

Department of Economics
Princeton University
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**ECONOMICS 554
INTERNATIONAL MONETARY THEORY AND POLICY II**

We will cover some basic issues in international macroeconomics, as well as current debates. Topics will include: the sovereign debt problem, dynamic models of open economies, financial and currency crises, exchange rate policy issues, and the reform of the international financial system. I will feel free to modify topics or readings according to the class interests or new developments.

There is no text for this course, but a basic reference is *Foundations of International Macroeconomics*, M. Obstfeld and K. Rogoff, MIT Press, 1996, henceforth OR. This is an excellent treatise and a great starting point for many of the issues we will cover. It includes very nice exercises.

The *grade* for the course will be based on:

- A midterm exam (40%), date to be agreed upon
- A short paper and presentation (60%), details to be provided later.

The plan for the course and associated readings are listed below. An asterisk identifies strongly recommended material.

1. International Capital Markets. The Sovereign Debt Problem

1.1 Overview

OR, Chapter 6

*Eaton, J. and R. Fernandez, "Sovereign Debt," in *Handbook of International Economics*, Vol. 3. (G. Grossman and K. Rogoff eds.), North Holland, 1995

Lucas, R. "Why Doesn't Capital Flow from Rich to Poor Countries?," *AER* 80 (1990), 92-96

1.2 Basic Models of Sovereign Lending

*Eaton, J. and M. Gersovitz. "Debt with potential repudiation." *REconStud* 48 (1981), 289-309

*Bulow, J. and K. Rogoff, "A constant recontracting model of sovereign debt," *JPE* 97 (1989), 155-78

Bulow, J. and K. Rogoff, "Sovereign debt: Is to forgive to forget?", *AER* 79 (1989), 43-50

Atkeson, A. "International Lending with Moral Hazard and Risk of Repudiation," *Econometrica* 59 (1991), 1069-1090

Kletzer, K. and B. Wright, "Sovereign Debt as Intertemporal Barter," *AER* 90 (2000), 621-39

1.3 Some Evidence

Conklin, J., "The theory of sovereign debt and Spain under Philip II," *JPE* 103 (1998), 483-513

Rose, A. "One Reason Countries Pay their debts: Renegotiation and International Trade," NBER WP 8853, March 2002.

Klingen, C., B. Weder and J. Zettelmeyer, "How Private Creditors Fared in Emerging Debt Markets, 1970-2000."

*Reinhart, C. and K. Rogoff, "Serial Default and the Paradox of Rich to Poor Capital Flows," *AER* forthcoming 2004.

2. Aggregate Models of Open Economy Macroeconomics

OR, 8.1-8.2, 9.1-9.4

*Dornbusch, Rudiger. "Expectations and Exchange Rate Dynamics," *JPE* 84 (December 1976), 1161-76

Rogoff, Kenneth. "Dornbusch's Overshooting Model after 25 years," *IMF Staff Papers* 49 (2002), 1-34

Eichenbaum, M. and C. Evans, 1995, "Some Empirical Evidence on the Effects of Shocks to Monetary Policy on Exchange Rates." *QJE* 110 (1995), 975-1009

3. Dynamic Equilibrium Models (including RBC and New Open Economy Macro)

3.1 International RBC Models (and related puzzles)

Backus, D., P. Kehoe, and F. Kydland, "International Real Business Cycles," *JPE* 100 (1992), 745-775

Mendoza, E. "Real Business Cycles in a Small Open Economy," *AER* 81 (1991), 797-818

*Backus, D., P. Kehoe, and F. Kydland, "International Business Cycles, Theory and Evidence," in *Frontiers of Business Cycle Research*, Tom Cooley editor

3.2 Nominal Rigidities and "New Open Economy Macroeconomics"

Bergin, P. and R. Glick, "Endogenous Nontradability and Macroeconomic Implications," NBER WP 9739, June 2003

*Betts C. and M. Devereux: "Exchange rate dynamics in a model of pricing-to-market", *JIE* 47, 569-598, 1998.

Bergin, P. "Putting the New Economy Macroeconomics to a test." Forthcoming, *JIE*

Corsetti G. and P. Pesenti: "Welfare and Macroeconomic Interdependence," *QJE* (2001), 421-45

Chari, V.V., P. Kehoe, and E. McGrattan, "Can Sticky Price Models Generate Volatile and Persistent Real Exchange Rates?" *REconStud* 69 (2002), 533-63

Devereux, M. and C. Engel. "Monetary Policy in the Open Economy Revisited: Price Setting and Exchange Rate Flexibility," *REconStud* 70, (2003)

Lane, P. "The New Open Economy Macroeconomics: A Survey," *JIE* 54 (2001), 235-66

OR, Ch. 10

*Obstfeld, M. and K Rogoff, "New Directions for Stochastic Open Economy Models," *JIE* 50 (2000), 117-53

*Obstfeld, M. and K Rogoff, "Exchange Rate Dynamics Redux," *JPE* 103 (1995), 624-60

Obstfeld, M. and K Rogoff, "Risk and Exchange Rates,"

2.3 Flexible Price Approaches

Perri, F. and J. Heathcote, "Financial Autarky and International Real Business Cycles," *JME* 49 (2002), 601-27

*Perri, F. and P. Kehoe, "International Business Cycles with Endogenously Incomplete Markets," *Econometrica* 70 (2002), 907-28

Alvarez, F. and A. Atkeson, "Money and Exchange Rates in the Grossman-Weiss-Rotemberg Model," *JME* 40 (1997), 619-640

*Alvarez, F., A. Atkeson, and P. Kehoe, "Money, Interest Rates, and Exchange Rates with Endogenously Segmented Markets," *JPE* (2002)

4. Financial and Currency Crises in Open Economies

4.1 "First" and "Second Generation" Models

OR, 8.4

* Flood, R., and P. Garber. "Collapsing Exchange Rate Regimes: Some Linear Examples." *JIE* 17 (1984): 1-13

Krugman, P. "A Model of Balance of Payments Crises." *JMCB* 11 (1979): 311-25

Krugman, P. *Currencies and Crises*. MIT Press, 1992

* Obstfeld, M. "The Logic of Currency Crises." *Cahiers Economiques et Monetaires* 43 (1994): 189-213.

4.2. Recent Approaches: Moral Hazard

Chang, R., "Understanding Recent Crises in Emerging Markets," Federal Reserve Bank of Atlanta *Economic Review*, Second Quarter 1999, 6-17.

Dooley, M. 1997. "A Model of Crises in Emerging Markets," NBER Working Paper 6300.

*Krugman, P. 1998. "What Happened to Asia?," mimeo, MIT.

Mc Kinnon, R., and H. Pill. 1996. "Credible Liberalizations and International Capital Flows: The Overborrowing Syndrome," in T. Ito and A. Krueger (eds.), *Financial Deregulation and Integration in East Asia*, Chicago: Chicago University Press.

4.3 Recent Approaches: Financial Panics

Calvo, G. "Varieties of Capital Market Crises," Working Paper 15, Center for International Economics, University of Maryland, 1995.

*Chang, R., and A. Velasco, "Financial Fragility and the Exchange Rate Regime," *Journal of Economic Theory*, 92 (2000), 1-34.

_____, "Liquidity Crises in Emerging Markets: Theory and Policy," in *NBER Macroeconomics Annual 1999* (Ben Bernanke and Julio Rotemberg, eds.), The MIT Press, Cambridge, 2000.

Chari, V.V. and P. Kehoe, "Hot Money," *JPE* 111 (2003), 1262-92

4.4. Global Games and the Debate on Equilibrium Multiplicity

Corsetti, G., B. Guimaraes and N. Roubini. "International Lending of Last Resort and Moral Hazard: A Model of IMF's Catalytic Finance." Working Paper, 2003

*Morris, S., and H. S. Shin. "Unique Equilibrium in a Model of Self Fulfilling Attacks." *American Economic Review* 88 (1998), 587-97.

4.5 Politics and Crises

Alesina, A., and G. Tabellini. "External Debt, Capital Flight, and Political Risk." *JIE* 27 (1989), 199-220

*Chang, R. "Financial Crises and Political Crises," working paper, Rutgers University, 2002

Chang, R. "Electoral Uncertainty and the Volatility of International Capital Flows," working paper, Rutgers University, 2003

Drazen, A. "Political Contagion in Currency Crises." In P. Krugman, ed. *Currency Crises*. Cambridge, MA: NBER 1998

4.6. Empirical Approaches

Demirguc-Kunt, A. and E. Detragiache, "The Determinants of Banking Crises," *IMF Staff Papers* 45 (1998), 81-109

Eichengreen, B., A. Rose and C. Wyplosz, "Contagious Currency Crises," NBER Working Paper 5681 (1996)

*Frankel, J. and A. Rose. "Currency Crashes in Emerging Markets: An Empirical Treatment." *JIE* 41 (1996), 341-68

*Kaminsky, G. and C. Reinhart, "The Twin Crises: the causes of banking and balance of payments problems." *AER* 89, 1999, 473-500

*Rodrik, D. and A. Velasco, "Short term capital Flows," NBER WP 7364, 1999.

Kamin, S. "Identifying the Role of Moral Hazard in International Financial Markets," International Finance Discussion Papers 736. Board of Governors of the Federal Reserve System, 2002

5. Financial Frictions and Open Economy Macroeconomics

5.1 Balance Sheets and Exchange Rates

*Aghion, P., P. Bacchetta, and A. Banerjee. "A Simple Model of Monetary Policy and Currency Crises." *EER* 44 (2000), pp. 728-738.

Aghion, P., P. Bacchetta, and A. Banerjee, "Financial Development and the Instability of Open Economies, *JME* forthcoming.

Calvo, G. "Capital Flows and Capital Market Crises: The Simple Analytics of Sudden Stops." *Journal of Applied Economics* 1 (1998), 35-54

*Céspedes, L., R. Chang and A. Velasco. "Balance Sheets and Exchange Rates." Working Paper, 2004.

Céspedes, L., R. Chang and A. Velasco, "IS-LM-BP in the Pampas." *IMF Staff Papers* 50 (2003), 143-56

*Krugman, P. "Balance Sheets, the Transfer Problem and Financial Crises," in: *International Finance and Financial Crises*, P. Isard, A. Razin and A. Rose (eds.), Kluwer Academic Publishers, 1999.

Burnside, C., M. Eichenbaum, and S. Rebelo. "Hedging and Financial Fragility in Fixed Exchange Rate Regimes." *EER*, 2001, 45(7), pp. 1151-1193.

Devereux, M. and P. Lane, "Exchange Rate Regimes and Monetary Policy Rules for Emerging Markets." Mimeo, University of British Columbia, April 2003.

Gertler, M., S. Gilchrist, and F. Natalucci, "External Constraints on Monetary Policy and the Financial Accelerator." Mimeo, NYU, October 2003

5.2 Fixed Versus Flexible Exchange Rates. Monetary Policy Rules in Open Economies

Calvo, G. and C. Reinhart, "Fear of Floating." *QJE* 117, (2002), 379-408.

*Levy Yeyati, E. and F. Sturzenegger. "To Float or to Fix: Evidence on the Impact of Exchange Rate Regimes on Growth." *AER* 93 (2003), 1173-93

Clarida, R., J. Gali, and M. Gertler. "Optimal Monetary Policy in Closed versus Open Economies: An Integrated Approach." NBER WP 8604, 2001

Svensson, L. "Open Economy Inflation Targeting," *JIE* 50 (2000), 155-183

Laxton, D. and P. Pesenti. "Monetary Policy Rules for Small, Open Emerging Economies," *JME*, forthcoming

Chang, R. and A. Velasco. "Dollarization: Analytical Issues," In: *Dollarization*, E. Levy Yeyati and F. Sturzenegger editors, MIT Press, 2003

6. Reform of the "International Financial Architecture"

*Tirole, J. "Inefficient Foreign Borrowing." *AER* 93 (2003), 1678-1702

*Caballero, R. and A. Krishnamurthy, "Excessive Dollar Debt: Financial Development and Underinsurance." *JFinance*, April 2003, 58(2), pp. 867-893.

Jeanne, O. "Why Do Emerging Economies Borrow in Foreign Currency?." Mimeo, IMF, October 2001.

Jeanne, O. "Debt Maturity and the Global Financial Architecture," CEPR Discussion paper 2520, August 2000

Gourinchas, P. and O. Jeanne, "The Elusive Gains from International Financial Integration," NBER WP 9684, May 2003.

Chari, V.V. and P. Kehoe, "Asking the Right Questions about the IMF," Federal Reserve Bank of Minneapolis *The Region*, 1999, 3-26.