

MACALESTER COLLEGE
Spring 2003

International Finance in Historical Perspective
(Economics 72)

Professor: Pete Ferderer

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Money links countries. Its primary function is as an instrument of exchange. Money provides a way of translating ideas into practice and of allocating resources. The management of money is at a fundamental level concerned with the flow of information. By itself, monetary exchange cannot produce the new ideas and technologies -- it is so to speak irrelevant to the heart of the mechanism that drives economic development -- but it is a nerve center, distributing ideas about how those technologies may be used. When it fails to function properly, the course of development is impeded and the enrichment of mankind halted.

- Harold James, 1996

Content: This course addresses the following questions: Why do countries issue their own currencies? What factors determine the exchange rate between currencies? Why do some countries find it in their best interest to fix or peg their exchange rate, while others allow the exchange rate to float? What explains the large swings in the degree of international capital mobility over the past 130 years? Why do nations have trade imbalances and what impact do they have on the broader economy? What role did the international financial system play in the Great Depression? What caused the international financial crisis observed in Latin America in 1994-95 and East Asia in 1997-98? Do currency boards or dollarization offer a solution to currency crises observed in the emerging market economies? What role does the International Monetary Fund play in the economic system? Is Europe an "optimum currency area?" How about the world? What impact will the euro have on the dollar's role as a vehicle currency?

This course examines international finance from a historical perspective and emphasizes the interplay between the "rules of the game" that govern the international financial system and economic performance. This approach has several advantages. First, the important relationships in international finance (e.g., the balance of payments, purchasing power parity, and interest rate parity) are examined in several different historical settings, leading to a deeper understanding of how they work. Second, the historical approach helps us to understand the endogenous nature of institutions. It illuminates, for example, why the International Monetary Fund was created. Finally, this approach sheds light on the role that international finance has played in the history of the twentieth century. For example, it becomes clear how WWI, the interwar gold standard, WWII, and monetary union in Europe are connected!

Expectations: I have four primary expectations for students. They should: a) attend all class meetings and be punctual, b) live by the code of academic honesty, c) work hard and keep up with the reading assignments, d) engage the course as an "active learner" (e.g., question, challenge, and stay involved.) I have six expectations for myself. I should: a) set high, yet attainable, standards, b) be fair and objective in grading, c) know my stuff, d) provide organized and stimulating lectures, e) promote class discussion that facilitates active learning, and d) be available outside of class for consultation.

Prerequisites: Economics 41, 51 and 61 are all required for registration in this course. This course builds on material covered in Introduction to International Economics (21), but 21 is not a prerequisite.

Readings: The one required book is Globalizing Capital: A History of the International Monetary System, Second Edition, by Barry Eichengreen. Copies are available at the Expanded Mind. In addition, I will be making extensive use of two books written by Paul DeGrauwe: 1) International Money: Postwar Trends and Theories, Second Edition, 1996; and 2) Economics of Monetary Union, Fourth Edition, 2000. All other readings (journal articles, book chapters and cases) are available: a) at the library reserve desk (marked "R"), b) through JSTOR, on the web (url given), or from me. I ask that each student purchase a ten-week subscription to The Economist. This will give you access to their electronic archive that contains topical articles.

Grades: Final grades are based on the following:

Weight	Activity	
	Class Participation	
20%	Class	
Presentations	Two or Three Take-Home Essays	10%
50%	Term Paper	
	20%	

Class participation entails answering and posing questions during class and contributing to case studies. Each student is asked to present one paper from the reading list. Eligible papers are

marked by "Student" below and students can work in groups of two. Papers will be allocated on a first-come-first-serve-basis. A two-page proposal of the term paper, complete with thesis question and a preliminary list of references, is due April 1. The final draft of the paper is due Friday, May 9. No exceptions will be granted for either deadline.

Web sites: An important web site for this course is the one constructed by Nouriel Roubini at NYU (<http://www.stern.nyu.edu/globalmacro/>). It contains links to a plethora of academic research on different topics (e.g., the Asian financial crisis, reform of the IMF, etc.), country-specific economic analyses, links to articles on international finance in the popular press, lectures, links to other web sites, data sources and more. This is a wonderful resource and should be useful for term paper research. The archive at *The Economist* (www.economist.com) should also be useful for this purpose. Note that some of the papers we will read are available at the National Bureau of Economic Research web site (www.nber.org) and are free of charge.

Course Outline and Reading List

Week	Topic and Readings
Jan. 28 (T)	<p>Introduction DeGrauwe, <i>International Money: Postwar Trends & Theories</i>, Chapter 1. (R)</p>
Jan. 30 (TH)	<p>Basic Concepts and A General Model Mankiw, "The Open Economy," Ch. 5 in <i>Macroeconomics</i>, Fifth Edition, 2003.</p>
Feb. 4 (T)	<p>The Policy Trilemma & History of Capital Mobility Obstfeld and Taylor, "Globalization and Capital Markets," http://www.nber.org/papers/w8846, pp. 1-16.</p>
Feb. 6 (TH)	<p>Classicism Mach I: The Price-Specie-Flow Mechanism Bordo, "The Gold Standard: Theory," in <i>The Gold Standard & Related Regimes</i>, 1999.</p>
Feb. 11 (T)	<p>The Classical Gold Standard: 1879-1914 Eichengreen, <i>Globalizing Capital</i>, Ch. 2 (focus on pp. 25-44). Meissner, "A New World Order: Explaining the Emergence of the Classical Gold Standard," Working Paper, University of Cambridge, 2001. (Student)</p>
Feb. 13 (TH)	<p>Post-war Floating & Hyperinflation: 1919-1926 Eichengreen, <i>Globalizing Capital</i>, Ch. 3 (pp. 51-57).</p>
Feb. 18 (T)	<p>Relinking to Gold: Case Study Rukstad, "The United Kingdom and the Gold Standard: 1925," Chapter 13 in <i>Macroeconomic Decision Making in the World Economy</i>, 1992. (R)</p>
Feb. 20 (TH)	<p>The Interwar Gold-Exchange Standard: 1927-1939 Eichengreen, <i>Globalizing Capital</i>, Ch. 3 (pp. 57-92). Bernanke, "The Macroeconomics of the Great Depression: A Comparative Approach," <i>JMC B</i>, February 1995. (JSTOR)</p>
Feb. 25 (T)	<p>Eichengreen & Sachs, "Exchange Rates and Economic Recovery in the 1930s," <i>Journal of Economic History</i>, 45 (1985). (JSTOR) (Student, skip theory)</p>
Feb. 27 (TH)	<p>Constructing New Rules of the Game: Case Study Carlson, "Negotiations Prior to 1944 Bretton Woods Conference."</p>
Mar. 4 (T)	<p>Operation of Bretton Woods: 1945-1971 DeGrauwe, <i>International Money</i>, Ch. 2 (p.16-22). (R) Eichengreen, <i>Globalizing Capital</i>, Ch. 4 (pp. 93-128).</p>
Mar. 6 (TH)	<p>The Collapse of Bretton Woods DeGrauwe, <i>International Money</i>, Ch 3 (pp. 26-39). (R)</p>

Eichengreen, *Globalizing Capital*, Ch. 4 (pp. 128-35) and Ch 5 (pp. 136-39).

Mar. 11 (T)

Keynesianism Mach I: A Critical Perspective

McKinnon, "The Exchange Rate and Macroeconomic Policy: Changing Postwar Perceptions," *Journal of Economic Literature*, June 1981, pp. 531-46. (JSTOR)

- Mar. 13 (TH) **Classicism Mach II: Global Monetarism**
 McKinnon, "The Exchange Rate and Macroeconomic Policy: Changing Postwar Perceptions," *Journal of Economic Literature*, June 1981, pp. 546-57. (JSTOR)
- Mar. 25 (T) **Keynesianism Mach II: Overshooting & Portfolio Balance Models**
 DeGrauwe, *International Money*, Ch. 5 (pp. 85-89) & 6 (pp. 105-21).
 (R)
The Economist, "Why Currencies Overshoot,"
 12/1/1990. (Student)
- Mar. 27 (TH) **Floating Exchange Rates: 1970s and 1980s**
 Eichengreen, *Globalizing Capital*, Ch. 5 (pp. 139-52).
 Sarano and Taylor, "Official Intervention in the Foreign Exchange Market: Is it Effective and, If So, How Does It Work?" *Journal of Economic Literature*, September 2001. (Student)
- Apr. 1 (T) **The Intertemporal Approach to the BOP, External Sustainability and the Equilibrium Real Exchange Rate**
 Hervey, and Merkel, "A Record Current Account Deficit: Causes and Implications," FRB of Chicago *Economic Perspectives*, 2000. (Student)
 Ventura, "A Theory of Current Accounts," <http://www.nber.org/papers/w9163>.
- Apr. 3 (TH) **Stein and Paladino, "Recent Developments in International Finance: A Guide to Research,"** *Journal of Banking and Finance*, 1998, pp. 1706-15.
- Apr. 8 (T) **Keynesianism Mach III: The New Open Economy Macro**
 Rogoff, "The Purchasing Power Parity Puzzle," *Journal of Economic Literature*, June 1996. (JSTOR) (Student)
- Apr. 10 (TH) **Krugman, "The Case for Exchange Rate Flexibility,"** Chapter 1 in *Exchange Rate Instability*, 1989.
 Obstfeld, "International Macroeconomics: Beyond the Mundell-Fleming Model," <http://www.nber.org/papers/w8369>.
- Apr. 15 (T) **Theory of Optimum Currency Areas**
 DeGrauwe, *Economics of Monetary Union*, Chs. 1-4.
 (R)
- Apr. 17 (TH) **Theories of Speculative Attacks**
 DeGrauwe, *International Money*, Ch. 4. (R)
- Apr. 22 (T) **The EMS Crisis: 1992-93**
 DeGrauwe, *Economics of Monetary Union*, Ch. 5.
 (Student)

Apr. 24 (TH) **Mexico and the Tequila Crisis: 1994**

Espinosa and Russell, "The Mexican Economic Crisis: Alternative Views,"

Federal Reserve Bank of Atlanta *Economic*

Review, January 1996. **(Student)**

Apr. 29 (T)

The Asian Crisis: 1997

Corsetti, et al., "What caused the Asian Currency and Financial Crisis?

Part I: An Overview" www.stern.nyu.edu/globalmacro/AsianCrisis.pdf

and "What caused the Asian Currency and Financial Crisis? Part II: The Policy Debate" www.stern.nyu.edu/globalmacro/asiacri2.pdf **(Student)**

May 1 (TH)

Currency Boards and Dollarization: A Solution?

Hanke, "Currency Boards," in *The Annals*, January 2002, pp. 87-105.
Velde and Veracierto, "Dollarization in Argentina," FRB of Chicago, First
Quarter 2000. **(ER) (Student)**

The Economist, "The ABCs of a Currency Board,"

11/1/1997.

The Argentine Crisis: 2001-02

Mussa, *Argentina and the Fund: From Triumph to Tragedy*,"

<http://www.iie.com/publications>. **(Student)**

The Economist, "Argentina: The Hole Gets Bigger," 11/21/02

May 6 (T)

Where Do We Go from Here?

Eichengreen, "International Monetary Options for the

Twenty-First

Century," in *The Annals*, January 2002, pp. 11-25.

Stiglitz, "Capital Market Liberalization and Exchange Rate Regimes: Risk
without Reward," in *The Annals*, January 2002, pp. 219-48.

Edwards, "Capital Mobility, Capital Controls, and Globalization in the
Twenty-First Century," in *The Annals*, January 2002, pp. 261-70.

Rogoff, "International Institutions for Reducing Global Financial
Instability," *Journal of Economic Perspectives*, Fall 1999, pp. 21-42.