

NYU Department of Economics
G31.3002.007, Spring 2005
Mondays 6:10PM-8:10PM, Room 715

FINANCIAL ISSUES IN LATIN AMERICA

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Course description

Systemic financial problems, from hyperinflation to fiscal, banking and currency crises, have loomed large in the economic history of Latin America. Indeed, it seems that every year some Latin American country or other manages to get itself into serious financial trouble. What explains the prevalence of macroeconomic instability in Latin America? The course attempts to answer this question by analyzing both fundamental and precipitating causes of Latin America's recent financial crises, focusing on economic policy and institutional shortcomings (in the fiscal, monetary, banking and exchange-rate areas), as well as on other domestic and external forces that have combined to generate instability in the region's economies and financial markets. We then use specific case studies to go more in depth into particular situations encountered in recent years. By the end of the course, having read and discussed more than 20 articles and 3 books, students gain an in-depth understanding of the financial problems that are being overcome and those that are more structural in nature – and of the major policy implications that follow.

Course requirements and grading

The course is structured as an interactive seminar providing students with ample opportunity to discuss the required readings in class, and to critique at least one of the recommended readings in writing. In order to reap all of the benefits from the course, students must plan on attending every class, doing all of the required readings before coming to class, and signing up to lead one class discussion. Attendance will be taken at the start of each class and quizzes on the readings will be given at the start of about half of the classes. One third of the grade will reflect class attendance and the quantity and quality of class participation. Another third of the final grade will follow from the scores obtained on the quizzes. And the final third of the grade will be derived from the quality of a paper with a maximum length of 2,000 words, to be delivered via e-mail by Monday May 9th, that will critique any one of the recommended readings in the course – namely, any one of the reading that were not discussed in class.

Schedule and readings

January 24: Volatility in Latin America

Required reading: Ricardo Hausmann et al., "Overcoming volatility in Latin America," in Economic and Social Progress in Latin America: 1995 Report (Washington, DC: IADB, 1995), pp. 189-218.

Recommended reading: Luis Catão and Bennett Sutton, "Sovereign defaults: the role of volatility," IMF Working Paper WP/02/149, September 2002, in www.imf.org/external/pubs/ft/wp/2002/wp02149.pdf

January 31: Fiscal fundamentals

Required readings:

1. Michael Gavin and Ricardo Hausmann, "Fiscal performance in Latin America: what needs to be explained?" in Democracy, Decentralization and Deficits in Latin America (Paris: OECD/IADB, 1998), pp. 33-64.
2. Ricardo Hausmann, "Good credit ratios, bad credit ratings: the role of debt structure," in George Kopits, editor, Rules-Based Fiscal Policy in Emerging Markets (New York: Palgrave MacMillan, 2004), pp. 30-52.

Recommended readings:

1. Ernesto Stein, Ernesto Talvi and Alejandro Grisanti, "Institutional arrangements and fiscal performance: the Latin American experience," in James Poterba and Jurgen von Hagen, editors, Fiscal Institutions and Fiscal Performance (Chicago: Univ. of Chicago Press, 1999), pp. 103-133.
2. George Kopits, "Fiscal rules: useful policy framework or unnecessary ornament?," IMF Working Paper WP/01/145, September 2001, in www.imf.org/external/pubs/ft/wp/2001/wp01145.pdf

February 7: Exchange-rate policy

Required readings:

1. Jeffrey Frieden, Piero Ghezzi and Ernesto Stein, "Politics and exchange rates: a cross-country approach," in The Currency Game: Exchange-Rate Politics in Latin America (Washington, DC: IADB, 2001), pp. 21-63.
2. Barry Eichengreen and Ricardo Hausmann, "Exchange rates and financial fragility," and the Comment by Martin Feldstein, in New Challenges for Monetary Policy (Kansas City: Federal Reserve Bank of Kansas City, 1999), pp. 329-378, available in www.kc.frb.org/PUBLICAT/SYMPOS/1999/S99eich.pdf plus www.kc.frb.org/PUBLICAT/SYMPOS/1999/S99feld.pdf

Recommended readings:

1. Andrea Bubula and Inci Otker-Robe, "Are pegged and intermediate exchange rate regimes more crisis prone?," IMF Working Paper WP/03/223, November 2003, in www.imf.org/external/pubs/ft/wp/2003/wp03223.pdf
2. Guillermo A. Calvo and Carmen M. Reinhart, "Fear of floating," in Quarterly Journal of Economics (May 2002), pp. 379-408.

February 14: Exchange-rate policy, cont'd

Required readings:

1. Felipe Larraín B. and Andrés Velasco, "Exchange rate policy in emerging-market economies: the case for floating," Princeton Essays in International Economics #224, December 2001.
2. Andrew Berg, Eduardo Borensztein and Paolo Mauro, "An evaluation of monetary regime options for Latin America," IMF Working Paper WP/02/211, December 2002, in www.imf.org/external/pubs/ft/wp/2002/wp02211.pdf

Recommended readings:

1. Guillermo Calvo and Frederic Mishkin, "The mirage of exchange-rate regimes for emerging-market countries," Journal of Economic Perspectives, Fall 2003, pp. 99-118.
2. Eduardo Levy-Yeyati and Federico Sturzenegger, "To float or to fix: evidence on the impact of exchange rate regimes on growth," American Economic Review, Vol. 93 #4, September 2003, pp. 1173-1193.

February 21: Presidents' Day holiday; no class

February 28: Monetary policy

Required readings:

1. Frederic S. Mishkin and Miguel A. Savastano, "Monetary policy strategies for Latin America," Journal of Development Economics (vol. 66, 2001), pp. 415-444.
2. Klaus Schmidt-Hebbel and Alejandro Werner, "Inflation targeting in Brazil, Chile and Mexico," Economía, Spring 2002, pp. 31-89.

Recommended readings:

1. Arminio Fraga, Ilan Goldfajn and André Minella, "Inflation targeting in emerging market economies," in Mark Gertler and Kenneth Rogoff, editors, NBER Macroeconomics Annual 2003 (Cambridge, MA: MIT, 2004), pp. 365-400.
2. M. S. Mohanty and Marc Klau, "Monetary policy rules in emerging market economies: issues and evidence," BIS Working Papers #149, March 2004, in www.bis.org/publ/work149.pdf
3. Evan Tanner, "Exchange market pressure, currency crises, and monetary policy: additional evidence from emerging markets," IMF Working Paper

WP/02/14, January 2002, in
www.imf.org/external/pubs/ft/wp/2002/wp0214.pdf

March 7: Role of capital flows

Required readings:

1. Guillermo A. Calvo, "Globalization hazard and delayed reform in emerging markets," Economía, Spring 2002, pp.1-29.
2. Graciela Kaminsky, Carmen Reinhart and Carlos Vegh, "The unholy trinity of financial contagion," Journal of Economic Perspectives, Fall 2003, pp. 51-74.

Recommended readings:

1. Pablo E. Guidotti, Federico Sturzenegger and Agustín Villar, "On the consequences of sudden stops," Economía, Spring 2004, pp. 171-214.
2. Sebastian Edwards, "Financial openness, sudden stops, and current-account reversals," American Economic Review, May 2004, pp. 59-64.
3. Ilan Goldfajn, "The swings in capital flows and the Brazilian crisis," in Stephanie Griffith-Jones et al., editors, International Capital Flows in Calm and Turbulent times (Ann Arbor, MI: Univ. of Michigan Press, 2003), pp. 267-290.
4. Carlos Arteta, Barry Eichengreen and Charles Wyplosz, "When does capital account liberalization help more than it hurts?," in Elhanan Helpman and Efraim Sadka, editors, Economic Policy in the International Economy (Cambridge: Cambridge Univ. Press, 2003), pp. 177-206.

March 14: Spring Recess begins; no class

March 21: Banking crises

Required reading: Inter-American Development Bank, Unlocking Credit: The Quest for Deep and Stable Bank Lending, (Washington, DC: IADB, 2004), Parts II and III, pp. 29-160, available in the bookstore.

Recommended readings:

1. Frederic S. Mishkin, "Financial policies and the prevention of financial crises in emerging market countries," in Martin Feldstein, editor, Economic and Financial Crises in Emerging Market Economies (Chicago: Univ. of Chicago Press, 2003), pp. 93-130.
2. Agustín G. Carstens et al., "Banking crises in Latin America and the political economy of financial sector policy," draft March 2004, in <http://enet.iadb.org/idbdocswebservices/idbdocsInternet/IADBPUBLICDOC.aspx?docnum=388380>
3. Liliana Rojas-Suárez, "Argentina and Uruguay in the 2000s: two contrasting experiences of banking crisis resolution," draft September 2004, in www.chicagofed.org/news_and_conferences/conferences_and_events/files/systemic_suarez.pdf

4. David S. Hoelscher et al., "Managing systemic banking crises," IMF Occasional Paper #224 (Washington, DC: IMF, 2003).

March 28: Case study: the "hard" peg in Argentina

Required readings:

1. Michael Mussa, Argentina and the Fund: From Triumph to Tragedy (Washington, DC: IIE, July 2002), available in the bookstore.
2. Arturo C. Porzecanski, "Argentina: the root cause of the disaster," ABN AMRO Emerging Markets Fortnightly (July 24, 2002), also in www.nber.org/~confer/2002/argentina02/porzecanski.pdf

Recommended readings:

1. Ricardo Hausmann and Andrés Velasco, "Hard money's soft underbelly: understanding the Argentine crisis," in Susan M. Collins and Dani Rodrik, editors, Brookings Trade Forum 2002 (Washington, DC: Brookings, 2003), pp. 59-119.
2. Steve H. Hanke, "The Argentine straw man: a response to currency board critics," Cato Journal, Spring/Summer 2003, pp. 47-57, in www.cato.org/pubs/journal/cj23n1/cj23n1-6.pdf
3. Andrew Powell, "Argentina's avoidable crisis: bad luck, bad economics, bad politics, bad advice," in Brookings Trade Forum 2002, pp. 1-58.
4. Guillermo A. Calvo, Alejandro Izquierdo and Ernesto Talvi, "Sudden stops, the real exchange rate and fiscal sustainability: Argentina's lessons," in Volbert Alexander et al., editors, Monetary Unions and Hard Pegs (New York: Oxford Univ. Press, 2004), pp. 151-181.
5. Enrique Alberola, Humberto López and Luis Servén, "Tango with the gringo: the hard peg and real misalignment in Argentina," in Banco de España Working Paper #405, 2004, in www.bde.es/informes/be/docs/dt0405e.pdf
6. IMF Independent Evaluation Office, Evaluation Report: The IMF and Argentina, 1991-2001 (Washington, DC: IMF, 2004), in www.imf.org/External/NP/ieo/2004/arg/eng/pdf/report.pdf

April 4: Case study: dollarization in Ecuador and beyond

Required reading:

1. Luis I. Jacome, "The late 1990s financial crisis in Ecuador," IMF Working Paper WP/04/12, January 2004, in www.imf.org/external/pubs/ft/wp/2004/wp0412.pdf
2. Gianni De Nicoló et al., "Dollarization of the banking system: good or bad?" IMF Working Paper WP/03/146, July 2003, in www.imf.org/external/pubs/ft/wp/2003/wp03146.pdf
3. Sebastian Edwards and I. Igal Magendzo, "Strict dollarization and economic performance: an empirical investigation," NBER Working Paper #9820, July 2003, in www.nber.org/papers/w9820

Recommended readings:

1. Paul Beckerman and Andrés Solimano, Crisis and Dollarization in Ecuador (Washington, DC: World Bank, 2002).
2. Andrew Berg and Eduardo Borensztein, "The pros and cons of full dollarization," in Dominick Salvatore et al., editors, The Dollarization Debate (New York: Oxford, 2003), pp. 72-101.
3. Eduardo Levy Yeyati and Federico Sturzenegger, "Dollarization: a primer," in Dollarization (Cambridge, MA: MIT, 2003), pp. 1-51.

April 11: Case study: capital controls in Chile

Required readings:

1. Sebastian Edwards, "Capital flows, real exchange rates, and capital controls: some Latin American experiences," in Sebastian Edwards, editor, Capital Flows and the Emerging Economies (Chicago: Univ. of Chicago Press, 2000), pp. 197-253.
2. Francisco Nadal-De Simone and Piritta Sorsa, "A review of capital account restrictions in Chile in the 1990s," IMF Working Paper WP/99/52, April 1999, in www.imf.org/external/pubs/ft/wp/1999/wp9952.pdf

Recommended readings:

1. José de Gregorio, Sebastian Edwards and Rodrigo O. Valdés, "Controls on capital inflows: do they work?," Journal of Development Economics, Vol. 63 #1, October 2000, pp. 59-83.
2. Bernard Laurens and Jaime Cardoso, "Managing capital flows: lessons from the experience of Chile," IMF Working Paper WP/98/168, December 1998, in www.imf.org/external/pubs/ft/wp/wp98168.pdf

April 18: Case study: banking crisis in Venezuela

Required reading: Ruth de Krivoy, Collapse: The Venezuelan Banking Crisis of 1994 (Washington, DC: Group of Thirty, 2000), available in the bookstore.

Recommended reading:

1. Carlos A. Molina, "Predicting bank failures using a hazard model: the Venezuelan banking crisis," Emerging Markets Review, Vol. 3 #1, pp. 31-50.
2. Alicia García-Herrero, "Banking crises in Latin America in the 1990s: lessons from Argentina, Paraguay and Venezuela," IMF Working Paper WP/97/140, October 1997, in www.imf.org/external/pubs/ft/wp/wp97140.pdf

April 25: Case study: debt defaults in Argentina and Ecuador

Required reading:

1. Punam Chuhan and Federico Sturzenegger, "Default episodes in the 1980s and 1990s: what have we learned?," March 2004, in www1.worldbank.org/economicpolicy/documents/mv/pgchapter08.pdf

2. Arturo C. Porzecanski, "Dealing with sovereign debt: trends and implications," forthcoming in Chris Jochnick and Fraser Preston, editors, Sovereign Debt at the Crossroads (New York: Oxford Univ. Press, 2004), also in www.cid.harvard.edu/events/DebtConference/#Readings.

Recommended readings:

1. Kenneth Rogoff and Jeromin Zettelmeyer, "Bankruptcy procedures for sovereigns: a history of ideas, 1976-2001," IMF Staff Papers (Vol. 49, #3), 2002, pp. 470-507.
2. Paolo Manasse, Nouriel Roubini, and Axel Schimmelpfennig, "Predicting sovereign debt crises," IMF Working Paper WP/03/221, November 2003, in www.imf.org/external/pubs/ft/wp/2003/wp03221.pdf
3. Charles W. Calomiris, "Lessons from Argentina and Brazil," Cato Journal, Spring/Summer 2003, pp. 33-45, in www.cato.org/pubs/journal/cj23n1/cj23n1-5.pdf
4. Mark Allen et al., "A balance sheet approach to financial crisis," IMF Working Paper WP/02/210, December 2002, in www.imf.org/external/pubs/ft/wp/2002/wp02210.pdf

May 2: Volatility in Latin America

Required reading: Ricardo Hausmann et al., "Overcoming volatility in Latin America," in Economic and Social Progress in Latin America: 1995 Report (Washington, DC: IADB, 1995), pp. 218-240.

Recommended readings:

1. César Calderón and Klaus Schmidt-Hebbel, "Macroeconomic policies and performance in Latin America," Journal of International Money and Finance, Vol. 22 #7, December 2003, pp. 895-923.
2. Sebastian Edwards, "Financial instability in Latin America," Journal of International Money and Finance, Vol. 22 #7, December 2003, pp. 1095-1106.

May 9: E-mail versions of paper due