



**Strategy 503 The World Economy
Section 003
Fall B 2008**

COURSE SYLLABUS

INSTRUCTOR: Simon J. Evenett

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Office Hours: By appointment.

CLASS AND EXAM TIMES AND LOCATIONS:

Monday, 27 October: 2.10pm-5.10pm.

Wednesday, 29 October: 2.10pm-5.10pm.

Saturday, 8 November: 9.00am-4.00pm

Saturday, 6 December: 9.00am-4.00pm

Classroom: K 1320.

Final Exam: Friday, 12 December, 7:00 to 9:00 pm in rooms E1530, E1540, K1310, K1320.

COURSE DESCRIPTION:

This course provides students with the concepts, tools and skill sets necessary to conduct in-depth analyses of the global economic landscape. Our goal is to understand the underlying market and institutional mechanisms that drive globalization, shape the international business environment, and influence the strategies of individual businesses. Topics we will cover include:

- What determines exchange rate fluctuations and currency crises? How do they affect domestic economies and firms' international competitiveness?
- What determines trade and investment across national boundaries? How are these flows influenced by government policies and international organizations?
- Given the unique challenges and opportunities of operating across borders, how do businesses make global sourcing, manufacturing and distribution decisions?

We emphasize a deep appreciation for, and understanding of, the interdependencies and interrelatedness in the world economy; knowledge of specific countries will not be the

focus of this course. Classes will use a combination of lectures, case analysis, and analytical discussion of key topics and current events, with students expected to play an active role in the classroom.

RELATIONSHIP TO OTHER COURSES:

This is a required core course for all MBA students (no waivers) and a prerequisite for all international business electives such as Strategy 520, 567, 582 and 584.

Strategy 503 is not simply an "international extension" of the core course Strategy 502. Rather the two courses are complementary. ST 502 focuses primarily on the interaction between firm characteristics and the external industry environment, and the implications for business-level strategy formulation. In ST 503 we examine the global macro-environment, and analyze how economic and political forces impact the competitiveness of firms. While we do address firm strategies, our main emphasis is on understanding the global environment as a necessary *precursor* to effective strategy formulation. Detailed treatment of specific country environments is deferred to the international electives.

ABOUT THE INSTRUCTOR:

Simon J. Evenett is Professor of International Trade and Economic Development, University of St. Gallen, Switzerland. He is also Program Director of the most established group of international trade economists in Europe, namely, the International Trade and Regional Economics Program of the Centre of Economic Policy Research. Professor Evenett is an expert in the commercial policy and strategies of the USA, EU, and the rising economic powers, such as China. He also closely follows WTO trade negotiations and bilateral and regional trade negotiations. Simon Evenett obtained his bachelor's degree in economics from the University of Cambridge and his doctoral degree (again in economics) from Yale University. Previously he has taught at Oxford University and for ten years held fellowships at the Brookings Institution, Washington DC. He was also Director of Economic Research, World Trade Institute, and has twice served as a World Bank official. Professor Evenett has also served as a Member on several high level committees on international commerce including The French Trade Minister's High Level Group on Globalisation; The Warwick Commission on the Future of the Multilateral Trading System; and The Zedillo Committee on the Global Trade and Financial Architecture. He is widely published and is a frequent public lecturer, including speaking to corporate executives about international business strategy.

READING MATERIALS:

A required packet of Course Materials for the 2008-09 academic year is available for purchase on CTools. Note this is different from the Course Materials used in 2007-08 and you must purchase a new packet. Other supplementary readings, both required and recommended (optional), will be posted on CTools before the relevant class session. The course does not use a textbook.

EVALUATION:

Evaluation is based on the standard Ross School of Business grading guidelines for core courses: Excellent (25%), Good (35%), Pass (35%), Low Pass/Fail (5%). Your grade will be determined by three components: (a) a midterm assignment, (b) a final exam, and (c) class participation.

Midterm assignment (10% of course grade)

A written exercise will be **distributed in class on 29 October and is due in class on 5 November**. It will cover our first four sessions, on exchange rates, and consists of a series of short-answer questions. This is an open-book, take-home exercise, but must be completed individually without consultation with anyone else.

Final exam (60% of course grade)

This is a comprehensive, open-book exam covering all the material in the course. It is scheduled for 12 December from 7:00 to 9:00 pm. No alternate time or make-up exam will be provided. Please drop the class if you anticipate any time conflict, and register instead for one of the sections offered in Winter A or Winter B.

Details on the exam, including policy on re-grading requests, will be provided closer to the date. In the meantime, problem sets drawn from past exam questions will be posted to CTools after the relevant class. These will not be graded and are not part of your evaluation, but working through the questions independently is crucial for your satisfactory performance in the final exam. Suggested answers will be posted in the final week, but you should not consult them until after you have attempted the problems first.

Class participation (30% of course grade)

You are expected to actively participate in discussions, case analyses and other exercises in class. To help with your preparation, discussion questions are listed alongside the reading assignments for each class session. As a general rule for all sessions, prepare to be “cold-called” on any of the discussion questions that appear in this syllabus.

Good participation grades reward students who demonstrate good preparation, mastery of the materials, and an ability to build on the comments and contributions of others. Every student has an obligation to advance our collective understanding of the course topics. A high participation grade requires class attendance and regular high-quality contributions. Students who contribute frequent but low-quality comments will be penalized. If you are unable to prepare for a particular class session, I will make every effort to avoid calling on you, provided that you notify me in advance. Please see me as early as possible if you encounter personal difficulties in participating spontaneously in class discussion.

CLASS POLICIES:

1. You are expected to attend *every* class session. In particular, students who miss the first class will be dropped automatically. The only exception is absences due to sudden family or health emergencies attested to by a doctor's letter *and* a letter signed by you affirming that your explanation is honor-code compliant. All other absences (including for job-related reasons) will reduce your grade.
2. Late entries and early departures from class, including for job-related reasons, are not allowed as they violate school policy and show disrespect for your fellow classmates.
3. You will not need your laptop in the class. Laptops, cell phones and any other electronic devices must be turned off throughout the class.
4. A class seating chart will be distributed during the first session. Please sit in the same seat and have your nameplate up throughout the semester. Cold calls should be expected in every class.
5. Hard copies of PowerPoint slides will be distributed in each class, and the electronic files posted to CTools *after* class.
6. You are most welcome to come and talk to me about any aspect of the class, during office hours. I will answer student e-mail within 24 hours.
7. If you need an accommodation for a disability, please let me know at your earliest convenience, so that we can work with the Office of Services for Students with Disabilities to determine if appropriate accommodations should be made. Information you provide will be treated as private and confidential.
8. You will be required to sign an honor code statement on all your written work for the course (see below).

ACADEMIC HONOR CODE:

Personal integrity and professionalism are fundamental values of the Ross Business School community. This course will be conducted in strict conformity with the Academic Honor Code. The Code and related procedures can be found at www.bus.umich.edu/Academics/Resources/communityvalues.htm. The site also contains comprehensive information on how to be sure that you have not plagiarized the work of others. Claimed ignorance of the Code and related information appearing on the site will be viewed as irrelevant should a violation take place. Non-Ross Business School students taking the course should also familiarize themselves with the Code as they will be subject to the Code as well while in this course.

COURSE SCHEDULE & READING ASSIGNMENTS:

In addition to the course-pack readings listed here, please read the required supplementary readings posted to CTools for each class. Additional discussion questions may also be posted.

Before Class Starts

Teaching Note: “A Primer on Macroeconomics” (Bradley Farnsworth)

Session 1 **27 October**

Exchange Rate Exposure and Adjustment

Teaching Note: “Foreign Exchange Rates” (Minyuan Zhao)

1. Who gains from a stronger euro? Who loses?
2. How did the dollar’s fall (a) benefit portfolio investors in the U.S. and (b) hurt Japanese manufacturers?
3. How can businesses adjust to a stronger home currency? A weaker home currency? Currency volatility?

Exchange Rate Determination

1. How was the company you interned for this past summer affected by the weak/falling dollar? How did it adjust?
2. How are exchange rates affected by (a) inflation and (b) interest rates? What is the relationship between inflation and interest rates?

Session 2 **29 October**

Balance of Payments and Exchange Rates

MIDTERM ASSIGNMENT DISTRIBUTED

Teaching Note: “Balance of Payments” (Bradley Farnsworth)

Douglas A. Irwin, *Free Trade Under Fire*, 2nd ed. (2005), Chapter 4 “What about the trade deficit?” pp. 123 - 130

1. What is the balance of payments? How is it affected by (a) government fiscal policy (budget) and (b) monetary policy (interest rate)?
2. What are the fundamental reasons for current account deficits? What is the relationship between the current account and the financial account? What is the relationship between an economy’s internal balance and its external balance?

3. Why does the U.S. have such a big current account deficit with China?
4. How has globalization affected the effectiveness of fiscal and monetary policies?

Exchange Rate Regimes and Currency Crises

Teaching Note: “Currency Crises” (Minyuan Zhao)

“The \$1.4 trillion dollar question,” *Atlantic Monthly* Jan/Feb 2008

“Exchange rate regimes: Fix or float?” *Finance and Development* March 2008

“China’s currency crunch,” *Foreign Policy* Jan/Feb 2008 (optional)

“Point of view: Converting a tiger,” *Finance and Development* March 2007 (optional)

1. What causes currency crises? What are the policy solutions to currency crises?
2. What is the role of the IMF in crisis? Are the criticisms of the IMF justified?
3. How does the U.S. finance its current account deficit? Do you think it can continue to do so? Why or why not?
4. Should Asian countries diversify their foreign reserve portfolios away from the U.S. dollar? Why or why not?
5. Who would like to see a stronger yuan? Who would not? How has yuan appreciation affected the U.S. dollar? How has it affected the U.S. current account deficit?

MIDTERM ASSIGNMENT DUE: 5 November 2008. Send assignment to: malwina.nowakowska@gmail.com, one of my assistants, and copied to me at simon.evenett@gmail.com.

Session 3

Morning, 8 November

International Trade

Teaching Note: “Trade and Competitiveness” (Linda Lim)

“Why trade is good for you,” *Economist* 1 October 1998

“A tale of two factories,” *Fortune* 14 September 2006

1. What determines the geographical location of industry, or the various points on an industry’s value-chain?
2. How and why does comparative advantage change over time? How do firms and workers adjust to changes in comparative advantage?
3. What are other sources of competitive advantage for firms (besides comparative advantage)? How do governments and businesses influence competitive advantage?

Trade Policy and Politics

“Douglas A. Irwin, “Three simple principles of trade policy,” pp. 10 – 17

“Jobs on another shore,” *Finance and Development* March 2008

1. How have the U.S. and Europe sought to counter developing countries' comparative advantage in agriculture, textiles and other manufactured consumer goods?
2. How do such policies affect different domestic interests (e.g. consumers, import-competing businesses, downstream industries, workers, government budgets, etc.)?
3. What are the trade policies of U.S. Presidential candidates John McCain and Barack Obama? Why did they choose these particular policies? What are the likely impacts of each candidate's trade policies on the U.S. and world economies?

Session 4

Afternoon, 8 November

Multilateral, Regional and Bilateral Trade Agreements

“Governing global trade,” *Finance and Development* December 2007

1. What is the WTO and why is it important to business?
2. Why has the Doha Development Round failed to date?
3. Do you think the U.S. and other countries are correct in pursuing Bilateral Trade Agreements (BTAs) and regional Free Trade Areas (FTAs) as alternatives to the multilateral WTO? What are their pros and cons? Which alternatives would multinational companies prefer, and why?

Controversies I: Trade, Labor and the Environment

“Has globalization reached its peak?” *Foreign Affairs* Jan/Feb 2007

“A new deal for globalization,” *Foreign Affairs* July/Aug 2007

“Ending the trade war in Washington,” *Foreign Affairs* May/June 2007

1. Should multinational corporations adopt home or host country standards for labor and the environment?
2. Why are there objections to companies from rich countries operating in poor countries? Are these objections justified?

Session 5

Morning, 6 December

Controversies II: Capital Market Volatility and Inequality

“Financial globalization: beyond the blame game,” *Finance and Development* March 2007

1. What are the advantages of the globalization of capital flows? What are the disadvantages? Should such flows be regulated, and if so, by whom?
2. Economists generally agree that globalization promotes growth and reduces poverty. How should governments and businesses regard and respond to its impact on inequality within and between countries?

Foreign Portfolio Investment

1. What is the motivation for making foreign portfolio investments? What are the risks to the investor?
2. Why are there concerns about the role of “sovereign wealth funds” in the U.S. and Europe? Are they justified? What, if anything, should be done about them?

Session 6

Afternoon, 6 December

Foreign Direct Investment

Teaching Note: “Foreign Direct Investment” (Minyuan Zhao)

“When China met Africa,” *Foreign Policy* May/June 2008

“The coming Euroinvasion,” *Foreign Policy* May/June 2008

1. Why do firms invest abroad?
2. How do multinational companies affect—and are affected by—their home and host country environments?

International Strategy

Case: “Koc Holdings: Arcelik White Goods”, *HBS #598033*

1. Why has Arcelik succeeded in Turkey? Why is it now pursuing international markets?
2. Can the key intangibles supporting Arcelik's success in Turkey be leveraged most effectively in Western Europe or in emerging markets?
3. In each area, should Arcelik expand by exporting or by foreign direct investment? By greenfield ventures or acquisitions? In wholly-owned or joint ventures? Why?
4. How might changes in the Turkish economic environment (e.g. inflation, interest rates and exchange rates) affect Arcelik's international expansion strategy and operations?

FINAL EXAM Friday, 12 December 7:00 to 9:00 pm