

Course Structure and Standard Syllabus

Course Topic: Monetary, Exchange Rate and Capital Account Policies

Course Title: Managing Capital Flows: Macroeconomic Analysis and Policies (MCF)

Objectives

This two-week course is devoted to fostering the understanding of the dynamics of capital flows and their effects on growth, macroeconomic volatility, and crisis risk. The course discusses the policy options available to reap the benefits of capital market integration while minimizing and mitigating its adverse consequences.

Through studies of actual crises, participants will learn how policy settings and failures in recognizing and addressing the buildup of vulnerabilities lead to crisis. They will also study what policies different countries put in place to stabilize the economy and how the economy evolved and recovered.

Topics to be covered include the benefits and costs of financial integration; the capital inflow problem; and models of currency crises and sudden stops of capital inflows.

Workshops and case studies are important components of the course. They allow the participants to grasp better the concepts and to take advantage of the experience of the instructors.

Learning objectives

- Participants will have a better understanding of the dynamics of capital flows. They will grasp the most important topics regarding the capital account, its liberalization, and its management.
- Participants will learn the policy options available to reap the benefits of capital market integration, while mitigating its adverse consequences.
- Participants will learn the main causes of capital account crises, how they evolve, their economic costs and what challenges a country faces to stabilize the economy.
- Participants will learn what policy options are available to policymakers to reduce the risk of a financial crisis, and how to best respond to a financial crisis – macroeconomic policies, macro and micro prudential policies and capital flow measures. They will also have a good understanding of the IMF's Institutional View.

Target Audience:

This course is intended for junior to mid-level policymakers in central banks and finance ministries who have policy responsibilities related to capital account management, macro-

prudential and micro-prudential policies, or macroeconomic policymaking. No prior specific knowledge of the material is assumed.

Core Units

0. Introductory Lecture
1. Balance of Payments: A refresher
2. Measuring Financial Integration
3. Long run Determinants of Capital Flows
4. Macroeconomic Volatility and Capital Flows
5. Capital Account Liberalization: Financial Reforms, Crises and Growth
6. Tracking, Interpreting, and Forecasting Capital Flows
7. Financial Crises: Why, When and How?
8. Dealing with Capital Flows

Prerequisites

Participants should have an advanced degree in economics or equivalent experience, good quantitative skills, and a good knowledge of Excel.

Performance Evaluation

Two multiple-choice quizzes will be given. One quiz will be given at the beginning and the other one at the end of the course.

EXTERNAL CURRICULUM REVIEW PROGRAM OUTLINE FOR MCF

UNIT 1: BALANCE OF PAYMENTS:

Outline of Lecture (1.5 hours)

- The balance of payments and its components
- Alternative representations of the balance of payments: standard vs analytical
- The link between the balance of payments and the national accounts
- The NIP and the balance of payments Principles of modern monetary policy

Workshop on Balance of Payments (1.5 hours)

Readings:

IMF, 2009, "Balance of Payments and International Investment Position Manual".

UNIT 2: MEASURING FINANCIAL INTEGRATION

Outline of Lecture (3 hours)

- Barriers to international capital flows
- A de facto measure of financial integration
- A de jure measure of financial integration
- Measuring financial liberalization using prices

- Global trends of international capital financial markets
- The structure of external balance sheets of countries; financial risk
- The exorbitant privilege
- Global imbalances

Workshop

No workshop

Readings:

Chinn, Menzie D. and Hiro Ito (2006). "What Matters for Financial Development? Capital Controls, Institutions, and Interactions," *Journal of Development Economics*, Volume 81, Issue 1, Pages 163-192 (October).

International Monetary Fund (2010, various years). *Annual Report on Exchange Arrangements and Exchange Restrictions (AREAER)*, Washington, D.C., International Monetary Fund.

Philip R. Lane and Gian Maria Milesi-Ferretti (2007), "The external wealth of nations mark II: Revised and extended estimates of foreign assets and liabilities, 1970–2004", *Journal of International Economics* 73, November, 223-250.

Guonan Ma and Robert Neil McCauley, 2013, *Is China or India more financially open?* BIS, Working Papers No 410

UNIT 3: LONG-RUN DETERMINANTS OF CAPITAL FLOWS

Outline of Lecture (1.5 hours)

- Review the predictions of the basic Neo-Classical Model
- Welfare gains from financial opening: theory and empirical quantification
- Introduce the standard puzzles regarding the direction of capital flows and the link between net inflows and growth
- Discuss the existing empirical explanation for the standard puzzles

Workshop

No workshop

Readings:

Barro, Robert J & Mankiw, N Gregory & Sala-i-Martin, Xavier, 1995. "Capital Mobility in Neoclassical Models of Growth," American Economic Review, American Economic Association, vol. 85(1), pages 103-15

Pierre-Olivier Gourinchas & Olivier Jeanne, 2006. "The Elusive Gains from International Financial Integration," Review of Economic Studies, Oxford University Press, vol. 73(3), pages 715-741.

Lucas, Robert (1990). "Why doesn't Capital Flow from Rich to Poor Countries?". American Economic Review 80 (2): 92–96

Pierre-Olivier Gourinchas & Olivier Jeanne, 2013. "Capital Flows to Developing Countries: The Allocation Puzzle," Review of Economic Studies, Oxford University Press, vol. 80(4), pages 1484-1515.

UNIT 4: MACROECONOMIC VOLATILITY AND CAPITAL FLOWS

Outline of Lecture (3 hours)

- Push and Pull factors of capital flows
- The link between capital flows and economic activity over the business cycle
- Tools to identify credit booms
- Examine whether the composition of capital flows matters

Workshops (two workshops each of 1.5 hours, 3 hours in total)

References:

UNIT 5: CAPITAL ACCOUNT LIBERALIZATION: FINANCIAL REFORMS, CRISIS AND GROWTH

Outline of Lecture (3 hours)

- Dual effects of capital account liberalization: growth vs. crisis
- Empirical evidence on the growth and financial stability effects of capital account liberalization
- Welfare economics of liberalization
- Sequencing of reforms
- IMF institutional view
- Caveats and open questions about the sequencing approach

References:

Bonfiglioli, Alessandra, Financial Integration, Productivity and Capital Accumulation, *Journal of International Economics* 76, 337-355 (December 2008)
<http://dx.doi.org/10.1016/j.jinteco.2008.08.001>

Kalantzis Y., "Financial fragility in small open economies: firm balance sheets and the sectoral structure" (forthcoming)," *Review of Economic Studies* (forthcoming),
<http://www.kalantzis.fr/papers/lnm.pdf>

UNIT 6: TRACKING, INTERPRETING, AND FORECASTING CAPITAL FLOWS

Lecture (1.5 hours)**Workshop (1.5 hours)****References:**

Koepke Robin, 2015, What Drives Capital Flows to Emerging Markets? A Survey of the Empirical Literature, Institute of International Finance, Working Paper

BIS 2009. "Capital Flows and Emerging Market Economies." CGFS Papers No. 33.

UNIT 7: FINANCIAL CRISIS: WHY, WHEN AND HOW?

Outline of Lecture (1.5 hours)

- What is a crisis? What is common to all crisis?
- Varieties of financial crises
- Twin and Triple crises

Workshop: Case Studies – Varieties of Crises (3 hours)

Through the study of actual crises participants will learn how policy settings and failures in recognizing and addressing the buildup of vulnerabilities lead to crisis. The crises studied are: Asia, Iceland, and Hungary

Readings:

Kaminsky, Graciela, 2006. "Currency crises: Are they all the same?" *Journal of International Money and Finance* 25,3, 503–527

Laeven, Luc, and Fabian Valencia, 2008. "Systemic banking crises: a new database" *IMF Working Papers* 08/224

Reinhart, Carmen and Kenneth S. Rogoff, 2011. "From Financial Crash to Debt Crisis," *American Economic Review*, 101(5), 1676-1706

Graciela L. Kaminsky and Carmen M. Reinhart, 1999. "The Twin Crises: The Causes of Banking and Balance-Of-Payments Problems", 89, 73-500

UNIT 8: DEALING WITH CAPITAL FLOWS

Outline of Lecture (4.5 hours)**Macroeconomic Policy**

- Fiscal and Monetary Policy
- Exchange rate policy
- Policy mix

Financial Regulation

- Idiosyncratic and systemic risk
- Capital flows and financial stability
- Microprudential tools
- Macroprudential tools
- Macroprudential policy vs. capital flow management

CFM and FX Interventions

- Rationale for capital controls
- Modalities: administrative, taxes, reserve requirements
- Effects on flows, maturity, exchange rates, interest rates, cost of lending for different borrowers

Readings:

Valentina Bruno, Hyun Song Shin (2015) Assessing Macroprudential Policies: Case of Korea
<http://www.nber.org/papers/w19084.pdf>

Olivier Jeanne & Anton Korinek, 2010. "Managing Credit Booms and Busts: A Pigouvian Taxation Approach," NBER Working Papers 16377, National Bureau of Economic Research, Inc.

J. Ostry, A. Ghosh, M. Chamon, M. Qhreshi (2011) Capital Controls: When and Why IMF
Economic Review

Magud, Nicolas E., Carmen Reinhart, and Kenneth S. Rogoff. 2011. "Capital Controls: Myth and Reality – A Portfolio Balance Approach." NBER Working Paper 16805, Cambridge, MA, National Bureau of Economic Research