https://en.wikipedia.org/wiki/Savings_and_loan_crisis

(ii) *The Enron Bankruptcy*

- Healy, Paul M., and Krishna G. Palepu. "The fall of Enron." *Journal of Economic Perspectives* (2003): 3-26

(iii) The Collapse of Long-Term Capital Management

- Allington, NFB, JSL McCombie, and M Pike. "Lessons not learned: from the collapse of Long-Term Capital Management to the subprime crisis." *Journal of Post Keynesian Economics* 34.4 (2012): 555-582.

5 & 6. IS ECONOMIC GROWTH PASSÉ? ON THE ECONOMICS OF HAPPINESS AND ITS INTERNATIONAL ASPECTS.

It is commonly assumed by many politicians that greater economic growth brings greater prosperity and welfare. But does increased growth actually bring greater happiness? For example, are you happier now than your parents were at your time of life? How do we determine whether some countries are better off than others if GDP per head is not a good measure?

(i) Is GDP per Head a Good Measure of Welfare?

* Stiglitz, J.E., Sen, A., Fitoussi, J-P (2010), *Mismeasuring Our Lives: Why GDP Doesn't Add Up*. New Press. (Downloadable: www.stiglitz-sen-fitoussi.fr/documents/rapport_anglais.pdf)

- Nordhaus, W. and Tobin, J. "Is Growth Obsolete?" Reprinted from Milton Moss (ed.), *The Measurement of Economic and Social Performance, Studies in Income and Wealth*, Vol. 38, NBER, 1973 <http://cowles.econ.yale.edu/P/cp/p03b/p0398a.pdf>

(ii) The Economics of Happiness

- Johns, H. and Ormerod, P. (2007) *Happiness, Economics and Public Policy*, IEA. (<http://www.iea.org.uk/files/upld-book416pdf?pdf>)
- Graham, C. "The Economics of Happiness" in the *New Palgrave Dictionary of Economics*, Durlauf, S. and Blume, L. (eds) (www.brookings.edu/views/papers/graham/2005graham_dict.pdf)
- Oswald, A.J. (1997), "Happiness and Economic Performance", *Economic Journal*.
- Blanchflower, D.G, and Oswald, A.J. (2004), "Money , Sex and Happiness: An Empirical Study", *Scandinavian Journal of Economics*, vol 106, pp. 393-415.

7 & 8. SHOULD WE WORRY ABOUT INCOME INEQUALITY?

The issue of costs of inequality has become a hotly debated in academic circles in recent years and Piketty's book, *Capital in the Twenty-first Century* became a best seller. This session looks at the issue of the degree of income inequality in the advanced countries and whether it should be a cause for concern.

- McCombie, J.S.L. and Spreafico, M.R.M. (2015) "Income Inequality: Does it Matter?" University of Cambridge, (mimeo) and references therein.
- Milanovic, Branko. 2014. "The Return of "Patrimonial Capitalism": A Review of Thomas Piketty's *Capital in the Twenty-First Century*." *Journal of Economic Literature*, 52(2): 519-34.
- * Stiglitz J.E. (2012), "Macroeconomic Fluctuations, Inequality, and Human Development, *Journal of Human Development and Capabilities*. 13(1). Pp. 31-58.

- Distributive Justice (notes)

9. RATIONAL EXPECTATIONS VERSUS BEHAVIOURAL ECONOMICS AND THE POLICY IMPLICATIONS

The standard axioms of mainstream economics assume complete rationality of an agent's behaviour and is usually couched in terms of utility maximisation. While it is appreciated that agents may not in practice behave like this, it is argued that essential insights into the functioning of the macroeconomy may be had if it assumed that they do. Behavioural economics challenges this view and shows that the way people actually make decisions is a far cry from the *a priorism* of orthodox economics. This session provides a brief introduction to these ideas and the "Nudge" policy implications.

- **Thaler, Richard H. *Misbehaving: The Making of Behavioral Economics*. WW Norton & Company, 2015.
- Richard H. Thaler, Cass R. Sunstein, (2012) *Nudge: Improving Decisions about Health, Wealth, and Happiness*." Penguin. Kahneman, Daniel. *Thinking, Fast and Slow*. Macmillan, 2011.
- Barberis, Nicholas C. (2013) "Thirty Years of Prospect Theory in Economics: A Review and Assessment." *Journal of Economic Perspectives*.
- Kahneman, Daniel. (2003) "A Psychological Perspective on Economics." *The American Economic Review* 93.2 pp,162-168.
- Buchholtz, Todd. (1999) "New Ideas from Dead Economists." New York: Plume.

10. THE ECONOMICS OF BREXIT

This session looks at the economics of Brexit. Why did was the referendum vote for Brexit. What are the likely economic consequences?

11. A SUMMARY OF THE COURSE.

Essays

The assessment will be by five essays of 1,500 words (one every two weeks). Essays may be hand written or typed and may be submitted by email (jslm2@cam.ac.uk) by the designated time and date. Readings for each week are from The Marshall Library in the Faculty of Economics and Politics but most are one-line or available on the USB stick.

The essays are not long but you should:

- • Make sure they are well structured. Each new paragraph should make a particular point. You can use subheadings, although as the essay is short, this is not a requirement.
- • Show evidence of reading beyond the lectures.
- • Explicitly cite your sources in a reference at the end of the essay.
- • Look at every argument. Have you justified it either theoretically or empirically? Avoid assertions without supporting evidence.
- • Google for recent articles and use Wikipedia (with caution).