Adverse selection in banking systems, 177 effect on banks' vulnerability, 177 Allocation of resources induced by interest group lobbying, 265 Pareto-efficient, 265-266 Asset markets, international in analysis of fiscal policy transmission, 11 in analysis of monetary policy transmission, 10 Balance of payments. See also Current account adjustment to imbalances, xvi-xvii current account estimates, 310 monetary and nonmonetary gold flows in, 305 monetary approach to, xvi Balance-of-payments crises conditions for, 133 model under uncertainty, 436-442 Mundell's analysis, 431-432 perfect-foresight equilibrium model, 441-442, 444-445 size of response parameters (Mundell), 432 Banking crises costs of (1980s-1990s), 172 defined, 183 developing country macroeconomic conditions surrounding, 185-190 economic conditions as predictors of East Asian (1997), 198 in emerging markets, 178-183 external debt as contributor to, 193-196

factors contributing to, 172-175 macroeconomic effects, 176 Banking systems under currency board, 124-132 developing countries need protection from contagion, 198-199 interbank market, 176-177 moral hazard in developing country, 175 supervision and regulation in emerging, market countries, 182-183 weakness as predictor of currency crises, 123 Banks consequences of failures of, 176 fragility of, 176-177 response to idea of lender-of-last-resort, 180-181 services provided by, 176 Bellagio Group, 65 Bond issues, euro-denominated private, 422-423 Bretton Woods system capital controls under, 64 collapse (1971-73), 54, 66, 426 creation of IMF, 64 as gold-exchange, or gold-dollar, standard, 53 gold-foreign exchange reserves ratios during, 69-85, 90-101 limits on holding, buying, and selling gold, 64 pegged exchange rates under, 63-64 Capital controls under Bretton Woods, 64

under European Union, 263

Capital flows Mundell's analysis of speculative, 432 Mundell's studies of inflows of capital, 277 Rybczynski-based link between trade volumes and, 276-277 Capital immobility, Feldstein-Horioka hypothesis, 315-322 Capital markets, European distortions affecting, 267 Capital mobility effect of inflows on trade between United States and some Latin American countries, 280-300 exchange rates as stabilizers with shocks and, 431-432 less than perfect, xv Mundell-Fleming model, 273 Mundell's model of perfect, xii-xiii Mundell's studies of, 273 perfect or near-perfect, 432 Central banks under currency board, 132 demand for gold, 54 emergence of modern, 55 functioning as currency board, 127-133 gold reserve requirements (1880-1972), 107-109 justification for holding gold reserves, 67-69 as lenders of last resort under different exchange rate regimes, 124-125, 133-134 in model of balance-of-payments crises, 433, 438-440 motives of interwar, 60 role in concept of fixed exchange rates, xiii-xiv sale of gold reserves (1990-1997), 67 shift from gold to gold-exchange standard, 56-59 shift in composition of and demand for total reserves (1885-1995), 69-85 stabilizing role in speculative environment, 432 supporters of rational expectations approach, 255 Consumers in model of monetary policy transmission, 18-21

Consumption choice bundle

effect of tariffs on, 468-469 with endogenous terms of trade, 485-492 with exogenous terms of trade, 479-485 in labor market search model, 470-479 Currency. See also Devaluation; Exchange rates; Foreign exchange reserves; Optimum currency areas devaluation probabilities in exchange rate-based stabilizations, 435-436, 439-440 euro as, 413, 416, 418, 423 Currency boards banking systems under, 124-132 central bank functioning as, 127-133 Currency crises. See also Speculative attacks, currency under currency board, 124 first-generation model of speculative attacks, 207, 208-215 fiscal policy during, 441 intertemporal microfoundations of, 434 link to financial sector crises, 123 policy determinants of, 456-462 predictability, 231-236 predictions of model under uncertainty, 434 as predictors, 198, 435 response of exchange rate policy in, 439-440 Currency reform, Germany (1948), 153-161 Current account identification of monetary shock effects on, 396-400 monetary and nonmonetary gold flows in data for, 305-313 Data sources analysis of capital and trade flows in some Latin American countries, 280-281 analysis of current account response to monetary shocks, 394-395 Australian current account, 309-310 Canada's balance of payments, 310 effect of exchange rate regime on

banking crises, 190 empirical evidence of macroeconomic

policy transmission, 12

estimates of gold in current accounts of European countries, 310-313 for gold flows in balance of payments, 306-313 gold inventories, 313, 315 for identification and dating of banking crises, 184 monetary policy transmission mechanism, 10 proposal for development of, 268-269 Devaluation analysis of variables preceding (1962-1983), 232-233 expectations of, 234 of fixed exchange rate, 209-210 model to predict timing of, 232 Distortions, economic affecting European economies, 266-268 caused by interest groups, 264-265 proposed economic analysis of, 268-270 redistributive effects, 265 Distribution of gold reserves (1927-30), 61-62 role of government in, 259-261, 265 Division of labor with fragmentation of production, 365-367 Dollar, U.S. de facto standard, 66 pre-1997 East Asian currencies pegged to, 424-425 East Asian countries after speculative attacks, 424 pre-1997 linked macroeconomic policies, 424-425 proposed common monetary standard, 427-428 Economic and Monetary Union (EMU) common monetary standard prior to, 423-424 Economic policy IMF-recommended structural reform, 256-257, 259, 263 proposed research program and reform, 268-270 World Bank recommendations for structural reform, 257, 259 Economic policy theory analysis of distortions, 264-268

issues and areas to analyse, 257-259 Mundell tradition, 253-255 Economic shocks. See also Monetary shocks effect on macroeconomic policy, 9-16 effect on terms of trade, 178-179, 184 impact on emerging market economies, 178-179 stabilization related to exchange rates with exogenous, 431-432 Emerging market countries causes of banking crises in, 178-190 effect of economic shocks on, 178-179 macroeconomic policy in, 178 problems of banking in, 176-177 Euro advent (1999), 413, 416 impact on U.S. dollar, 418 as regional currency, 423 European Commission decisions based on economic principles, 263-264 Exchange rate regimes as contributor to banking crises, 190-193 potential effect on banks in emerging markets, 179-181 role in developing country banking crises, 190-193, 197-198 Exchange rates. See also Currency; Foreign exchange reserves post-World War I, 59 response to monetary shocks of nominal and real, 31, 40-42 shadow exchange rate, 210, 215-218 use of pegged and flexible rates, 179-181 Exchange rates, fixed business-cycle behavior with, 434-435 call option in currency crises, 214 conditions for domination of flexible exchange rate, 431 demand for reserves during periods of, 69-87 devaluation in financial crisis, 209-210 effect of tightening commitment to, 223 fragility of regimes, 236 with lender of last resort, 133-134 in model of business cycles and balanceof-payments crises, 438-442

Exchange rates, fixed (cont.) in model using first- and secondgeneration models, 229-231 Mundell's contribution to, xiii optimal commitment to, 224-229 stability and predictability of, 53 stabilizing properties of, 432 while sterilizing, 212-213 Exchange rates, floating or flexible demand for reserves during periods of, 69-87 domination by fixed exchange rate, 431 effect of managed floating regime, 53 in financial crisis, 209-210 gold in regime of, 66-69 with lender of last resort, 134-136 Mundell's contribution, xiv-xv Factor mobility complementarity between international trade and, 274–277 Mundell's contribution to ideas of international, xx, 365 relation to trade in HOS model, 277 substitutability of international trade and, 273-274 Factors of production international fragmentation, 369-371 international trade with fragmentation, 371-380 Federal Reserve System creation and guarantee function, 60 Feldstein-Horioka capital immobility hypothesis, 315-17, 322 Financial sector. See also Banking systems effect on banks of domestic structure of, 181-182 Mexican crisis (1994-1995), 181-182 relation of exchange rate regime to fragility of, 123-124 role in banking crises of domestic, 196-197 role in banking crises of domestic and external, 174-175, 196-197 Firms in model of monetary policy transmission, 23 PTM and non-PTM, 27-29 Fiscal policy during currency crises, 441 effect of pricing-to-market, 11

267 Maastricht Treaty, 258, 424 model of business cycles and balanceof-payments crises, 440-442 monetary dynamics, xv-xviii, xxi Mundell-Fleming model, xii-xv transmission, 10-11 Foreign direct investment (FDI) effect on trade of own- and otherindustry FDI, 292-297 effect on trade of own- and other-sector FDI, 289-292, 298-300 inflow effect on trade between United States and some Latin American countries, 280-300 model of inflow effect on volume of trade, 277-280 sectoral composition of trade and (1972-1994), 283-286 testing effects on trade of, 286, 288-294 U.S. capital flows by region and sector (1973-1994), 281-283 Foreign exchange reserves. See also Currency; Exchange rates commitment in speculative attack to, 214 in first-generation models of speculative attack, 213-215 gold in, 308 as share of total reserves (1880-1996), 69-85, 90-101, 110-111 sterilizing attack on, 212-213 Free rider problem, 269 Germany, West. See also Monetary policy, German postwar breakdown of postwar monetary system, 155-156 with postwar currency reform, 155-161 rationing, wage and price freeze (1935-1944), 154-155 Globalization meaning of, 365-366 welfare gains from, 367 Gold

under Bretton Woods, 63-64

future monetary role of, 84

60-61

in central banks' reserve portfolios, 67

dollar price in interwar period, 60

gold cover ratio in interwar period,

European Union treatment of income,

holdings by monetary authorities, 53-55 monetary role (1870-1914), 305 role in floating exchange rate regime, 66-69 in share of total reserves (1885-1995), 69-85 as traded commodity (1870-1914), 305 Gold Bloc, 71 Gold convertibility abandonment (1930s), 63 under gold-dollar standard, 63 post-World War I, 59 Gold-dollar standard post-World War II, 63-66 Gold-exchange standard collapse and disintegration (1930s), 54, 65 dependence on foreign exchange reserves, 61-63 of Mundell, 53 prewar and interwar, 53, 56-63 shift to, 56-58 timing in development of, 69-85 Gold Pool, 66 Gold reserves central bank requirements for (1880-1972), 107-109 central bank sales of (1990-1997), 67 central banks' collective responsibility, 68-69 gold as war chest, 69 international distribution (1927-1930), 61-62 persistence of retaining, 67-68 post-1971 value, 66-67 Gold standard capital immobility hypothesis under, 315-318, 322 development of international, 55-56 gold as official international settlement under, 305 gold-foreign exchange reserves under, 90-101, 110-111 interwar, 60, 321-322 shift to gold-exchange standard, 56-58 Government economic role in the economy, 259-262 justifications for intervention, 259-262 in model of monetary policy

transmission, 22-23

Heckscher-Ohlin-Samuelson (HOS) model, 274-277 Information bank operation in environment of asymmetric, 177 cascades in currency attacks, 219-220 Insurance in asset markets, 11 cross-country consumption, 21-22 Interest groups distortions created by, 264-268 free rider problem, 269 incentives of, 264-265 Interest rates in labor market search model, 473 levels in speculative attacks on currency, 211-213 related to banking crises in developing countries, 185-190, 198 response to monetary shocks, 31, 41 before and during speculative attack, 234 International Monetary Fund (IMF) Articles of Agreement creating SDR, 65 creation under Bretton Woods, 64 Keynesian economics, Mundell's contribution to refinement of, 253-254 Labor markets distortions affecting European, 267 effect of division of labor on, 365-367 Mundell's contribution to concept of mobility in, xviii-xix Labor market search model effect of endogenous terms of trade, 485-492 of intertemporal maximization, 470-479 model of effect of exogenous terms of trade, 479-485 Latin American countries FDI effects on trade (1972-1994), 286-300 sectoral pattern of trade with United States (1973-1994), 282-286

Law of one price (LOOP)

prices satisfying and deviating from,

deviations from, 10

18-19, 23-26

reforms (1940s-1950s), 145-147

Maastricht Treaty. See also Economic and Monetary Union (EMU) fiscal constraints, 424 fiscal policy provisions, 258 Macroeconomic policy effect of transmitted shocks on, 9-16 in emerging market countries, 178 empirical evidence of international transmission of, 11-16 limits and objectives of, 256 policy transmission mechanism (Obstfeld-Rogoff), 17-49 Macroeconomics dynamic models, 9-10 microeconomic analysis of, 268 open economy (Obstfeld-Rogoff), 9-10 Markets. See also Asset markets, International; Labor market; Money market; Pricing-to-market (PTM) clearing in model of monetary policy transmission, 27-28 government intervention to correct failure, 259-261 market classification principle, xvi Mexican financial crisis (1994–1995), 181– 182 Mobility. See Capital mobility; Factor, mobility; Labor markets Monetary dynamics (Mundell), xv-xvii Monetary overhang European strategy to deal with, 163-165 factors contributing to postwar European, 145-153 measurement and dissolution of, 147-150 Monetary policy. See also Fiscal policy effect when pricing-to-market, 10-11 with fixed exchange rate regime, xiv international transmission of shocks to, 9-11 Italian government stabilization policy (1993-1996), 257-258 monetary dynamics, xv-xviii, xxi monetization during World War II in Europe, 145 Mundell-Fleming model, xii-xv political economy of choices for reform, 163-165 politicized interwar, 60 reform in Europe (1944-1952), 160-163

Monetary policy, German postwar in Allied occupation zones (1948), 156 currency reform (1948), 153-154, 156-161 reform in Germany, 153-159 before and during World War II, 154-156Monetary policy transmission model calibration, 29-31 equilibrium, 28-29 quantitative evaluation, 31-49 two-country model of mechanism, 17-29 Monetary shocks current account response to, 393 effect of trade in noncontingent nominal bonds, 40-41 effect on current account variation, 399-400, 405-406 expansion effect in monetary policy transmission model, 31-40 government spending effect in model of monetary policy transmission, 42-49 identification of effects on current account, 396-400 in monetary policy transmission model, 31-42 pricing-to-market in model of monetary policy transmission, 41-42 response of exchange rates to, 31, 40-42 response of interest rates to, 31, 36, 37, 41 Monetary standard pre-1997 East Asian, 424 proposed for East Asia, 427-428 Monetary system, international goldbased, 54 Money market in first-generation models of speculative attacks, 208-215 Money supply. See Monetary overhang Moral hazard in banking systems, 177 in developing country banking systems, 175 effect on banks, 177 Mundell-Fleming model, xii-xv, 9-11, 123, 273, 393, 431, 467, 506

Mundell-Tobin effect, xix

Nonlinearity in extended first-generation model of speculative attack, 216-220 in first-generation models of speculative attack, 215 in second-generation model of speculative attack, 220-223 Optimum currency areas, xviii-xix, xxi literature of, 228 Mundell's 1961 model, 228-229, 415 theory of, 123, 415 Optimum Currency Areas conference (1970), 413-416 Price controls in Europe during and after World War II, 145 price setting in model of monetary policy transmission, 23-26 Pricing-to-market (PTM) in analysis of monetary and fiscal transmission effects, 10-11 defined, 10 link to monetary transmission mechanism, 10-11 in monetary policy transmission model, 11, 23-26 PTM and non-PTM firms, 26-29 Private sector model of business cycles and balance-ofpayments crises, 436-438 Privatization, 267-268 Production process fragmentation of, 365-368 pricing of products in international trade, 369-371 Property rights in market-traded and fixed exchange rate policy, 214 PTM. See pricing-to-market (PTM) Purchasing power parity (PPP) in monetary policy transmission model, 22 Rational expectations

approach, 254–255 equilibrium in model of business cycles and balance-of-payments crises, 445– 447 Ricardian model, 277, 288 Risk premium

in first-generation models of speculative attack, 213, 215 Rybczynski theorem, 276-277 Shocks. See Economic shocks; Monetary shocks Special Drawing Rights (SDRs), 65-66 Speculative attacks, currency in Europe (1990s), 233 first-generation models, 207, 208-215 information cascades, 219-220 macroeconomic effects (Mundell's model), 435, 456-462 option pricing, 214 predictability, 231-236 relevance of analysis of, 432 second-generation models, 207-208, 220-223 selling at shadow price, 210 Stabilization policy exchange rate-based, 431-432, 434-435, 438-440 model of business cycles and balance-ofpayments crises, 438-442 monetary dynamics, xv-xviii, xxi Mundell-Fleming model, xii-xv, xx Sterilization in first-generation models of speculative attacks, 212-213 Stolper-Samuelson theorem, 274 Tariffs consumption choice bundle effect, 468-

469 effect on employment in labor market search model, 470-479 effect on intertemporal utility, 493-494 effect on reservation wage, 468-469 effect on steady state utility, 492-493 effect with endogenous terms of trade, 485-492 effect with exogenous terms of trade, 479-485 in Mundell-Fleming model, 467 Technologies, fragmented or integrated, 367-368 Terms of trade. See also Tariffs country influence in model of labor market search, 470-479 effect of shocks to, 178-179, 184 effect on consumption choice bundle

Terms of trade (cont.) with exogenous, 479-485 response to monetary shocks, 31, 42 Trade, international. See also Capital mobility; Factor, mobility; Foreign direct investment, (FDI); Monetary shocks; Tariffs; Terms, of trade complementarity between factor mobility and, 274-277 effect of liberalization on, 367 FDI inflow effect between United States and some Latin American countries, 280-300 with fragmentation, 371-379 intensive growth of, 366 pricing of products sold in, 369-371 sectoral net export position of Latin American countries (1972–1994), 286-287 substitutability of factor mobility and, 273-274 testing effect of FDI on, 286, 288-294 Treaty of Rome (1958) agricultural subsidies and tariffs, 266-267 Triffin Dilemma, 61, 64 Uncertainty balance-of-payments crises under, 436-442 in first-generation models of speculative attack, 213–215 predictions of currency crises under, 434 Unemployment intertemporal search unemployment theory, 468-469 United States effect of FDI on trade with Latin American countries, 286-300 FDI flows to various regions (1973-1994), 281-284 sectoral composition of FDI to Latin America (1973-1994), 281-282 sectoral composition of trade and FDI to Latin American countries, 283-286 Vector auto-regression (VAR)

identification with restrictions on variable relationships, 400–404 identification with restrictions on variables, 396–400 pricing-to-market monetary policy shocks, 11–16

Wealth effect

in model of business cycle transmission and balance of payments, 433, 444-445