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Winter 2005  
Lectures TTh 9 to 10:50  
Room 139 econ

## Economics 217

### **MONEY AND FINANCE IN ECONOMIC DEVELOPMENT**

Required texts (available in the Stanford Bookstore):

STANFORD COURSE READER containing:

McKinnon, Ronald I., *Money and Capital in Economic Development*, Brookings Institution, 1973.

Williamson, John and Molly Mahar, *A Survey of Financial Liberalization*, Princeton Essays in International Finance, No. 211, November 1998.

McKinnon, Ronald I., *The Order of Economic Liberalization: Financial Control in the Transition to a Market Economy*, 2<sup>nd</sup> Edition, Johns Hopkins University Press, 1993.

The World Bank, *Finance for Growth: Policy Choices in a Volatile World*, co-publication of the World Bank and the Oxford University Press, 2001.

Easterly, William, *The Elusive Quest for Growth: Economists' Adventures and Miasadventures in the Tropics*, MIT Press, 2001

McKinnon, Ronald I. *Exchange Rates under the East Asian Dollar Standard: Living with Conflicted Virtue* MIT Press, 2005 (available in early February)

Though not ordered for this course, a book students with macroeconomic interests may want to consult is

Agénor, Pierre-Richard, and Peter J. Montiel, *Development Macroeconomics*, Princeton University Press, 2<sup>nd</sup> edition, 1999. The most complete and encyclopedic reference work on the macroeconomics of open, developing economies-including problems of foreign exchange management. Many of the topics covered below are treated in more technical detail in this book-but references to the book are not in the course outline.

All readings, except for those from the textbooks in the bookstore, are in the course outline below and will be in the second-floor lounge of the Landau Economics Building. Either use in lounge or copy and replace immediately. The honor system here is important for keeping the reserve materials on the shelf. Textbooks (but not the Reader) the library possesses will be on reserve in Meyer.

For course credit in Econ. 217, students need only take the final exam. For comprehensive credit in economic development, students must also take Econ. 214 and submit a field paper as a condition for receiving a comprehensive grade. The field paper can cover material in 214 or 217. But the grade itself will be just the mean of the two course grades.

Econ 265 and 266 in international economics nicely complement courses in development. Students with interests in economic development are encouraged to take courses in the international area.

## COURSE OUTLINE

In the readings below, the students are responsible for the main ideas rather than all the technical and statistical details. The lectures provide guidance on what points to emphasize.

### 1. Foreign Aid, the Capital Market, and Financial Repression

- Easterly, William (2001), Chs. 1-3, "Panaceas that Failed: Aid for Investment"
- Burnside, Craig, and David Dollar (2000), "Aid Policies and Growth", *Amer Econ Rev*, Sept. pp 847-66.
- Easterly, W., Levine, R., Roodman, D. 2003 "New Data, New Doubts: A Comment on Burnside and Dollar's "Aid Policies and Growth", 2000", NBER Working Paper 9846
- McKinnon (1973), Chs. 1-7 (include Technical Appendix of Ch.2). Course Reader
- Krugman, Paul, "Interest Rate Ceilings, Efficiency and Growth: A Theoretical Analysis" (unpublished) August 1978.
- Molho, Lazaros E., "Interest Rates, Saving, and Investment in Developing Countries", *IMF Staff Papers*, 33(1) 1986: 90-116.
- Charlier, Florence, "Social Constraints on Savings in Africa: The Complementarity Hypothesis Revisited", Center for Research in Economic Growth, Memo 329. March, 1999.
- McKenzie, David J. and Woodruff, C., "Do Entry Costs Provide an Empirical Basis for Poverty Traps? Evidence from Mexican Micro Enterprises", Stanford Working Paper, 2003

### 2. Informal Credit Markets in Rural Areas, Adverse Selection, and Microfinance

- Bottomly, Anthony, "Interest Rate Determination in Underdeveloped Rural Areas", *American Journal of Agricultural Economics*, May 1975. Reprinted in Coats and Khatkhate, eds. *Money and Monetary Policy in Less Developed Countries*, Pergamon Press, 1980, pp 449-464.
- World Bank Symposium on Imperfect Information and Rural Credit Markets, *The World Bank Economic Review*, 4(3) Sept. 1990:
- Hoff, Karla and Joseph Stiglitz, "Introduction: Imperfect Information and Rural Credit Markets-Puzzles and Policy Perspectives", pp. 235-50.
- Udry, Christopher, "Credit Markets in Northern Nigeria: Credit as Insurance in a Rural Economy", pp. 251-70.
- Alem, Irfan, "Imperfect Information, Screening, and the Costs of Informal Lending: A Study of a Rural Credit Market in Pakistan", pp. 329-50.
- Stiglitz, Joseph, "Peer Monitoring and Credit Markets", pp 351-66.
- Morduch, Jonathan, "The Microfinance Promise", *Journal of Econ. Literature*, Dec.1999 pp.1569-614.
- Robinson, Marguerite, "Indonesia: The Role of Savings in Developing Sustainable Commercial Financing of Small and Micro Enterprises", Ch.9 in Ernest A. Brugger and Sarath Rajapatirana, eds. *New Perspectives on Financing Small Businesses in Developing Countries*, ICS Press, San Fran. 1995.

### 3. Financial Deepening, Inflation, and the Productivity of Capital

- McKinnon (1993), Chs. 1-4.
- The World Bank (2001), Overview and Ch. 1, "Making Finance Effective"
- Charlier, Florence (2002), "The Impact of Interest Liberalization on Saving, Investment, and Growth: Evidence from Sub-Saharan Africa", *Saving and Development, Quarterly Review*, (4) pp. 355-80
- King, Robert, and Ross Levine, "Finance and Growth: Schumpeter Might be Right", *Quarterly Journal of Economics*, 108 (3), August 1993, pp. 717-38.

- Fischer, Stanley, "The Role of Macroeconomic Factors in Growth", *Journal of Monetary Economics*, Dec. 1993, pp. 486-512.
- De Gregorio, J., and P.E. Guidotti, "Financial Development and Economic Growth", *World Development*, 23(3) March 1995, pp. 433-58.
- Levine, Ross, and Sara Sevros, "Stock Markets, Banks, and Economic Growth" *American Economic Review*, June 1998, pp. 537-558.
- Boyd, John, Ross Levine, and Bruce Smith, "The Impact of Inflation on Financial Sector Performance", *Journal of Monetary Economics* 47, 2001, pp.221-48.
- International Monetary Fund, "Growth and Institutions", *World Economic Outlook*, April 2003. pp 95-128

#### **4. Financial Liberalization, Deposit Insurance, and Moral Hazard in Banks**

- Demirguc-Kunt, Asli, and Edward J. Kane, "Deposit Insurance Around the Globe: Where Does it Work?" *The Journal of Economic Perspectives*, Spring 2002. pp 175-95.
- Cho, Yoon Je, "Inefficiencies from Financial Liberalization in the Absence of Well-functioning Capital Markets," *Journal of Money Credit and Banking*, May 1986, pp.191-99.
- McKinnon (1993), Ch. 7. "Macroeconomic Instability and Moral Hazard in Banking".
- Villanueva, Delano, and Abbas Mirakhor, "Strategies for Financial Reforms: Interest Rate Policies, Stabilization, and Bank Supervision in LDCs", *IMF Staff Papers*, Sept. 1990: 509-536.
- The World Bank (2001), Ch.2, "Preventing and Minimizing Crises".
- Williamson, John, and Molly Mahar, "A Survey of Financial Liberalization", Princeton Essays in International Finance, No. 211, November 1998. Course Reader

#### **5. Financial Restraint, "Market-Enhancing" Rent Shifting, and Government Failure in Finance**

- Hellman, Thomas, Kevin Murdoch, and Joseph Stiglitz, "Financial Restraint: Toward a New Paradigm", in Masa Aoki, et al, eds., *The Role of Government in East Asian Economic Development*, Clarendon Press, Oxford, 1997, pp 163-207.
- \_\_\_\_\_ "Liberalization, Moral Hazard in Banking, and Prudential Regulation: Are Capital Requirements Enough?" *American Economic Review*, March 2000, pp. 147-165. (Students are not responsible for algebraic details.)
- Cho, Yoon Je, "Government Intervention, Rent Distribution, and Economic Development in Korea" in Masa Aoki, et al, eds., *The Role of Government in East Asian Economic Development*, Clarendon Press, Oxford, 1997. Pp. 208-32.
- The World Bank (2001), Ch. 3, "Government Failure in Finance".
- Barth, J. R., G. Caprio, and R. Levine, "Bank Regulation and Supervision: What Works Best?" August 2001 (unpublished).

#### **6. The Inflation Tax and the Fiscal Deficit**

- Friedman, Milton, "Government Revenue from Inflation", *Journal of Political Economy*, July/August, 1971, pp. 846-56.
- Nichols, Donald A., "Some Principles of Inflationary Finance", *JPE*, March/April 1974, pp. 423-430.
- Tanzi, Vito, "The Impact of Macroeconomic Policies on the Level of Taxation and the Fiscal Balance in Developing Countries", *IMF Staff Papers*, Vol. 36 No. 9, Sept. 1989. pp. 633-56.
- Giovannini, Alberto, and Martha de Melo, "Government Revenue from Financial Repression," *American Economic Review*, Sept., 1993, pp. 953-63.

Fry, Maxwell, "Can Seigniorage Revenue Keep China's Financial System Afloat?", The Birmingham Business School and International Finance Group, Sept 1996.

McKinnon (1993), Ch.13, "Financial Growth and Macroeconomic Stability in China" pp. 187-216.

## **7. Managing Inflation and the Exchange Rate in a Repressed Economy**

McKinnon (1993), Chs. 5, 8, 9, and 14.

Brock, Philip, "Government Deficits and the Composition of Inflationary Finance", *CREG* memo. 254, Stanford, Feb. 1982.

Tanzi, Vito, and Mario Blejer, "Inflation, Interest Rate Policy, and Currency Substitution in Developing Countries", *World Development*, Vol. 10, no. 9, 1982. pp. 781-89.

Guidotti, Pablo, and Carlos Rodriguez, "Dollarization in Latin America", *IMF Staff Papers*, Sept.1992, pp. 518-44.

Inter-American Development Bank, "Financial Dollarization", Ch.4 *2005 Report* , pp 49 -66.

Bruno, Michael, and Stanley Fischer, "Seigniorage, Operating Rules, and the High Inflation Trap", *Quarterly Journal of Economics*, 105(2), May 1990, pp. 353-74.

## **8. The Stabilization Problem**

McKinnon, (1973), Chs. 7-12.

McKinnon, (1993), Ch. 6.

Vegh, Carlos A., "Stopping High Inflation", in *IMF Staff Papers*, 39 (2), Sept. 1992, pp. 626-95.

## **9. International Financial Liberalization: Growth or Overborrowing with Financial Crises?**

World Bank (2001), Ch. 4 "Finance without Frontiers".

McKinnon (1993). Ch. 10.

McKinnon, R. and Pill, H, "The Overborrowing Syndrome and Economic Liberalization" Ch. 6 in McKinnon (2005)

Edwards, Sebastian, "The Mexican Peso Crisis", *The World Economy*, 21(1), January 1998, pp. 1-30.

Kaminsky, Graciela, and Carmen Reinhart, "The Twin Crises: The Causes of Banking and Balance of Payments Problems." *American Economic Review*, vol 89(3) June 1999. pp. 473-501.

Levine, Ross, "International Financial Liberalization and Economic Growth, *Review of International Economics*. November 2001. pp 688-702.

Reisen, Helmut, and Marcelo Soto, "Which Types of Capital Inflows Foster Developing Country Growth?", *International Finance*, Spring 2001, pp 1-14.

Wei, Shang-Jin, "Domestic Crony Capitalism and International Fickle Capital: Is there a Connection?", *International Finance*, Spring 2001. pp 15-46.

Prasad, E, Rogoff, K, Wei,S, and Kose, M. "Financial Globalization, Growth, and Volatility in Developing Countries: Some Empirical Evidence", NBER Working Paper 10942, December 2004.

## 10. The Choice of an Exchange Rate Regime

- Fischer, Stanley, “Distinguished Lecture on Economics in Government-“Exchange Rate Regimes: Is the Bipolar View Correct?” *The Journal of Economic Perspectives*, Vol 15(2), Spring 2001, p. 3-24.
- Reinhart, Carmen, “The Mirage of Floating Exchange Rates”, *Amer. Econ. Rev.*, May 2000, pp.65-70.
- Calvo, Guillermo, and Carmen Reinhart, “Fear of Floating” *Quarterly Journal of Economics* May 2002. pp 379-408.
- Eichengreen, Barry, and Ricardo Hausmann, “Exchange Rates and Financial Fragility”, Pacific Basin Conference, Sept. 23-24 1999, (unpublished).
- Hausmann, Ricardo,(2003) ‘The Mystery of Original Sin’, March, Harvard Working Paper
- McKinnon, Ronald, and Gunther Schnabl. “The East Asian Dollar Standard, Fear of Floating, and Original Sin”, Ch 1 in McKinnon (2005)
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- “China: A Stabilizing or Deflationary influence in East Asia? The Case of Conflicted Virtue”, Ch. 5 in McKinnon (2005)

## 11. Institution Building and Economic Reform

- Hernandez, Leonardo and Parro, Fernando, “Economic Reforms, Financial Development, and Growth: Lessons from the Chilean Experience”, Stanford SCID Conference, October 2004.
- Easterly, William (2001), *The Elusive Quest for Growth*, Chs. 4-14.
- Kenen, Peter (2002), “The International Financial Architecture: Old Ideas and New Initiatives”, *International Finance*, pp. 23-46, Spring.
- McKinnon, Ronald “The World Dollar Standard, New Rules for the Game?” Stanford WP Aug. 2003.
- McKinnon (2005) Chs. 7 and 8.