

ECON-630 Monetary Theory and Policy

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Tuesdays 5:30-8:00
Spring 2008

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"[S]o much barbarism ... still remains in the transactions of most civilized nations, that almost all independent countries choose to assert their nationality by having, to their own inconvenience and that of their neighbors, a peculiar currency of their own."

-- J.S. Mill, *Principles of Political Economy*, Vol. II (1894).

Monetary theory and policy

This class covers analysis of key issues in monetary theory and policy, including relationships between money, output and prices; hyperinflations; business cycles; inflation targeting; monetary unions; monetary policy in open- and emerging-market economies; and the future of money. The objective of the class is to provide a rigorous overview of these issues, with emphasis on recent scholarly work and policy debates.

Monetary Theory and Policy is one of the recommended classes for the monetary field for PhD students (the other being ECON-631 Financial Markets). The course should be accessible to students who have made reasonable progress in their core macroeconomics sequence. M.A. students should have completed ECON-501 and ECON-505. PhD students should have completed ECON-702 [Macro I]; completion of ECON-712 [Macro II] is advantageous but not necessary. Material in the class may overlap with ECON-702 and -712. Exposition will be mostly in terms of linear models and diagrams; models using calculus will be presented but in a self-contained way.

Readings

This course is reading-intensive, although readings can be done selectively (i.e. identify the paper's key argument, the way in which it is elaborated, and key steps of its theoretical or econometric development). Two books are available at the AU bookstore:

- Carl Walsh, *Monetary Theory and Policy*, 2nd edition (MIT Press, 2003).
- Ben Bernanke and Michael Woodford, eds., *The Inflation-Targeting Debate* (NBER, 2005).

Additionally, articles are available electronically in the "Course Documents" section of the class website.

Graded work

The grade for this class will be determined as follows:

Item	Contribution to final grade (percent)	Due date
VAR project	12.5	Feb. 19
Midterm	20	March 4 (take home - class does not meet that night)
Policy debates	12.5	April 8 or 15
Research paper (15-20 pages, instructions distributed soon)	25	Apr. 22 (last day of class)
Final exam	25	May 6 (take home)
Class participation	5	Throughout

VAR project

In the VAR project, you will be expected to run basic vector-autoregressive analyses using data on monetary-policy variables, output and prices for a country of your choice. The assignment requires you to use Eviews -- a software package that emphasizes time-series applications and is widely used for analysis of macroeconomic and financial data. There will be a tutorial on Eviews and VARs to help you get started.

Course Outline

1. Introduction: Review of monetary-policy basics and background on contemporary issues (Jan. 15-22)

Mankiw, "Aggregate Supply and Demand" [hardcopy]

Frederic S. Mishkin. "Monetary policy strategy: How did we get here?" NBER Working Paper No. 12515 (Sept. 2006).

Ken Rogoff, "Globalization and disinflation," *Federal Reserve Bank of Kansas City Economic Review*, 2003 (Fourth Quarter), pp. 45-78.

2. Empirical evidence on money and output (Jan. 22)

Carl Walsh, *Monetary Theory and Policy*, Chapter 1

David Wheelock, "Monetary Policy in the Great Depression: What the Fed Did, and Why," *Federal Reserve Bank of Kansas City Economic Review*, Mar/Apr. 1992, pp. 3-28.

3. Inflation and growth in the long-run (Jan. 29 - Feb. 5)

Carl Walsh, *Monetary Theory and Policy*, Chapters 2-4.

Milton Friedman, "The Role of Monetary Policy," *American Economic Review*, March 1968.

Paul de Grauwe and Magdalena Polan, "Is Inflation Always and Everywhere a Monetary Phenomenon?" *Scandinavian Journal of Economics*, 2005.

Stanley Fischer, Ratna Sahay, Carlos Vegh, "Modern Hyper- and High Inflations," *Journal of Economic Literature*, Sept. 2002.

Thomas Sargent, Noah Williams, and Tao Zha. "The conquest of South American inflation" (Dec. 2006).

4. The business cycle: Monetary policy in the short-run (Feb 12)

Walsh, "Imperfect Information" (the Lucas model) pp. 200-208.

Marvin Goodfriend, "Monetary Policy in the New Neoclassical Synthesis: A Primer," *Federal Reserve Bank of Richmond Economic Quarterly*, Vol. 90, No. 3 (Summer 2004).

Roger Farmer, "Animal spirits"

Bharat Trehan, "Why has output become less volatile?" *Federal Reserve Bank of San Francisco*, Sept. 2005.

5. Contemporary monetary-policy practice: Inflation targeting (Feb. 19-26)

Barro-Gordon model -- Walsh, pp. 365-378, 393-397.

Ben Bernanke and Frederic Mishkin, "Inflation targeting: A new framework for monetary policy?" *Journal of Economic Perspectives*, Spring 1997.

Prof. Starr's hand-out on the Fed, ECB, and Bank of England

Selected chapters from Bernanke and Woodford, *The Inflation Targeting Debate* [also read comment and discussion for each chapter]:

1. King, "What has inflation targeting achieved?"
2. Svensson & Woodford, "Implementing Optimal Policy through Inflation-Forecast Targeting"
5. Orphanides & Williams, "Imperfect Knowledge, Inflation Expectations, and Monetary Policy"
6. Ball and Sheridan, "Does inflation targeting matter?"
8. Goodfriend, "Inflation targeting in the U.S.?"

Greenspan, Alan, "Risk and Uncertainty in Monetary Policy," *American Economic Review*, volume 94, no. 2, May 2004, pg. 33-40.

Benjamin Friedman, "The Greenspan Era: Discretion, rather than rules" (NBER Working Paper 12118, March 2006)

International Monetary Fund, "Does inflation targeting work in emerging markets?"

6. Monetary Union (March 18-25)

Robert Mundell, "A Theory of Optimum Currency Areas," *American Economic Review*, November, 1961.

Willem Buiter, "To Purgatory and Beyond: When and how should the accession countries from Central and Eastern Europe become full members of the EMU?" CEPR Discussion Paper Series No. 4342, April 2004.

Peter Kenen and Ellen Meade, "EU Accession and the Euro: Close Together or Far Apart?" IIE Policy Brief 03-9 (Oct. 2003).

Alberto Alesina and Robert Barro, "Currency Unions," *Quarterly Journal of Economics*, 2002.

Hsiao Chink Tang, "An Asian monetary union?" April 2006.

Steven K. Buigut and Neven T. Valev, "Is the proposed East African Monetary Union an optimal currency area? A structural vector auto-regression analysis", *World Development*, Vol. 33, No. 2, 2005, pp. 2119-2133.

7. Open-economy/international dimensions of monetary policy (March 25-April 1)

The Economist, "Currency competition"

Menzie Chinn and Jeffrey Frankel, "Will the Euro Eventually Surpass the Dollar as Leading International Reserve Currency?" (2006).

Maurice Obstfeld and Ken Rogoff, "The unsustainable US current account deficit revisited" (Nov. 2005)

Ricardo Caballero and Arvind Krishnamurthy, "Inflation targeting and sudden stops" -- Chapter 10 of Bernanke and Woodford.

Corinne Ho and Robert N McCauley, "Living with flexible exchange rates: issues and recent experience in inflation targeting in emerging market economies," BIS Working Paper No. 130 (Feb. 2003).

Maurice Obstfeld and Ken Rogoff, "Global Implications of Self-Oriented National Monetary Rules," *Quarterly Journal of Economics*, Vol. 117, May 2002, 503-36.