

Columbia University SIPA
INAF U6415, Fall 2006
Mondays 4:10-6:00PM, Room 802

FINANCIAL ISSUES IN LATIN AMERICA

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Course description

Systemic financial problems – fiscal, banking, currency and debt crises, often in highly damaging combination – 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, the latest one being the Dominican Republic (2003-04). 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, students have an in-depth understanding of the financial problems that are being overcome and of those that are more structural in nature – and of the major policy implications that follow.

Course requirements and grading

The course has been updated, such that most readings now date to 2005 or 2006. During the first half of each class, Prof. Porzecanski will summarize the main ideas on the policy issue or case study of the day, and during the second half he will guide a class discussion of the topic at hand. In order to reap the benefits from the course, students should plan on attending every class – in fact, attendance will be taken – and on doing all of the required readings before coming to class, because credit will be given to students who answer the questions raised in class by other students or the professor. The other course requirements are one final exam to take place on Monday, December 11th; and one essay of a maximum length of 2,000 words, written on one of three topics specified at the end of this syllabus, to be delivered via e-mail by Monday, December 18th at the latest. Class attendance and the quantity and quality of class participation will contribute to 20% of the final grade; the final exam will count for 40%; and the essay will account for the final 40%.

Schedule and reading

September 11: The critical role of financial issues

Required readings:

1. Anoop Singh et al., "Stabilization and Reform in Latin America: A Macroeconomic Perspective on the Experience Since the Early 1990s," IMF Occasional Papers #238 (Washington, DC: IMF, 2005), Chapter II ("Taking Stock"), pp. 3-25.
2. Anoop Singh, "Macroeconomic Volatility: The Policy Lessons from Latin America," IMF Working Paper WP/06/166, July 2006.

September 18: Fiscal fundamentals

Required readings:

1. Anoop Singh et al., "Stabilization and Reform in Latin America," op. cit., Chapter III ("Fiscal Sustainability"), pp. 26-44.
2. Luiz de Mello and Nanno Mulder, "Fiscal Adjustment in Latin America: Trends and Stylized Facts," in Luiz de Mello, editor, Challenges to Fiscal Adjustment in Latin America (Paris: OECD, 2006), pp. 19-41.
3. 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.
4. Sebastián Briozzo, "The Importance of Going Local: Shifting Away from Foreign Currency Sovereign Debt in Latin America," in Sovereign Ratings in Latin America (New York: Standard & Poor's, September 2005), pp. 7-12.

September 25: Monetary and exchange-rate policies

Required readings:

1. Anoop Singh, et al., "Stabilization and Reform in Latin America," op. cit., Chapters IV ("Monetary and Exchange Rate Regimes") and VI ("Financial Dollarization in Latin America"), pp. 45-62 and 79-89.
2. Inter-American Development Bank, Unlocking Credit: The Quest for Deep and Stable Bank Lending (Washington, DC: IADB, 2004), Chapter 4 ("Financial Dollarization"), pp. 49-65.

October 2: Monetary and exchange-rate policies, cont'd

Required readings:

1. Agustín Carstens and Luis I. Jácome, "The 1990s Institutional Reform of Monetary Policy in Latin America," Banco Central de Chile Working Paper #343, December 2005.

2. IMF, World Economic Outlook September 2005 (Washington, DC: IMF, 2005), Chapter IV (“Does Inflation Targeting Work in Emerging Markets?”), pp. 161-186.
3. Sebastián Edwards, “Exchange Rate Policies in Latin America: Fads, Fashions and Disappointments,” draft, August 2005.

October 9: Banking crises

Required readings:

1. Anoop Singh, et al., “Stabilization and Reform in Latin America,” op. cit., Chapter V (“Latin American Financial Systems: Crises and Reforms”) pp. 63-78.
2. Inter-American Development Bank, Unlocking Credit, op. cit., Chapters 3 (“Determinants and Characteristics of Banking Crises”), 5 (“Banking Crisis Resolution”) and 10 (“Foreign Banks”), pp. 29-48, 67-83 and 129-139.

October 16: Role of capital flows

Required readings:

1. Anoop Singh, et al., “Stabilization and Reform in Latin America,” op. cit., Chapter VII (“External Vulnerabilities”), pp. 90-105.
2. World Bank, Global Development Finance 2006 (Washington, DC: World Bank, 2006), Vol. 1, Chapter 5 (“Challenges in Managing Capital Flows”), pp. 139-168.
3. Pablo E. Guidotti, Federico Sturzenegger and Agustín Villar, “On the Consequences of Sudden Stops,” Economía, Spring 2004, pp. 171-214.
4. Graciela Kaminsky, Carmen Reinhart and Carlos Vegh, “The Unholy Trinity of Financial Contagion,” Journal of Economic Perspectives, Fall 2003, pp. 51-74.

October 23: Case study: Local bond markets in Mexico and elsewhere

Required readings:

1. Serge Jeanneau and Camilo E. Tovar, “Domestic Bond Markets in Latin America: Achievements and Challenges,” BIS Quarterly Review, June 2006, pp. 51-64.
2. Camilo E. Tovar, “International Government Debt Denominated in Local Currency: Recent Developments in Latin America,” BIS Quarterly Review, December 2005, pp. 109-118.
3. Serge Jeanneau and Carlos Pérez Verdia, “Reducing Financial Vulnerability: The Development of the Domestic Government Bond Market in Mexico,” BIS Quarterly Review, December 2005, pp. 95-107.

October 30: Case study: Inflation targeting in Chile and Peru

Required readings:

1. José De Gregorio, et al., "Flexible Exchange Rate with Inflation Targeting in Chile: Experience and Issues," draft, May 2005.
2. Adrián Armas and Francisco Grippa, "Targeting Inflation in a Dollarized Economy: The Peruvian Experience," IADB Working Paper #538, September 2005.

November 6: No class meeting: Academic Holiday

November 13: 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), Chapters 1, 2 and 3, pp. 1-52.
2. Arturo C. Porzecanski, "Argentina: The Root Cause of the Disaster," ABN AMRO Emerging Markets Fortnightly, July 24, 2002, pp. 1-6.
3. 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.

November 20: Case study: Banking crisis in Venezuela

Required reading: Ruth de Krivoy, Collapse: The Venezuelan Banking Crisis of 1994 (Washington, DC: Group of Thirty, 2000), Chapters 1-5, pp. 1-194.

November 27: Case study: Capital controls in Brazil and Chile

Required readings:

1. Bernardo S. de M. Carvalho and Márcio G.P. Garcia, "Ineffective Controls on Capital Inflows Under Sophisticated Financial Markets: Brazil in the Nineties," NBER Working Paper #12283, May 2006.
2. Kevin Cowan and José de Gregorio, "International Borrowing, Capital Controls and the Exchange Rate: Lessons from Chile," NBER Working Paper #11382, May 2005.
3. Kristin J. Forbes, "The Microeconomic Evidence on Capital Controls: No Free Lunch," NBER Working Paper #11372, May 2005.

December 4: Case study: Debt defaults in Argentina and Uruguay

Required reading:

1. Federico Sturzenegger and Jeromin Zettelmeyer, Debt Defaults and Lessons from a Decade of Crises, forthcoming (Cambridge, MA: MIT Press, 2006), Chapters 1, 2, 8 and 10, pp. 1-43, 120-143, and 152-162.
2. Arturo C. Porzecanski, "From Rogue Creditors to Rogue Debtors: Implications of Argentina's Default," Chicago Journal of International Law, Summer 2005, pp. 311-332.

December 11: Final exam: True/False and Multiple-Choice questions

December 18: E-mail versions of essay due

Choose from among the following three topics for your 2,000-word paper, which must demonstrate the application of concepts learned in class and should include citations to a bibliography of at least five (5) academic or official studies beyond those listed in this syllabus.

1. Your boss, the Minister of Finance, believes that since interest rates are lower in the international capital market relative to those prevailing in the domestic capital market, now is the time to borrow abroad rather than at home. Write a memorandum explaining why "not all that shines is gold."
2. Your boss, a senior IMF official responsible for Latin America, is wondering whether the Fund should insist that all countries in the region that have not done so already should now shift to an inflation targeting regime. Before making this decision, however, she wants to hear a contrarian view, so write a memorandum detailing the case against the universal adoption of inflation targeting in the region.
3. Your boss, the President of a Central Bank who is also the supervisor of the country's banks, knows that there is a large bank that is losing money, and he wonders out loud whether he remembers everything that he must do to preserve the country's financial stability before and after the bank in question comes knocking at his door. Write a memorandum detailing what he should be prepared to do in the months ahead