Economics @ Lady Margaret Hall

Economics of the EU Gavin Cameron Hilary 2004

Please find attached reading lists for this term's tutorials on the Economics of the EU. Readings that are especially recommended are marked with an asterisk, all other references appear in alphabetical order.

We will alternate between tutorials and classes. For the tutorial I expect you to write an essay (to be handed in at the tute itself) and for the classes I expect you to prepare answers to the questions given.

Tutorials will take place in my LMH office: flat 2, 1 Fyfield Road. If you walk along Norham Gardens towards LMH, 1 Fyfield Road is just on the corner about 40 yards before the LMH porters' lodge. It is a large house with two front doors. Come to the left hand front door and ring the top left bell.

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Week One: Tutorial

Bretton Woods and the ERM

Reading:

There has been a number of different exchange rate regimes in the OECD since World War II, beginning with the Bretton Woods agreement. In fact, exchange rate and balance of payments issues have occupied a large proportion of policymakers' time and many attempts have been made to stabilize foreign exchange markets. Krugman and Obstfeld (2003) discuss the history of the various regimes. Skidelsky (2000) provides an excellent historical background. Krugman (1979 and 1989) gives a good theoretical overview of the case for stable exchange rates, while de Grauwe (2000) and El-Agraa (2001) detail the European experience.

Essay:

'Why did the Bretton Woods system break down? Did the ERM of the EMS fail for the same reasons?'

References:

- * Krugman, P. and Obstfeld, M. (2003) International Economics: Theory and Policy (Addison Wesley: New York) 6th edition, chapters 18-21.
- * Obstfeld, M. (1995) 'International Currency Experience: New Lessons and Lessons Relearned', *Brookings Papers on Economic Activity*.
- * Skidelsky, R. (2000) *John Maynard Keynes: Fighting for Britain*, *1937-1946* (Macmillan: London) especially chapters 6-10.

Artis, M. and Lewis, M. (1993) 'Apres le deluge: monetary and exchange-rate policy in Britain and Europe', *Oxford Review of Economic Policy*, vol. 9, no. 3, reprinted in Jenkinson, T. (1996) *Readings in Macroeconomics* (OUP: Oxford) chapter 3.

Bordo, M. and Eichengreen, B. eds. (1993) A Retrospective on the Bretton Woods System (Chicago University Press: Chicago).

de Grauwe, P. (2000) The Economics of Monetary Union (OUP: Oxford) chapter 5.

El-Agraa, A. (2001) *The European Union: Economics and Policies*(Prentice-Hall: Harlow) 6th edition, chapter 17 (Mayes).

Krugman, Paul (1979) 'A model of balance of payments crises', *Journal of Money, Credit and Banking*, 11, 3, 311-325, reprinted in Krugman, Paul (1998) *Currencies and Crises* (MIT Press: Cambridge, MA).

Krugman, Paul (1989) 'The case for stabilizing exchange rates', Oxford Review of Economic Policy, reprinted in Jenkinson, T. (1996) Readings in Macroeconomics (OUP: Oxford) chapter 5.

Week Two: Class

Growth

Reading:

The rapid growth in the Europe during the Golden Age of 1948 to 1973 was followed by a prolonged slowdown in the 1970s and 1980s. Crafts and Toniolo (1996) and Maddison (1987 or 1991) provide the classic growth-accounting based studies of the Golden Age and subsequent slowdown. Bruno and Sachs (1985) is a standard account of the impact of stagflation on the OECD. See also my OECD lectures on this topic:

http://www.nuff.ox.ac.uk/Users/Cameron/lmh/lectures/oecd.html

Questions for discussion:

- 1. How important were the following factors in accounting for the rapid pre-1973 'Golden Age' European growth?
 - i. The Marshall Plan.
 - ii. Labour supply and structural change.
 - iii. High investment.
 - iv. Technological transfer and catch-up.
 - v. The demand-side and export-led growth.

2. How would you account for the productivity slowdown in Europe since the early seventies?

References:

- * Cameron, G. and Wallace, C. (2002) 'Macroeconomic Performance in the Bretton Woods Era, And After', *Oxford Review of Economic Policy*, Winter, 18, 4, 479-494.
- Crafts, N. and Toniolo, G. (1996) *Economic Growth in Europe Since 1945* (CUP: Cambridge) especially chapters 1 (Crafts & Toniolo), 2 (Eichengreen), 5 (Boltho) and 6 (Bean and Crafts).
- * Maddison, A. (1991) Dynamic Forces in Capitalist Development (OUP: Oxford).

Maddison, A. (1987) 'Growth and slowdown in advanced capitalist economics: techniques of quantitative assessment', *Journal of Economic Literature*.

Baumol, W., Nelson, R. and Wolff, E. (1994) *Convergence of Productivity* (OUP: Oxford) especially chapters 2 (Maddison) and 4 (Abramovitz).

Cameron, G. (2003) 'Why did UK manufacturing productivity growth slow down in the 1970s and speed up in the 1980s?', *Economica*, 2003, 70, 277, 121-141: http://hicks.nuff.ox.ac.uk/users/cameron/papers/economicapdf

Crafts, N. and Mills, T. (2000) 'After the Golden Age: A Perspective on Growth Rates that Speeded Up, Slowed Down, and Still Differ', *The Manchester School*, 2000, 68-91.

Dowrick, S. and Nguyen, D. (1989) 'OECD comparative economic growth 1950-85: catchup and convergence', *American Economic Review*.

Eichengreen, B. ed (1995) Europe's Postwar Recovery (CUP: Cambridge).

Temple, J. (2001) 'Structural change and Europe's Golden Age', Bristol University Economics Discussion Paper 01/519: http://www.ecn.bris.ac.uk/www/ecjrwt/abstracts/realloc21.pdf

Week Three: Tutorial

Unemployment

Reading:

After the first oil shock, unemployment rose dramatically across the OECD and has stayed high subsequently. Europe has suffered particularly badly compared with the USA, but even in countries that have succeeded in reducing unemployment there remains a relatively high level of non-employment among working age men (Netherlands, UK). The standard interpretation of the rise in unemployment is that it is due to the accumulation of labour market rigidities (see Siebert, 1997, with Nickell, 1997, giving a more nuanced account). Oswald et al. (1998) discuss some interesting implications of oil shocks.

Essay:

'Why did unemployment rise after 1973 in the OECD as a whole, and to such differing degrees in different countries?'

References:

- * Nickell, S. (1997). 'Unemployment and Labor market rigidities: Europe versus North America', *Journal of Economic Perspectives*, vol. 11, No. 3.
- * Siebert, H. (1997) 'Labour Market Rigidities: At the Root of Unemployment in Europe', Journal of Economic Perspectives vol. 11, No. 3.
- * Nunziata, L. (2002) 'Unemployment, Labour Market Institutions and Shocks', Nuffield Working Paper 2002-W16: http://www.nuff.ox.ac.uk/economics/papers/2002/w16/p4unemploymentWP.pdf

Artis, M. and Nixson, F. (2001) *The Economics of the European Union* (OUP: Oxford) 3rd ed, chapter 14 (Bertola).

Bean, C. (1994) 'European unemployment: A Retrospective', European Economic Review.

Bruno, M. and Sachs, J. (1985) Economics of Worldwide Stagflation (Basil Blackwell: Oxford), chapter 11.

OECD (1994) The Jobs Study: Facts Analysis Strategies (OECD: Paris)

Oswald, A., Carruth, A. and Hooker, M. (1998) 'Input Prices and Unemployment Equilibria: Theory and Evidence for the United States', *Review of Economics and Statistics* pp. 621-628:

http://www.warwick.ac.uk/fac/soc/Economics/oswald/CHO.pdf

Solow, R. 'What is Labour-Market Flexibility? What is it Good For?', *Proceedings of the British Academy*, Volume 97, pp. 189–211.

Soskice, D. (1990) 'Wage determination: the changing role of institutions in advanced industrialized countries', *Oxford Review of Economic Policy*, vol. 6, no. 4, reprinted in Jenkinson, T. (1996) *Readings in Macroeconomics* (OUP: Oxford) chapter 10.

Turner, D., Boone, L., Giorno, C., Meacci, M., Rae, D., Richardson, P. (2001) 'Estimating the Structural Rate of Unemployment for the OECD Countries', *OECD Economic Studies*, 33, II.

Week Four: Class

Inflation

Reading:

Inflation, which had been fairly subdued in the 1950s and 1960s, also became a major preoccupation of OECD and European governments in the 1970s, with the breakdown of the Phillips Curve. Oswald et al. (1998) and Bruno and Sachs (1985) discuss the issues thoroughly and Bernanke et al. (1999) detail the emergence of independent central banking as a response to the inflation of the 1970s and 1980s.

Questions for discussion:

- 1. To what extent was the inflation of the 1970s and the disinflation of the 1980s explained by trends in oil prices?
- 2. What are the other possible explanations?
- 3. To what extent did the experience of inflation differ across the OECD in the 1970s and 1980s?
- 4. How was monetarism implemented?
- 5. Was monetarism successful?
- 6. Why do central banks now appear to prefer inflation targeting to monetary targeting?

References as for week 3, plus:

- * Bernanke, B., Laubach, T., Mishkin, F. and Posen, A. (1999) Inflation Targeting (Princeton University Press: Princeton), chapter 12.
- * Bruno, M. and Sachs, J. (1985) Economics of Worldwide Stagflation (Basil Blackwell: Oxford), chapters 8-10.
- * Oswald, A., Carruth, A. and Hooker, M. (1998) 'Input Prices and Unemployment Equilibria: Theory and Evidence for the United States', *Review of Economics and Statistics* pp. 621-628: http://www.warwick.ac.uk/fac/soc/Economics/oswald/CHO.pdf

Anderton, R. and Barrell, R. (1995) 'The ERM, Structural changes in European Labour Markets', *Weltwirtschaftliches Archive*.

Blanchard, O. and P-A Muet (1993) 'Competitiveness through Disinflation: An Assessment of the French Macroeconomic Strategy', *Economic Policy* No. 16.

Ito, T. (1992) *The Japanese Economy* (MIT Press: Cambridge, MA) chapter 14 and pp. 125-134.

Jenkinson, T. (1990) 'Inflation Policy', Oxford Review of Economic Policy, vol. 6, no. 4, reprinted in Jenkinson, T. (1996) Readings in Macroeconomics (OUP: Oxford) chapter 8.

Krause, L. and Salant, W. (1977) Worldwide Inflation (Brookings Institution: Washington, DC) chapters 1-4.

Week Five: Tutorial

Inequality

Reading:

There are three major explanations of the rise in inequality across the OECD and Europe since the 1970s: trade, technology, and institutions. Atkinson (1999) provides a good account of the main trends, while Freeman (1995) and Wood (1995) provide contrasting explanations. DiNardo and Pischke (1997) provide a skeptical view of technology, while many of the other papers cited below are supportive.

Essay:

'Is the rise in European unemployment the counterpart of the rise in US inequality?'

References:

- * Atkinson, A. (1999) 'The Distribution of Income in the UK and OECD Countries in the Twentieth Century', *Oxford Review of Economic Policy*, 15.
- * Freeman, R. (1995) 'Are your wages set in Beijing?', *Journal of Economic Perspectives*, Summer, pp. 15-32.
- * Wood, A. (1995) 'How Trade Hurt Unskilled Workers', *Journal of Economic Perspectives*, Summer, pp. 57-80.

Burtless, G. (1995) 'International Trade and the Rise of Earnings Inequality', Journal of Economic Literature, 33 (2), p 800-816.

Cameron, G. (1998) 'Economic Growth in the Information Age: From Physical Capital to Weightless Economy', *Journal of International Affairs*, vol. 51, no. 2. pp. 447-471: http://hicks.nuff.ox.ac.uk/users/cameron/papers/jia.pdf

Di Nardo, J. and Pischke, J-S (1997) 'The Returns to Computer Use Revisited: Have Pencils Changed the Wage Structure Too?', *Quarterly Journal of Economics*, 112, 291-303: http://papers.nber.org/papers/w5606.

Freeman R. and Katz, L. (1995) 'Rising Wage Inequality: The United States vs. Other Countries', in R.Freeman (ed) *Working Under Different Rules* (Russell Sage Foundation: New York).

Haskel, J., and Slaughter, M., (2000) 'Does the Sector Bias of Skill-Biased Technological Change Explain Changing Wage Inequality?' revised version of NBER Working Paper 6565, August: http://www.qmw.ac.uk/~ugte153/WSiteDocs/sbtc800.pdf

Krugman, P. and Obstfeld, M. (2003) *International Economics: Theory and Policy* (Addison Wesley: New York) 6th edition, pp. 80-81 and pp. 229-233.

Machin, S. (2001) 'The Changing Nature of Labour Demand in the New Economy and Skill-Biased Technology Change', *Oxford Bulletin of Economics and Statistics*, 63, pp. 753-776.

Nickell, S. and Bell, B. (1996) 'Changes in the Distribution of Wages and Unemployment in OECD Countries', *American Economic Review Papers and Proceedings* pp 302-308.

Week Six: Class

Customs Unions and Regionalism

Readings:

For much of the postwar period, the GATT and WTO focussed on multilateral trade arrangements. Recently, there has been more emphasis on bilateral trade arrangements. Wonnacot and Wonnacot (1981) is the classic reference on why unilateral tariff reduction is such a great policy. It is worth reading about the effects of EU integration and NAFTA to understand the economic processes as work.

Questions for discussion:

- 1. How does a customs union differ from a free trade area?
- 2. What is trade creation?
- 3. What is trade diversion and trade deflection?
- 4. Under what conditions will trade creation outweigh trade diversion?
- 5. Are the arguments for free trade in capital the same as those for free trade in goods?
- 6. Is regionalism a threat to world trade efficiency?

References:

- * Krugman, P. and Obstfeld, M. (2003) International Economics: Theory and Policy (Addison Wesley, 6th edition), chapter 9.
- * Krugman, P. (1993) 'Regionalism versus multilateralism: analytical notes' chapter 3 in De Melo, J. and Panagariya, A. eds. *New Dimensions in Regional Integration* (Cambridge University Press).
- * Wonnacot, P. and Wonnacot, R. (1981) 'Is Unilateral Tariff Reduction Preferable to a Customs Union? The Curious Case of the Missing Foreign Tariffs', *American Economic Review* vol. 71.
 - Badinger, H. (2001) 'Growth Effects of Economic Integration the case of the EU member states (1950-2000)', IEF Working Paper No. 40, http://fgr.wuwien.ac.at/institut/ef/wp/WP40.pdf

Bhagwati, J. (2000) The Wind of the Hundred Days: How Washington Mismanaged Globalization (MIT Press), chapters 25-30.

Burfisher, M., Robinson, S., and Thierfelder, K. (2001) 'The Impact of NAFTA on the United States', *Journal of Economic Perspectives*.

El-Agraa, A. (2001) *The European Union: Economics and Policies*(Prentice-Hall: Harlow) 6th edition, chapters 5, 7 and 8.

Sapir, A. (1993) 'Regionalism and the New Theory of International Trade', World Economy.

Week Seven: Tutorial

Internal and External Balance with floating and fixed exchange rates

Readings:

The Mundell-Fleming model and the Salter-Swan model are the workhorse models for thinking about internal and external balance, and are well described in many of the references. Krugman (1992) is a great reference for the reminder that it is important to always remember the national income accounting identity and also links the issue to the great debate between Ohlin and Keynes on the effect on transfers between countries on trade balances. It is well worth refreshing your memory on such important, but basic, topics as the definition of the current and capital accounts, and the relationship between national saving and the external balance.

Essay:

Starting from a position of current account deficit is a devaluation necessary or sufficient in order to achieve balance on the current account? Is current account balance desirable?

References:

- * Krugman, P. and Obstfeld, M. (2003) International Economics: Theory and Policy (Addison Wesley, 6th edition), chapters 12-13.
- * Caves, Frankel and Jones (1999) *World Trade and Payments : an Introduction* (Harper Collins, 8th edition), chapters 15-20.
- * Krugman, P. (1992) *Currencies and Crises* (MIT) chapters 1 and 2.

Bliss, C. (1990) 'Unbalanced Payments: Adjustment and Policy', Oxford Review of Economic Policy, Autumn.

Cuthbertson, K. and Taylor, M. (1987) 'Macroeconomic Systems' (Blackwell) chapter 5.

Krueger, A. (1983) Exchange Rate Determination (Cambridge).

Sodersten, B. and Reed, G. (1994) *International Economics* (Macmillan, 3rd edition), chapters 23-26.

Williamson, J. and Milner, C. (1991) The World Economy (Harvester Wheatsheaf), chapter 12.

Week Eight: Class

Floating Exchange Rate vs Exchange Rate Management

Readings:

Policymakers often claim to dislike the volatility of floating exchange rates. But why are they so volatile? The standard model is due to Dornbusch and can be found in most of the readings. The model draws upon both the theory of Purchasing Power Parity and the theory of Interest Parity. European political leaders have been obsessed by exchange rate stability since the breakup of the Bretton Woods system. With the EMU project having finally led to a single currency, there is now great pressure on the UK to join. De Grauwe (2000) is a great introduction to the issues, while HMT (1997) gives a clear account of the five tests. Forder and Huhne (2001) is a chatty introduction. See also mv OECD lecture on this topic: http://www.nuff.ox.ac.uk/Users/Cameron/lmh/lectures/oecd.html

Questions for discussion:

- 1. Describe and assess the theory of Purchasing Power Parity.
- 2. Describe and assess the theory of Interest Parity and the Fisher effect.
- 3. Describe and assess the Dornbusch overshooting model.
- 4. Does volatility matter?
- 5. Define an optimum currency area
- 6. Is Europe an optimum currency area?

References:

- * Krugman, P. and Obstfeld, M. (2003) International Economics: Theory and Policy (Addison Wesley, 6th edition), chapters 13-16.
- * Taylor, M. P. (1995) 'The Economics of Exchange Rates' *Journal of Economic Literature* Vol.33(1) March, pp.13-47.
- * de Grauwe, P. (2000) *Economics of Monetary Union* (OUP: Oxford), 4th ed.

Cote, A. (1994) 'Exchange Rate Volatility and Trade: A Survey', Bank of Canada working paper 94-5: http://www.bankofcanada.ca/publications/working.papers/1994/wp94-5.pdf

Frankel, J.A., and Rose A.K. (1995) 'Empirical Research on Nominal Exchange Rates', chapter 33 in G.M. Grossman and K. Rogoff (eds.) *Handbook of International Economics, Volume 3,* North Holland.

H.M. Treasury (2003) *UK Membership of the Single Currency: An Assessment of the Five Economic Tests* (H.M. Treasury: London): http://assessment.treasury.gov.uk/

Artis, M. and Nixson, F. (2001) *The Economics of the European Union* (OUP: Oxford) 3rd ed, chapters 12 (Artis and Bladen-Hovell) and 13 (Ongena and Winkler).

Economic Policy (1998) Issue No 26 especially papers by Dornbusch et al, Eichengreen & Wyplosz and Obstfeld & Peri.

Forder, J. and Huhne, C. (2001) Both Sides of the Coin (London: Profile Books), 2nd edition.

Oxford Review of Economic Policy, 1998, Vol 14, No 3, issue on EMU (particularly Assessment by Allsopp & Vines, papers by Eichengreen, Artis and Maclennan, Muellbauer & Stephens).