

MACALESTER COLLEGE
Fall 2007

International Finance in Historical Perspective
(Economics 422)

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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 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 and why, in some cases, do they abandon their currency for that of another country (e.g., “dollarisation”) or enter into a monetary union (e.g., the euro)? What factors determine the exchange rate between currencies? Why do some countries find it advantageous to “peg” their exchange rate, while others float? What are the causes and consequences of international capital flows? Why do nations have trade imbalances and what impact do they have on the economy? What role did the gold standard play in the Great Depression? What caused the recent international financial crises in Latin America (1994), East Asia (1997-98), Russia (1998) and Argentina (2001)? Do currency boards, dollarisation or capital controls offer a solution to these crises? What role does the International Monetary Fund play in the system? 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. The historical approach helps us to understand the endogenous nature of institutions (e.g., why the International Monetary Fund was created) and sheds light on the role that international finance has played in shaping world history. For example, some have argued that “had the major central banks pursued policies of price stability instead of adhering to the gold standard, there would have been no Great Depression, no Nazi revolution, and no World War II” (Mundell, *American Economic Review*, June 2000, p. 331). By drawing on historical analogy we can better understand how our current actions will influence the future.

Prerequisites: All students must complete intermediate macroeconomics and econometrics before enrolling in this course.

Expectations: I have four 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.

Readings: The main text for the course is *International Finance Theory & Practice* (2006), by Steven M. Suranovic. It is available at <http://internationalecon.com/Finance/financehome.php> for a cost of \$18. Go to this link, hit “download” and then “the complete International Finance Text” to obtain the entire book as a pdf file. You should also purchase a copy of *Globalizing Capital: A History of the International Monetary System* (1998) by Barry Eichengreen. Finally, I ask each of you to obtain a 12 week subscription to *The Economist* for \$19.95. With this, you can access their historical archive of articles. Go to www.economistacademic.com to order your subscription with the ID number I supply you.

Grades: Final grades are based on the following:

<u>Activity</u>	<u>Weight</u>
Term Paper	20%
Exam	20%
Take-home Essay	20%
Participation (class discussion and case studies)	20%
Problem Sets	10%
Article Presentation	10%

Daily participation points are assigned as follows: missing in action (0), sleeping (1), alert but silent (2), made contribution (3), and excellent contribution (4). Students are required to present one article during the semester. Eligible articles are marked by “S” (for student) and are allocated on a first-come-first-serve-basis. A two-page proposal for the term paper, complete with thesis question and list of references, is due Monday, March 7. Final drafts are due Monday, May 2. No exceptions will be granted for these deadlines. Good papers to look at for term paper ideas are marked by “TP” on the reading list. Term papers, article presentations and problem sets can be completed by groups of two students.

Reading List

This reading list is not set in stone and I may add or delete papers as the semester progresses. The letter in front of each reading indicates who is responsible for presenting it: P = Professor, Student = Student, and C = Class Discussion.

Date	Topic and Readings
Sep. 5 (W)	Introduction [1-P] Mundell, "A Reconsideration of the Twentieth Century," <i>American Economic Review</i> , June 2000. (JSTOR)
	<u>Basic Concepts and Equilibrium Relationships</u>
Sep. 7 (F)	Balance of Payments [1-P] Suranovic, Ch. 5. [2-C] <i>The Economist</i> , "Bye-bye EMBI," 2/27/2007. (Original Sin) (http://www.economist.com/finance/displaystory.cfm?story_id=8752792) [3-C] Kumar, "Does Foreign Direct Investment Help Emerging Economies?" FRBD <i>Economic Letter</i> , 1/2007. (http://dallasfed.org/research/ecllett/2007/el0701.pdf)
Sep. 10 (M)	Intertemporal Model of Trade Imbalances [1-P] Suranovic, Ch. 6. [2-P] Obstfeld & Rogoff, <i>Foundations of International Macroeconomics</i> , 1996, Ch.. 1.
Sep. 12 (W)	Balance of Payments: Country Experiences [1-S] 5-minute student presentations
Sep. 14 (F)	The Foreign Exchange Market [1-P] Suranovic, Ch. 10. [2-P] Rime, "New Electronic Trading Systems in Foreign Exchange Markets" in Derek C. Jones, ed., <i>New Economy Handbook</i> (2003), Ch. 21, p. 469-504. (http://faculty.haas.berkeley.edu/lyons/Rime%20New%20Electronic%20FX.pdf)
Sep. 17 (M)	The Foreign Exchange Market Laboratory Experiments – Private Value Auctions [Case] "Lufthansa" in <i>Cases in International Finance</i> , by Michael Moffett, 2001. [Case] "Ecuadorian Debt for Development" in Michael Moffett, 2001.
Sep. 19 (W)	Interest Rate Parity [1-P] Suranovic, Chs. 20 and 40.
Sep. 21 (F)	Exchange Rate Regimes [1-P] Suranovic, Ch. 80.
Sep. 24 (M)	Applications [1-C] <i>The Economist</i> , "Soft Currency," 7/26/2007. (http://www.economist.com/finance/displaystory.cfm?story_id=9545488) [2-C] <i>The Economist</i> , "Yuan for all, All for the Yuan," 11/16/2006. (http://www.economist.com/finance/displaystory.cfm?story_id=8173920) [3-C] <i>The Economist</i> , "Carry on Speculating," 2/22/2007. (http://www.economist.com/finance/displaystory.cfm?story_id=8742054) [4-C] <i>The Economist</i> , "The Global Gusher," 1/4/2007. (http://www.economist.com/finance/displaystory.cfm?story_id=8496988)

- Sep. 26 (W) **Purchasing Power Parity**
 [1-P] Suranovic, Ch. 30.
 [2-C] Taylor & Taylor, "The Purchasing Power Parity Debate," *Journal of Economic Perspectives*, Fall 2004, p. 135-58.
- Sep. 28 (F) **Currency Misalignment**
 [1-P] Stein, "The Natural Real Exchange Rate of the US Dollar and Determinants of Capital Flows, in *Estimating Equilibrium Exchanged Rates*, Edited by John Williamson, 1994,
 [2-C] Williamson, "The Renminbi Exchange Rate and the Global Monetary System," Peterson Institute, 10/29/2003.
<http://www.iie.com/publications/papers/print.cfm?doc=pub&ResearchID=269>
[Falling Dollar](http://www.pbs.org/newshour/bb/economy/jan-june04/dollar_04-19.html#) (http://www.pbs.org/newshour/bb/economy/jan-june04/dollar_04-19.html#) (Rog)
[China Delinks](http://www.pbs.org/newshour/bb/asia/july-dec05/currency_7-21.html#) (http://www.pbs.org/newshour/bb/asia/july-dec05/currency_7-21.html#)
- Oct. 1 (M) **Exam**
- Historical Evolution of Institutions and Ideas**
- Oct. 3 (W) **The Policy Trilemma**
 [1-P] Obstfeld & Taylor, "Global Capital Markets: Overview and Origins," in *Global Capital Markets: Integraion, Crisis, and Growth*. 2004.
 (<http://200.32.4.58/~ely/obstfeld-taylor.pdf>)
- Oct. 5 (F) **Emergence of the Gold Standard**
 [1-P] Suranovic, Ch. 80.
 [2-S] Meissner, "A New World Order: Explaining the Emergence of the Classical Gold Standard," Working Paper, University of Cambridge, 2001.
 (<http://www.nber.org/papers/w9233.pdf>)
- Oct. 8 (M) **The Gold Standard: 1879-1914**
 [1-C] Eichengreen, *Globalizing Capital*, Ch. 2 (focus on pp. 25-44).
- Oct. 10 (W) **Post-war Floating: 1919-1926**
 [1-C] Eichengreen, *Globalizing Capital*, Ch. 3 (pp. 51-57).
[Hyperinflation](http://www.youtube.com/watch?v=qZ_MudzreIk) (http://www.youtube.com/watch?v=qZ_MudzreIk)
- Oct. 12 (F) **Case Study: Relinking to Gold**
 [1-C] Rukstad, "The United Kingdom and the Gold Standard: 1925," Chapter 13 in *Macroeconomic Decision Making in the World Economy*, 1992.
- Oct. 15 (M) **The Interwar Gold-Exchange Standard: 1927-1939**
 [1-C] Eichengreen, *Globalizing Capital*, Ch. 3 (pp. 57-72).
 [2-C] James, *The End of Globalization*, pp. 1-30.
- Oct. 17 (W) **The Great Depression**
 [1-P] Eichengreen, *Globalizing Capital*, Ch. 3 (pp. 72-92).
 [1-P] Bernanke, "The Macroeconomics of the Great Depression: A Comparative Approach," *JMC B*, February 1995. (**JSTOR**)
[The Crash](http://www.youtube.com/watch?v=AJERXNhKHdY&mode=related&search=) (<http://www.youtube.com/watch?v=AJERXNhKHdY&mode=related&search=>)
[Pain](http://www.youtube.com/watch?v=gplaq2yRgg) (<http://www.youtube.com/watch?v=gplaq2yRgg>)
[Hitler](http://www.youtube.com/watch?v=K0CTjG6hEQM&NR=1) (<http://www.youtube.com/watch?v=K0CTjG6hEQM&NR=1>)
[Devaluation](http://www.youtube.com/watch?v=3_ex0sTsb_I) (http://www.youtube.com/watch?v=3_ex0sTsb_I)

- Oct. 19 (F) **Designing A New World Order**
 [Case] Carlson, "Negotiations Prior to 1944 Bretton Woods Conference."
 WWII (<http://www.youtube.com/watch?v=OD1gWA9Rtwk>)
 Welcome to Bretton Woods (<http://www.youtube.com/watch?v=GVytOfPZe8>)
- Oct. 22 (M) **Operation of the Bretton Woods System**
 [1-C] Eichengreen, *Globalizing Capital*, Ch. 4 (pp. 93-128).
 [2-C] Suranovic, Ch. 100.
 Ideology (<http://www.youtube.com/watch?v=TtOtV-gE3YQ>)
- Oct. 24 (W) **The Collapse of Bretton Woods**
 [1-P] Eichengreen, *Globalizing Capital*, Ch. 4 (pp. 128-35).
 [2-P] DeGrauwe, "Why Fixed Exchange Rates Systems Collapse," *International Money*, Ch. 3, pp. 26-39.
 Nixon Feels the Heat (<http://www.youtube.com/watch?v=iRzr1QU6K1o>)
- Oct. 26 (F) **Fall Break**
- Oct. 29 (M) **The AA-DD Model**
 [1-P] Suranovic, Ch. 60.
 Mundell http://nobelprize.org/nobel_prizes/economics/laureates/1999/mundell-interview.html
- Oct. 31 (W) **The AA-DD Model**
 [1-P] Suranovic, Ch. 70.
- Nov. 2 (F) **Reflections on Mundell**
 [1-P] Russell Boyer, University of Western Ontario
- Nov. 5 (M) **The Floating Dollar Standard: 1970s**
 [1-C] DeGrauwe, "The System without commitments," *International Money*, Ch. 5.
- Nov. 7 (W) **The Floating Dollar Standard: 1980s**
 [2-C] Eichengreen, *Globalizing Capital*, Ch. 5 (pp. 136-45).
- Nov. 8 (F) **The Floating Dollar Standard**
 [2-C] Eichengreen, *Globalizing Capital*, Ch. 5 (pp. 145-52).
 Plaza Accord (<http://www.youtube.com/watch?v=g2vMRjOIoXY>)
- Nov. 12 (M) **Theory of Optimum Currency Areas**
 [1-P] Mundell, "A Theory of Optimum Currency Areas," *American Economic Review*, September 1961, 657-65. (JSTOR)
 [2-C] Mundell http://nobelprize.org/nobel_prizes/economics/laureates/1999/mundell-interview.html
 Good Site: <http://homepage.ntlworld.com/peter.mickle/m/euro/OCAs.htm>
- Nov. 14 (W) **Currency Blocs**
 [1-S] Feige, et al. "Unofficial Dollarization in Latin America," in *The Dollarization Debate*, edited by Salvatore, Dean and Willett, 2003.
 [2-C] Mundell, "The Case for the Euro: Part I," WSJ, 5/28/1998. (ProQuest)
 [3-C] Mundell, "The Case for the Euro: Part II," WSJ, 5/29/1998. (ProQuest)
- Nov. 16 (F) **Exchange Rate Crises: First & Second Generation Models**
 [1-P] DeGrauwe, "Modeling the Collapse of Fixed Exchange Rate System," *International Money*, 1996, Ch. 4.
- Nov. 19 (M) **The EMS Crisis (1992)**

- [1-C] Eichengreen, *Globalizing Capital*, Ch. 5 (pp. 152-81).
 [2-S] Whitt, "Monetary Union in Europe," FRB of Atlanta *Economic Review*, 1994.
Black Wednesday: (<http://www.youtube.com/watch?v=AHDsO7gvXHQ>)
- Nov. 21 (W) **The Asian Crisis (1997): Third Generation**
 [1-S] Eichengreen, "Understanding Asia's Crisis," Ch. 9, *Capital Flows & Crises*.
 [2-P] Chang and Velasco, "A Model of Financial Crises in Emerging Markets,"
Quarterly Journal of Economics, May 2001. (JSTOR)
- Nov. 23 (F) **Thanksgiving Break**
- Nov. 26 (M) **The Argentine Crisis (2001)**
 [1-S] Hausmann and Velasco, "Hard Money's Soft Underbelly: Understanding the
 Argentine Crisis," *Brookings Papers on Economic Activity*, 1:2005.
 (http://ksghome.harvard.edu/~rhausma/paper/btf02_hard_money.pdf)
 [2-C] *The Economist*, "A Victory by Default," May 3, 2005.
 (http://www.economist.com/business/displaystory.cfm?story_id=E1_PSTVSSJ)
- Nov. 28 (W) **Institutional Fallout**
 [1-C] Fischer, "Exchange Rate Regimes: Is the Bipolar View Correct," *Journal of
 Economic Perspectives*, Spring 2001. (JSTOR)
 [2-C] Stiglitz, "Capital Market Liberalization and Exchange Rate Regimes: Risk
 without Reward," in *The Annals*, January 2002, pp. 219-48. (S)
 (<http://ann.sagepub.com/cgi/reprint/579/1/219.pdf>)
- Nov. 30 (F) **A World Currency?**
 [1-C] Mundell, "Currency Areas, Exchange Rate Systems, and International Monetary
 Reform," in *The Dollarization Debate*, edited by Salvatore, et al., 2003.
 (<http://www.columbia.edu/~ram15/cema2000.html>)
- Dec. 3 (M) **Real Effects of Common Currencies**
 [1-S] Rose, "One Money, One Market: Estimating the Effect of Common Currencies
 on
 Trade," *Economic Policy*, December 1999.
 [2-S] Edwards, "Dollarization: Myths and Realities," in *The Dollarization Debate*,
 edited by Salvatore, et al., 2003.
- Dec. 5 (W) **Global Imbalances**
 [1-P] Goldberg & Dillon, "Why A Dollar Depreciation May Not Close the U.S. Trade
 Deficit," FRBNY Current Issues, June 2007.
 (http://www.newyorkfed.org/research/current_issues/ci13-5.pdf)
 [2-C] Williamson, "The Choice of the Exchange Rate Regime: The Relevance of
 International Experience to China's Decision,"
<http://www.petersoninstitute.org/publications/papers/williamson0904.pdf>
- Dec. 7 (F) **Global Imbalances: Student Debate**
 [1-S] Obstfeld & Rogoff, "Global Current Account Imbalances and Exchange Rate
 Adjustments," *Brookings Papers on Economic Activity*, 1:2005.
 (<http://www.economics.harvard.edu/faculty/rogoff/papers/BPEA2005.pdf>)
 [1-S] Dooley, Garber & Folkerts-Landau, "The Two Crises of International
 Finance," NBER Working Paper No. 13197, June 2007.
 (<http://www.nber.org/papers/w13197.pdf>)
- Dec.. 10-14 **Term Paper Presentations**