

Macalester College
Spring 2001

International Money and 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 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: What determines the price at which different currencies trade for one another? Should governments “fix” the exchange rate at a particular level? If so, what level? What does the pursuit of external policy goals, such as fixed exchange rates, imply about the ability of policy-makers to address internal goals (e.g., full-employment and low inflation)? Why do nations have trade imbalances and what impact do they have on the broader economy? What are the causes of the international financial crisis observed in Latin America in 1994-95 and Asia in 1997-98? What role do international institutions, such as the International Monetary Fund, play in the economic system? Is Europe an “optimal currency area”? 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. Students who are currently enrolled in 41 or 61 can take this course only if they receive permission from the instructor. This course builds on material covered in Introduction to International Economics (21), but 21 is not a prerequisite.

Readings: There are three books for the course, all available at the Expanded Mind bookstore: 1) International Money and Finance, Sixth Edition, by Michael Melvin; 2) International Money, Second Edition, by Paul De Grauwe; and 3) Globalizing Capital: A History of the International Monetary System, Second Edition, by Barry Eichengreen. Students are expected to purchase a ten week subscription to The Economist magazine (\$18 per student). This will give you access to their electronic archive of articles that appear on the reading list. All other readings (journal articles, book chapters and cases) are available on either electronic reserve (ER), standard reserve (SR), or through JSTOR.

Grades: Final grades are based on the following:

<u>Activity</u>	<u>Weight</u>
Class Participation	20%
Problems	10%
First Exam	20%
First Essay	15%
Second Essay	15%
Term Paper	20%

Class participation entails answering and posing questions during class and contributing to case studies. Student contributions to classroom discussion will be recorded each day. A two-page outline of the paper, complete with the thesis question and a preliminary list of references, is due on Monday, March 26. The final draft of the paper is due on Friday, May 4. No exceptions will be granted for either deadline. Students are encouraged to work in groups of two.

Important Web Sites:

<u>Organization</u>	<u>Address (http://)</u>	<u>Comments</u>
NBER	www.nber.org/	Penn World Tables
World Bank	www.worldbank.org	papers and data
Government Pubs	www.gpo.ucop.edu/catalog/erp97.html	Data!!!!!!
IMF	www.imf.org/external/index.htm	International
St. Louis Fed	www.stls.frb.org/	FRED data base
Board of Governors	www.bog.frb.fed.us/	Data
OECD	www.oecdwash.org	Intern. Econ. Org.
Bernkopf’s Home Page	www.patriot.net/users/bernkopf	Central Bank Links
<i>The Economist</i>	www.economist.com	Data and Ideas

Course Outline and Reading List

Week	Topic and Readings
Monday Jan. 29	<p>Introduction <i>The Economist</i>, "One World?" 10/18/1997.</p> <p style="text-align: center;"><u>Fundamental Ideas and Relationships</u></p>
Wednesday Jan 31	<p>Exchange Rates and the FX Market Melvin, M., Ch. 1. <i>New York Times</i>, "Dollar Makes Canada Land of the Spree," 8/1/1999.</p>
Friday Feb. 2	<p>Government Intervention in the FX Markets Melvin, M., Ch. 1. <i>The Economist</i>, "Getting out of a fix," 11/20/97. <i>New York Times</i>, "Central Banks Move to Rescue an Ailing Euro," 9/23/2000.</p>
Monday Feb. 5	<p>Balance of Payments Accounting Melvin, M., Ch. 2. <i>The Economist</i>, Figures to Fret About," 7/11/98. Higgins, M. and T. Klitgaard, "Viewing the Current Account Deficit as a Capital Inflow," <i>Current Issues in Economics and Finance</i>, Dec. 1998. (ER)</p>
Wednesday Feb. 7	<p>Risk and Hedging Melvin, M., Ch. 4.</p>
Friday Feb. 9	<p>Interest Rate Parity Melvin, M., Ch. 5 <i>The Economist</i>, "Mahathir, Soros and the Currency Markets," 9/27/1997.</p>
Monday Feb. 12	<p>Case Study Rose, A. "The European Currency Crisis of 1992." (Ruminator bookstore)</p>
Wednesday Feb. 14	<p>Purchasing Power Parity Melvin, M., Ch. 8.</p>
Friday Feb. 16	<p>Elasticities Approach to the Balance of Trade Melvin, M., C. 9 (pp. 145-157).</p>
Monday Feb. 19	<p>Absorbtion Approach to the Balance of Trade Melvin, M., C. 9 (pp. 158-159). Mankiw, G., Ch. 8. (SR) <i>The Economist</i>, "A Capital Competition," 11/5/98.</p>
Wednesday Feb. 21	<p>Monetary Approach to the Balance of Payments Melvin, M., C. 9 (pp. 159-167). <i>The Economist</i>, "Talk is Cheap (and so is the Dollar)," 9/21/1996. <i>The Economist</i>, "Buy Hard: with a Vengeance," 8/26/1995.</p>
Friday Feb. 23	<p>The International Mobility of Capital Melvin, M., Chs. 6 & 7. <i>The Economist</i>, "Capital goes Global," 10/25/97. <i>The Economist</i>, "Stay-at-home Shareholders," 2/17/1996.</p>

Monday Feb. 26	Review
Wednesday Feb. 28	Exam
	<u>Evolution of the International Financial System</u>
Fri. & Mon. Mar. 2 & 5	The Classical Gold Standard: 1879-1914 Eichengreen, B. <i>Globalizing Capital</i> , Ch. 2. McKinnon, R., "The Rules of the Game: International Money in Historical Perspective," <i>Journal of Economic Literature</i> , March 1993. (JSTOR)
Wednesday Mar. 7	Post-war Floating & Hyperinflation: 1919-1926 Eichengreen, <i>Globalizing Capital</i> , Ch. 3 (pp. 51-57).
Friday Mar. 9	Case Study Rukstad, M., "The United Kingdom and the Gold Standard: 1925." (SR)
Mon. & Wed. Mar. 12 & 14	The Interwar Gold Standard: 1927-1939 Eichengreen, B. <i>Globalizing Capital</i> , Ch. 3. DeGrauwe, P., <i>International Money</i> , Ch. 1. Bernanke, B., "The Macroeconomics of the Great Depression: A Comparative Approach," <i>JMC B</i> , February 1995. (JSTOR) Eichengreen, B. and J. Sachs, "Exchange Rates and Economic Recovery in the 1930s," <i>Journal of Economic History</i> , 45 (1985). (JSTOR) Nurske, R. <i>The Gold Exchange Standard</i> , 1944. (ER)
Friday March 16	Case Study Carlson, J., "Negotiations Prior to 1944 Bretton Woods Conference." (ER)
Monday March 26	The N-1 and Adjustment Problems DeGrauwe, P., Chs. 2 and 3.
Wednesday March 28	Operation of Bretton Woods: 1945-1971 Eichengreen, B. <i>Globalizing Capital</i> , Ch. 4.
Friday March 30	Case Study Rukstad, M. "Nixon's New Economic Policy: 1971." (SR)
	The Post-1971 Floating-Rate Dollar Standard
Monday April 2	Overview DeGrauwe, Paul, <i>International Money</i> , Ch. 5 (pp. 85-89) Eichengreen, B. <i>Globalizing Capital</i> , Ch. 5 (pp. 136-52).
Wed. & Fri. April 4 & 6	Exchange Rate Models Melvin, M., Ch. 10. Taylor, M., "The Economics of Exchange Rates," <i>JEL</i> , March 1995. (JSTOR) DeGrauwe, Paul, <i>International Money</i> , Chs. 6 & 7. <i>The Economist</i> , "Why Currencies Overshoot," 12/1/90.
Monday April 9	Central Bank Interventions DeGrauwe, Paul, <i>International Money</i> , Ch. 10.

- Wednesday
April 16 **Case Study**
Klein, M., "Can this Currency be Saved?" (Ruminator bookstore)
- Friday
April 13 Good Friday (no class)
- Monday
April 16 **Vehicle Currencies**
Melvin, M., Ch. 3 (pp. 59-64).
Krugman, P., "The International Role of the Dollar: Theory and Prospect," in
Currencies in Crisis, 1992. **(ER)**
- Exchange Rate Crises**
- Wednesday
April 18 **Theories of Speculative Attacks**
DeGrauwe, Paul, *International Money*, Ch. 4.
- Friday
April 20 **Europe 1992-93**
Whitt, J., "Monetary Union in Europe," Federal Reserve Bank of Atlanta
Economic Review, January 1994. **(ER)**
DeGrauwe, P., Ch. 3 (pp. 39-44).
- Monday
April 23 **Mexico and the Tequila Crisis: 1994**
Espinosa and Russell, "The Mexican Economic Crisis: Alternative Views,"
Federal Reserve Bank of Atlanta *Economic Review*, January 1996. **(ER)**
The Economist, "Too Little, Not Too Much," 6/24/95.
- Wednesday
April 25 **Asia and the Emerging Markets: 1997**
The Economist, "Emerging Asia's Sombre Era," 8/24/96.
The Economist, "Why Did Asia Crash?" 1/10/98.
The Economist, "Are Crashes Catching?" 8/3/96.
- The Search for New Rules**
- Friday
April 27 **Optimal Currency Areas and the Euro**
Krugman & Obstfeld, *International Economics*, Ch. 20. **(ER)**
Eichengreen, B. *Globalizing Capital*, Chs. 5, 160-186.
The Economist, "The Etiquette of Merging Currencies," 12/9/95.
The Economist, "Euro Brief," 10/17/98-12/5/98.
- Monday
April 30 **Capital Controls**
Neely, C., "An Introduction to Capital Controls," FRB of St. Louis *Review*,
Nov/Dec. 1999. **(ER)**
- Wednesday
May 2 **Currency Boards and Dollarization: The Answer?**
The Economist, "The ABCs of a Currency Board," 11/1/97.
The Economist, "Argentina's Currency Strengths," 1/14/95.
Chang, R. "Dollarization: A Scorecard," FRB of Atlanta *Economic Review* Third
Quarter 2000. **(ER)**
The Economist, "One World, One Money," 9/26/1998.
- Fri. & Mon.
May 4 & 7 **Term Paper Presentations**