

Doing Business in Emerging Markets**297E****A hybrid course****By****Sebastian Edwards***Henry Ford II Distinguished Professor**Anderson Graduate School of Management, UCLA**Revised Syllabus**03-18-2014*

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Description of the course

In this course we concentrate on *emerging markets*, the group of nations with the greatest economic potential in terms of growth and consumer expansion. We discuss what makes emerging markets (EMs) unique and particularly attractive to investors. We deal with risks and challenges, rewards and returns, cultural issues and future trends. The focus of the course is on institutions, financial issues, exchange rates, potential for economic growth, and currency crises – such as the ones experienced by Turkey, South Africa, and Argentina in early 2014. Examples from Asia, Latin America, Central and Eastern Europe, and Africa will be discussed in great detail.

This is a hybrid course, and that makes it unique. We will meet on Campus three times – on Sundays April 6, April 27 and May 18 – for 5 hours each time. The rest of the classes will be on line. There will be a discussion board where everyone will participate. The TA will provide answers to questions posted on the board, and I will provide video with commentary/answers based on the board discussion.

There will be some quizzes based on the online material.

When we meet in person we will devote most of the time to discussion, problem solving, and solving cases. In that sense, this course will put teaching “on its head”: the lectures will take place at home, and the homework will be done in school.

Many of the discussions on the board – and some of the discussions on campus – will be “in real time,” in the sense that they will deal with real life issues taken from that particular week’s investment banks’ reports.

Some of the topics covered in the course include the following:

- Political risk in emerging markets
- Credit risk in EMs.
- Currency risk in EMs.
- Who are the future winners? (From the BRICs to the MIST)
- Inflation as an EM problem
- The world financial architecture and the EMs: The World Bank and the International Monetary Fund (IMF)
- Currency crises in the EMs.
- Can EMs have an independent monetary policy?
- Investment disputes: Legal and Financial angles
- International trade and business opportunities: The basics of protectionism

Requirements

Managerial Economics (405) and the basic finance and stats courses are prerequisites. It would be nice if you have taken 406 (The Global Economy), but this is not a requirement.

The final grade will be made up of the following components:

• Midterm	20%
• Discussion boards’ participation	20%
• Class participation (in residence)	20%
• Final	40%

Both the midterm and the final will be “take home exams.”

Readings:

There is one book that we will read back to back: Sebastian Edwards, *Left Behind: Latin America and the False Promise of Populism*, University of Chicago Press, 2010.

Students will also have to read a number of academic articles. These will be placed on the course’s website. In addition, there will be one or two industry/news articles each week. These will also be placed on the website.

Discussions in the chat room will be on class material, on readings, and on the news articles distributed weekly.

In what follows I provide a Guide to the course. I suggest when to watch the videos, and I provide a list of required readings.

OUTLINE

1. Before getting started: An introduction to EMs (Week 0)

This online material is introductory and should be viewed before our first in residence meeting.

- What is an EM?
- Great opportunities with significant risks
- Types of risks
 - Political
 - Credit Currency
 - Currency risk
- Different types of EMs
- Inequality
- Poverty
- Low wages and low productivity
- Doing business in EMs
 - What should we focus on?
 - How do we assess challenges and opportunities?

Videos:

Video 0: Administrative issues and course description

Video 1: Doing Business in Ems

Video 2: Political Risk

Video 3: Finding the winners

Video 4: Total Factor Productivity

Residence 1: April 6

Readings:

- Left Behind: Chapters 1 and 8
- Doing Business Web Site: <http://www.doingbusiness.org/> (explore this fascinating web site at your leisure).
- J. Houghton and R. Khandker, “*Handbook of Poverty and Inequality*,” The World Bank, 2009, Chapter 2
- J. Houghton and R. Khandker, “*Handbook of Poverty and Inequality*,” The World Bank, 2009, Chapter 6

2. **Where are the next winners, or from the BRICS to MIST: The Goldman-Sachs Emerging Market Model (Week 1, UCLA)**

This will be the first “in residence” session, and will take place on April 6. We will discuss the first case for the course. The question addressed is this: “How can we predict which countries will be the super performers in the next twenty years?” The emphasis will be on how fast income will grow and, thus, on how fast consumption will expand.

This session will be based on two sources: (1) The Goldman-Sachs model of economic growth for emerging markets; and (2) the “Doing Business around the World” dataset developed by the World Bank.

Students will read the case as well as some additional material before the meeting. We will then have two discussions: (1) A general discussion on the virtues and applicability of the GS model. And (2), discussions at group levels on whether it is reasonable to change attention away from the BRICs and move it to the MIST countries.

Videos:

Video 3: Finding the winners

Video 4: Total Factor Productivity

Residence 1: April 6

Readings:

In preparation for this session students will read the case (to be distributed in due course) and the following material:

- Goldman –Sachs, “Dreaming in BRICs 2050”, 2003
- *Left Behind*, Chapters 2 and 3
- Citi, “Global Growth Generators, “ 2011

After the session the following material should be read:

- *Class Notes on the Goldman Sachs model*

3. Currency Risk in Emerging Markets: Conceptual Framework (Weeks 2 and 3; Videos)

In this part of the course a series of videos will cover issues related to currency risk. This material will allow students evaluate whether a country's currency is "out of line with fundamentals," and whether to expect large swings in currency values.

Some of the concepts developed in these videos will include:

- Trade weighted exchange rate
- Real effective exchange rate (REER)
- Trade balance
- Current account
- Incomes account
- Financial account
- Balance of payments
- Equilibrium REER and fundamentals
- Dutch Disease
- Interest parity condition: Covered and uncovered

Videos:

Video 5: Currency Risk
 Video 6: Competitiveness
 Video 7: Exchange Rates
 Video 8: EREER
 Video 9: Advanced EREER
 Video 10: Overvaluation
 Conversation 1
 Residence 2: April 27

Readings:

- *Left Behind*, Chapters 4 and 5
- Central Bank of Turkey, "The Real Exchange Rate: Definitions and Calculations," Ankara, 1997.
- Catao, Luis, "Why Real Exchange Rates?" *Finance and Development*, 2007

- International Monetary Fund, “Real Exchange Rate Appreciation in Emerging Markets,” January 2014
- JP Morgan, “Revisiting G10 Fair-Value Exchange Rates,” 2008
- Edwards, S. “Is the U.S. Current Account Sustainable?” *Brookings Papers on Economic Activity*, 2005 (Read pages 211-227; you may ignore the rest)
- IMF, “Early Warning Exercise,” 2011
- Edwards, S. and M. Savastano, “Exchange Rates in Emerging Economies” U of Chicago Press, 2000

4. Two Currency Crises: Mexico and East Asia (Week 4, UCLA)

This will be our second “in residence” meeting and will take place on April 27. We will use the material covered in the videos, as well as the material in the readings, to discuss and analyze three major crisis episodes in EM: Mexico in 1994-1995, and East Asia in 1997-98.

The discussion will be organized around a case and will take place, during the first half of the session, in groups. During the second half of the session we will have a general discussion. We will then use the conclusions from the case to analyze the current currency situation in China.

Before the meeting on campus the students will read the following material:

- *Left Behind*: Chapter 5
- IMF, “The Effectiveness of Capital Controls and Prudential Policies” 2011
- Edwards, S, “Lessons from Mexico and East Asia,” *Brookings*, 1999
- Kaminsky, G. et al, “Leading Indicators of Currency Crises” IMF 1998

Videos:

Video 9: Advanced EREER

Video 10: Overvaluation

Conversation 1

Residence 2: April 27

5. Credit Risk: Conceptual Framework (Week 5 and 6; Videos)

In this part of the course a series of videos will cover issues related to credit risk. This material will allow students evaluate whether a country’s fiscal policy is “out of line with fundamentals” and, thus, unsustainable.

We will discuss the experience of Greece in 2008-2014, and of other fiscally related crisis. We will also deal with debt restructuring. In particular, we will analyze how much investors in sovereign bonds have lost in a number of historical defaults and restructurings.

Some of the concepts developed in these videos will include:

- Fiscal balance
- Primary balance
- Country risk premium
- Sustainable balance
- “Haircuts”
- Costs of restructuring debt

Videos:

Video 11: Sovereign Risk

Video 12: Sovereign Risk II

Video 13: Sovereign Risk III

Video 14: Sovereign Risk IV

Video 15: Haircuts and Losses

In Residence 3

Readings:

- Juan José Cruces, Christoph Trebesch, “Haircuts and the cost of sovereign default” *VOX*, 13 October 2011
- Jaramillo, L. and C.M. Tejada, “Sovereign Credit ratings and Spreads in Emerging Markets,” *IMF WP*, 2011
- Edwards, S. “LDC’s Foreign Borrowing and Default Risk,” *American Economic Review*, 1984
- Edwards, S. “The pricing of bonds and bank loans in international markets,” *European Economic Review*, 1986

6. An Investment Dispute: Argentina in the 2010s (Week 7; UCLA)

This will be our third “in residence” meeting and will take place on April 27. The case for this session will be based on the succession of legal disputes during the first two decades of the 21st century involving Argentina.

Investors from all over the world converged into Argentina after 1991. They were attracted by the country's vast riches, its promise of currency stability, and its deep-market reforms. A decade later a major currency crisis erupted, and the government of Argentina abrogated all sort of contracts. A number of multinational companies resorted to arbitration in the ICSID. The total amount in dispute was in the billions of USD.

We will discuss the arguments presented by Argentina to the arbitration tribunal, and discuss counterarguments. We will also discuss the actual rulings in many of these cases.

Before the meeting on campus the students will read the following material:

Videos:

In Residence 3

Readings:

- *Left Behind: Chapter 6*
- *IMF: The Role of the IMF in Argentina (Executive Summary). Complete Report at: <http://www.imf.org/External/NP/ieo/2004/arg/eng/>*

7. Does China have an exchange rate advantage? (Weeks 8, 9, and 10: Videos)

In a series of videos we will discuss issues related to exchange rates and currency risk. The treatment of these topics will be more advanced than in the previous module, and our focus will be analyzing exchange rate policy in China. In particular we will analyze whether China has had an exchange rate advantage. We will than discuss whether other countries could (or should) follow the Chinese currency model.

We will also analyze what would be the likely exchange rate between the yuan and the USD if the market was completely free.

Finally, we will discuss the connection between exchange rate policy and commercial policy (import tariffs and export subsidies).

Videos:

Video 16: China Productivity

Video 17: China and Carry Trade

Video 18: China and Sterilization

Video 19: The future of the renminbi

Video 20: Summary and Farewell

Conversation 2

Readings:

- Cheung, YW, M.D. Chinn, E. Fuijji, “China’s Current Account and Exchange Rate,” National Bureau of Economic Research WP 14673, 2009 (Focus on pages 1 to 9; and pages 27-30. Skim the rest).
- Cline, W.M. “Renminbi Undervaluation, China’s Surplus, and the US Trade Deficit,” *Petersen Institute for International Economics*, 2010