

Department of Economics, Harvard University, v. November 9, 2009

**Economics 1545: International Financial and Macroeconomic Policy**

**Professor Kenneth Rogoff**

**Time and Place:** Fall 2009; M, W, 1–2:30 pm., [REDACTED]

**Office Hours:** [REDACTED] Mondays 3–4 PM, or by appointment

**Email:** [REDACTED] (N.B. When sending an email pertaining to this course, please put "1545" in the subject header.)

**Teaching Assistant:** Thomas Sampson, [REDACTED]

**Staff Assistant:** Jane Trahan, [REDACTED]

**Overview:**

This is an advanced international finance and macroeconomics course that uses a mix of theoretical, empirical and policy frameworks to analyze topical problems in international finance.

**Prerequisites:**

Economics 1011b (preferably) or 1010b (Knowledge of basic calculus will be assumed.)

**Background Texts:** (On reserve at Lamont Library, and available for purchase at the COOP)

- [\*Foundations of International Macroeconomics\*](#), by Maurice Obstfeld and Kenneth Rogoff, MIT Press, 1996.
- [\*This Time Is Different: Eight Centuries of Financial Folly\*](#), by Carmen Reinhart and Kenneth Rogoff, Princeton University Press, 2009, (selected chapters).

**Readings:**

Readings can be accessed online or are available on Reserve at Lamont Library.

*Primary* readings are denoted by an \* symbol. Supplementary readings will be summarized in class but are not required.

**Problem Sets:**

Students are encouraged to work with others on the problem sets, and it is permissible to hand in a single answer sheet for up to three students, with all three receiving the same group grade.

### Course Requirements:

- Midterm: Wednesday October 14 (in-class, closed book; but exam will provide most of the basic formulas you might require, to lessen need for memorization). Analytical problems on the exam will closely parallel material covered in problem sets (but will generally require much less algebra), and the essay problem will relate to a central topic covered extensively in class.
- Final: The final will have a larger essay component than the mid-term. The final will draw on the entire course, though any technical material on the final will be closely related to material covered in Problem Set III.
- Short policy paper: You will be asked to write a short policy paper on a topic drawn from a list of questions relating to reform of the international monetary system. A one-page outline of your paper is due on Wednesday, **October 28 or before my first meeting with your group, whichever is earlier**, and the complete paper is due on Monday **November 16**. These papers will form the basis for class discussions and (depending on class size) in-class presentations during the final four meetings of the class. The papers are intended to be short and succinct—there is an absolute total page limit of 10 double-spaced (12 pt.) pages (roughly 2500 words): Only figures and references are excluded in this limit. *The papers do not need to include any formal analytical or econometric analysis*; you may write them in a style you find suitable to the question you are addressing. The final exam will include (a choice of) essay questions relating to the paper topics that you and your classmates have chosen.
- Problems: There will be 3 problem sets, due Sept 14, Oct. 5 and Nov 16.

### Grades:

Problems: 10%, Mid-term: 20%, Final: 35%, Paper: 35%

## Topics

### I. MODELS OF EXCHANGE RATES

\*Rogoff, Kenneth, "[Dornbusch's Overshooting Model After Twenty-Five Years](#)," IMF Staff Papers 49, Special Issue, 2002 (35 pages). (This link is to a [slightly earlier version](#) that will give you a higher quality printout.)

\*Obstfeld and Rogoff: pp. 513-530.

Frankel, Jeffrey, and Andrew Rose, 1995, "Empirical Research on Nominal Exchange Rates," in G Grossman and K Rogoff (eds), *Handbook of International Economics*, vol. 3 (Elsevier).

Rogoff, Kenneth and Vania Stavrakeva, "[The Continuing Puzzle of Short-Horizon Exchange Rate Forecasting](#)," manuscript, Harvard University, July 30, 2008.

### II. THE PURCHASING POWER PARITY PUZZLE AND RELATED PUZZLES

\*Kenneth Rogoff, "[The Purchasing Power Parity Puzzle](#)," *Journal of Economic Literature* 34, June 1996, 647-68.

\*Obstfeld and Rogoff: pp. 199-225.

Imbs, Jean, Haroon Mumtaz, Morton O. Ravn, and Helene Rey, "[PPP Strikes Back: Aggregation and the Real Exchange Rate](#)," *Quarterly Journal of Economics* 120(1): 1-43.

Goldberg, Penny K. and Michael Knetter, "[Goods Prices and Exchange Rates: What Have We Learned?](#)" *Journal of Economic Literature* 35 (September 1997): 1243-72.

Taylor, Alan, M., "[Potential Pitfalls for the Purchasing-Power Parity Puzzle? Sampling and Specification Biases in Mean-Reversion Tests of the Law of One Price](#)," *Econometrica* 69(2) (March 2001): 473-98.

Reidel, Demian and Jan Szilagyi, "[A Biased View of PPP](#)," manuscript, Harvard University, February 2005.

\*Gopinath, Gita and Ricardo Rigobon, "[Sticky Borders](#)," *Quarterly Journal of Economics* 123(2): 531-575.

### III. SPECULATIVE EXCHANGE RATE ATTACKS

**Basic models and empirical issues: Salant–Henderson–Krugman model, multiple equilibria (“generation 2”).**

\*Obstfeld and Rogoff: pp. 558-567, 635-638, 648-653.

### IV. BANK RUNS AND THE PERSISTENCE OF THE GREAT DEPRESSION

\*Diamond, Douglas and Philip H. Dybvig, "[Bank Runs, Deposit Insurance, and Liquidity](#)," *Journal of Political Economy* 91(3): 401-19, June 1983.

\*Bernanke, Ben, "[Nonmonetary Effects of the Financial Crisis in the Propagation of the Great Depression](#)," *American Economic Review* 73 (June 1983): 257-76.

Cole, Harold and Lee Ohanian, "New Deal Policies and the Persistence of the Great Depression," *Journal of Political Economy*, 112(4) August, 2004, 779-816.

Eggertsson, Gauti, "Great Expectations and the End of the Great Depression," *American Economic Review* 98, September 2008, 1476-1516.

Bernanke, Ben S. *Essays on the Great Depression*. Princeton University Press, 2000.

Gorton, Gary and Andrew Metrick, "[Securitized Banking and the Run on Repo](#)," Yale ICF Working Paper No. 09-14.

Gorton, Gary and Andrew Metrick, "[Haircuts](#)," Yale ICF Working Paper No. 09-15.

**Also: International transmission of the Great Depression via faults in the inter-war gold standard.**

\*Obstfeld and Rogoff: pp. 626-630.

\*Eichengreen, Barry and Jeffrey Sachs, "[Exchange Rates and Economic Recovery in the 1930s](#)," *Journal of Economic History*, vol. XLV, no. 4, December 1985, also NBER working paper 1498, May 1986.

### V. PERFORMANCE OF EXCHANGE RATE REGIMES

\*Rose, Andrew, "[One Money, One Market: Estimating the Effects of a Common Currency on Trade](#)," *Economic Policy* 15(30), April 2000, 7–45.

Klein, Michael W. and Jay C. Shambaugh, "[Fixed Exchange Rates and Trade](#)," NBER Working Paper 10696, August 2004.

\*Husain, Aasim, Ashoka Mody, and Kenneth Rogoff, "Exchange Rate Durability and Performance in Developing versus Advanced Economies," *Journal of Monetary Economics* 52 (January 2005), 35-64. (Click on Digital Object Identifier (DOI).)

Baldwin, Richard, Di Nino, Virginia, Fontagne, Lionel, De Santis, Roberto, and Taglioni, Daira, "Study on the Impact of the Euro on Trade and Foreign Direct Investment," *European Economic and Monetary Union Working Paper No. 321*, May 2008.

Frankel, Jeffrey, "[The Estimated Effects of the Euro on Trade: Why Are They Below Historical Effects of Monetary Unions Among Smaller Countries?](#)" NBER working paper 14542 (December 2008).

Tenreyro, Silvana, "[Currency Unions in Prospect and Retrospect](#)," manuscript, London School of Economics and Political Science, October 2009

## VI. GLOBAL CURRENT ACCOUNT IMBALANCES

\*Obstfeld and Rogoff: pp. 1-84.

\*Obstfeld, Maurice and Kenneth Rogoff, "[The Unsustainable US Current Account Position Revisited](#)," in Richard Clarida (ed.), *G7 Current Account Imbalances: Sustainability and Adjustment*, University of Chicago Press, 2007 (with revisions).

Gourinchas, Pierre-Olivier and Helene Rey, 2007, "International Financial Adjustment," *Journal of Political Economy* 115(4), 665-703.

\*Cooper, Richard, "Global Imbalances: Globalization, Demography, and Sustainability," *Journal of Economic Perspectives*, 2008, Issue 3, 93-112.

Dooley, Michael P., Peter Garber and David Folkerts Landau, "The Revived Bretton Woods System: The Effects of Periphery Intervention and Reserve Management on Interest Rates & Exchange Rates in Center Countries," [NBER Working Paper 10332](#), March 2004.

## VII. GLOBAL CAPITAL MARKET INTEGRATION: ADVANCED COUNTRIES

\*Obstfeld, Maurice and Kenneth Rogoff, "[The Six Major Puzzles in International Macroeconomics: Is There a Common Cause?](#)" in Ben Bernanke and Kenneth Rogoff (eds.), *NBER Macroeconomics Annual 2000* (Cambridge: MIT Press), pp. 339-390 (Comments 390-412). [Lecture notes](#).

\*Obstfeld and Rogoff: pp. 161-164.

Guo, Kai, "[Exchange Rates and Asset Prices in An Open Economy with Rare Disasters](#)," mimeo, Harvard University, October 2007.

## VIII. GLOBAL CAPITAL MARKET INTEGRATION: DEVELOPING COUNTRIES

\*Kose, M. Ayhan, Eswar Prasad, Kenneth Rogoff and Shang-Jin Wei, "[Financial Globalization, A Reappraisal](#)," December 2006 (revised version of International Monetary Fund, Working Paper WP/06/189, August 2006).

## IX. WHY MONEY FLOWS FROM NORTH TO SOUTH

\*Moral Hazard: Obstfeld and Rogoff: pp. 407- 419.

Externalities to Human Capital: Robert E. Lucas, 1988, "Why Doesn't Capital Flow from Rich to Poor Countries," [American Economic Review](#), May 1990, pp. 92-96.

Alfaro, Laura, Sebnem Kalemli-Ozcan, Vadym Volosovych, "Why Doesn't Capital Flow from Rich to Poor Countries? An Empirical Investigation," [NBER working paper 11901](#), December 2005.

## X. JAPAN'S DEFLATION TRAP

\*Krugman, Paul, "[It's Baaack: Japan's Slump and the Return of the Liquidity Trap](#)," *Brookings Papers on Macroeconomic Activity*, 1998, v2, 137-205. (including comment by Dominguez and Rogoff) (N.B.: Our focus will be on the analytics as covered in the [HANDOUT](#)).

Eggertsson, Gauti B. and Michael Woodford, "The Zero Bound on Interest Rates and Optimal Monetary Policy," [Brookings Papers on Economic Activity](#) 34 (2003), volume 1, 139-235

## XI. INTERNATIONAL FINANCIAL CRISES

\*Reinhart, Carmen and Kenneth Rogoff, "Is the 2007 US Sub-Prime Financial Crisis So Different? An International Historical Comparison," [American Economic Review](#) 98 (May 2008): 339-344.

\*Reinhart, Carmen and Kenneth Rogoff, "The Aftermath of Financial Crises," [American Economic Review](#) 99 (May 2009): 466-472.

\*Reinhart, Carmen and Kenneth Rogoff, *This Time Is Different: Eight Centuries of Financial Folly*, Princeton University Press, 2009, (selected chapters).

Reinhart, Carmen and Kenneth Rogoff, "[Banking Crises: An Equal Opportunity Menace](#)," manuscript, Harvard University, December 2008.

\*Allen, Franklin, and Douglas Gale, *Understanding Financial Crises*, Oxford: Oxford University Press, 2007, ch 3.

Geanakoplos, John, "The Leverage Cycle," forthcoming in [NBER Macroeconomics Annual 2009](#), Daron Acemoglu, Kenneth Rogoff, and Michael Woodford (eds), April 10, 2009.

Bolton, Patrick, Tony Santos and Jose Scheinkman, "[Inside and Outside Liquidity](#)," mimeo, Princeton University, March 30, 2009,

Diamond, Douglas and Raghuram Rajan, "Liquidity Shortages and Banking Crises," [NBER working paper 10071](#), October 2003.

Bolton, Patrick, and Mathias Dewatripont, *Contract Theory*, Cambridge: MIT Press. 2005, pp. 397-418.

Gorton, Gary, "[Slapped in the Face by the Invisible Hand: Banking and the Panic of 2007](#)," mimeo, Yale University, April 3, 2007.  
[http://papers.ssrn.com/sol3/cf\\_dev/AbsByAuth.cfm?per\\_id=17513](http://papers.ssrn.com/sol3/cf_dev/AbsByAuth.cfm?per_id=17513)

## **XII. OIL AND THE GLOBAL ECONOMY**

\*Dvir, Eyal and Kenneth Rogoff, "[The Three Epochs of Oil](#)," mimeo, Harvard University, March 2009.

## **XIII. MONEY, EXCHANGE RATES AND PRICES: SELECTED TOPICS, SEIGNIORAGE AND COMMODITY CURRENCIES**

Lecture notes on "Money, Inflation, and Exchange Rates."

### **SECTION II: Paper Topics**

#### **BACKGROUND READINGS**

##### **1. Should Sweden enter the euro system with four years?**

Reade, J.J. and U. Volz (2009a), [Too Much to Lose, or More to Gain? Should Sweden Join the Euro?](#), Economics Series Working Papers 442, Department of Economics, University of Oxford, Oxford.

Also see shorter Voxeu essay, Reade, J. James and Ulrich Volze, "Should Sweden join the eurozone?" <http://www.voxeu.org/index.php?q=node/3955>

Grahn, Ralf (2009): '[Swedish opinion on euro turns](#)', Grahnlaw Blogspot, 19 April

Calmfors, L., H. Flam, N. Gottfries, M. Jerneck, R. Lindahl, J. Haaland Matlary, C. Nordh Berntsson, E. Rabinowicz and A. Vredin (1997), *EMU: A Swedish Perspective*, Kluwer Academic Publishers, Boston, Dordrecht and London.

Baldwin, R. (2006), "[In or Out? Does it Matter? An Evidence Based Analysis of the Euro's Trade Effects](#)," Center for Economic Policy Research, London.

Ferreira-Lopes, A. (2008), "[In or Out? The Welfare Costs of EMU membership](#)," Economic Research Center Working paper 14/08, ISCTE, Lisbon University Institute

Soderstrum, U (2008), "[Re-evaluating Swedish Membership in EMU: Evidence from an Estimated Model](#)," NBER Working Paper 14519.

Vaubel, R. (2004), "A Critical Analysis of EMU and of Sweden Joining It," in J. Ljungberg (ed), *The Price of the Euro*, Palgrave Macmillan, NY, 87-95

European Commission on Economic and Financial Affairs, "Sweden and the Euro: A Factsheet,"  
[http://ec.europa.eu/economy\\_finance/the\\_euro/your\\_country\\_euro9164\\_en.htm](http://ec.europa.eu/economy_finance/the_euro/your_country_euro9164_en.htm)

HM Treasury, [UK Membership in the Single Currency: An assessment of the five economic tests](#), June 2003 (246 pages).

Lucrezia Reichlin and Giancarlo Corsetti, "[Should the UK join the euro?](#)" *The Edge* 11 (November 2002): 22-25. A PDF file of the magazine is available at [http://www.sais-jhu.edu/faculty/sandleris/IMT/Readings/R\\_Reichlin\\_ShouldUKjointheEuro.pdf](http://www.sais-jhu.edu/faculty/sandleris/IMT/Readings/R_Reichlin_ShouldUKjointheEuro.pdf)

Buti, Marco and Vitor Gaspar, [The First Ten Years of the Euro](#), VOX, December 2008.

Frankel, Jeffrey, [The Euro at ten: Why do effects on trade between members appear smaller than historical estimates among smaller countries?](#) Dec 2008

### [The Single Market and the Euro](#)

Philip Lane, "[The Real Effects of Monetary Union](#)," (2006) *Journal of Economic Perspectives* 20(4): 47-66.

Frankel, Jeffrey, "The Estimated Effects of the Euro on Trade: Why Are They Below Historical Effects of Monetary Unions Among Smaller Countries?" [NBER working paper 14542](#), December 2008

Buiter, Willem, "[Why the United Kingdom Should Join the Eurozone](#)," forthcoming *International Finance* 2008 (Also at NBER.)

Tenreyro, Silvana, "[Currency Unions in Prospect and Retrospect](#)," manuscript, London School of Economics and Political Science, October 2009

**2. The US has significant risk (30% or greater) of experiencing pronounced Japan-like symptoms over the next 5-10 years: especially much lower medium term growth than before the crisis, soaring budget deficits, more frequent than usual recessions.**

Giannetti, Mariassunta and Andrei Simonov (2009). "[On the real effects of bank bailouts: Micro-Evidence from Japan](#)," EFA 2009 Bergen Meetings, June.

[Mariassunta Giannetti](#) [Andrei Simonov](#), The real effects of bank bailouts: Evidence from Japan, Voxeu <http://www.voxeu.org/index.php?q=node/4011>

[Keiichiro Kobayashi](#), [The G20's Blind Spot: President Obama must squarely face the bad asset problem](#), March 26, 2009

Hoshi, Takeo and Anil K. Kashyap, 2008, "[Will the U.S. Bank Recapitalization Succeed? Lessons from Japan](#)", NBER Working Paper 14401.

Adam Posen, "Seven Reasons the US Today is Not Like Japan 15 Years Ago," Institute for International Economics, September, 2008 <http://www.iie.com/realtime/?p=20>

Maurice Obstfeld, "[Time of Troubles: The Yen and Japan's Economy, 1985-2008](#)" NBER Working paper 14816, March 2009

**3. The G-20 is right to focus on containing global (current account) imbalances to well below their pre-crisis levels (say to roughly half or less within four years). US must achieve higher national savings rate, if necessary substantially strengthening financial regulation and oversight. China must allow its exchange rate to significantly appreciate over time, and redirect production towards domestic demand instead of exports.**

Obstfeld, Maurice and Kenneth Rogoff, "[Global Imbalances and the Financial Crisis: Products of Common Causes](#)," Harvard University, October 13, 2009.

Cooper, Richard, "Global Imbalances: Globalization, Demography, and Sustainability," [Journal of Economic Perspectives](#), 2008, Issue 3, 93-112.

Michael P. Dooley, David Folkerts-Landau, Peter Garber, "The Revived Bretton Woods System: The Effects of Periphery Intervention and Reserve Management on Interest Rates & Exchange Rates in Center Countries," [NBER Working Paper 10332](#), March 2004.

Michael P. Dooley, David Folkerts-Landau, Peter Garber, "An Essay on the Revived Bretton Woods System," [NBER Working Paper 9971](#), September 2003.

Prasad, Eswar and Raghuraj Rajan, "[A Pragmatic Approach to Capital Account Liberalization](#)," working paper, Cornell University, 2008

Goldstein, Morris, "[A \(Lack of\) Progress Report on China's Exchange Rate Policies](#)," Working Paper 07-5, Peterson Institute, June 2007.

Policy Brief 07-4: [Global Imbalances: Time for Action](#), Peterson Institute for International Economics.

Lardy, Nicholas R., [China: Toward a Consumption-Driven Growth Path](#), Policy Brief 06-6, Peterson Institute, October 2006.

Goldstein, Morris, and Nicholas Lardy, [Debating China's Exchange Rate Policy](#), Peterson Institute for International Economics, 2008 (**This book has an excellent collection of topical articles**) (**Also available in hard copy at Harvard libraries.**)

Cline, William, and John Williamson, "Equilibrium exchange rates," Voxeu, April 2009. <http://www.voxeu.org/index.php?q=node/3666>