Economics/IR 635 Exam 2 - Review

Forces Shaping 19th and 20th Century Development of Economic Theory

Economic and Financial Crises 2006-2009

Transmission of the crises World Wide

Sovereign Debt Problems and Fiscal Policy Debate, Reserves and Currency Wars

1) 19th Century Development of Economic Theory
   - Perfect Market Model
   - Supply and Demand – Price determination
   - Say’s Law
   - Equilibrium in the product market and in the factor markets

2) Developments in the Early 20th Century
   - Development of central banks
   - Move from the gold standard
   - International monetary systems – Exchange rates, reserves, adjustment
   - Difficulties of international monetary systems

3) Great Depression
   - Trade barrier and decline of world trade
   - Decline of world investment
   - Currency inconvertibility
   - Worldwide decline in output, living standards
   - Should government have strong role in the economy?
   - Keynes write General Theory of Employment, Interest and Money
   - Keynes vs. Classical economists
   - Roosevelt’s programs – Social Security, Unemployment insurance, etc.

4) 1945-1980’s
   - Bretton Woods institutions – IMF, World Bank, later GATT
   - Establishes rules for new international monetary system
   - Key Currency system - $, gold
   - Breakdown of Bretton Woods, Smithsonian
   - 1971-1973 Move to current system of exchange rates
   - Acceptance of Keynes and role of the government, mixed economy
   - Deficit financing - OK
   - Counter cyclical monetary and fiscal policy
   - Growth of trade and government, acceptance of social safety net
   - Open trading system – GATT and WTO

5) 1980 – 2007 – Revival of Neo-classical thinking and Monetarism
   - Monetarism, Friedman, Chicago School
   - Effect on economic policy – move back towards free market
   - Washington consensus and neo-liberal thinking for developing countries
   - De-regulation – airlines, shipping, communications
   - Financial market lack of regulation, new instruments

Fall 2015
6.) Late 1980s to 2009 Financial Crises
   - US Savings and Loan crisis of the 1980s
   - 1987 stock market crash
   - Collapse of Japanese Stock Market
   - Long Term Capital collapse
   - Collapse of Japanese Stock Market
   - Tech Boom and Bust

7) Mortgage Crisis and Housing Bubble
   - Subprime lending
   - Rosen’s analysis – easy credit, low interest rates, speculation, dangerous loan forms
   - Secondary mortgage market
   - Development of Collateralized Debt Instruments
   - Financial market innovation in an unregulated environment

8) Financial Market Meltdown
   - The Minsky Moment
   - Explanations and implications

10) Policy Response of the Federal Reserve
   - Traditional measures
   - Unthinkable actions
   - Role of the lender of the last resort

11) Congressional and Executive Actions
   - Fiscal policy
   - Empowering other financial institutions, e.g. FDIC
   - “Only Four Ways Out"
   - Rethinking macroeconomics
   - Krugman criticisms and commentary
   - Financial Overhaul 2010

12) International transmission
   - Balance of Payments
   - Types of exchange rate systems
   - Official reserves and the dollar as a reserve currency
   - Role of other currencies
   - Why dollar likely to remain the world’s currency in the near future
   - Global imbalances – US Twin Deficit and other issues

13) Impact of the global crisis on the developing world
   - Degree of global ties
   - Channels of impact – Commodity prices, trade, capital markets, remittances and migration, tourism, financing for small and medium sized enterprises (SMEs)
   - Impact on poverty, human development and vulnerable groups

14) European Union and European Monetary Union (EMU)
   - How did the EMU develop?
Exam 2 Review

- What is an optimal currency area?
- What are the advantages and disadvantages of adopting a common currency?
- Is the EU an optimal or suboptimal currency area? Why?

15) Sovereign Debt Problem
- Greece fiscal problems and Greek bailout agreement
- Other EU countries fiscal problems
- Reasons for fiscal problems,
- European debt crisis
- Austerity measure vs. stimulus measures

16) Stimulus vs. Austerity policy choices
- Concern over growing fiscal deficits
- Pro – More stimulus
- Pro- Austerity
- Using exchange rates changes for dealing with debt problems

17) Reserves and reserve currencies
- What are international reserves?
- Currently, what are the most important reserve currencies?
- Why are reserves important for countries to have?
- How are reserves acquired?
- Is the dollar likely to remain the world’s major reserve currency?

18) Currency Issues
- Yuan – Dollar relationship
- China and the IMF and the SDR
- Exchange rate determination & appreciation & depreciation
- Problems with pegged exchange rates

19) Economic concepts
- Main accounts of the balance of payments
- Exchange rate systems
- Laws of supply and demand in exchange rate markets
- Tools of monetary policy and fiscal policy and how they are used
- Currency market intervention by governments

Exam 2 – Reading:
Text, Carbaugh Chapter 10, 17, pages 280- 306, 383-384, 397-402,
Downloads, Articles 66, 70, 73, 75(pages 797-826), 77, 78, 83, 87, 88, 89, 90, 91
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Exam 2– Sample Questions

Here are the written section exam questions. Please use any diagrammatic or graphic presentations which were presented in class in preparing your answers, as well as readings and lecture materials. You will be asked to answer some of the questions below on the exam.

1. What are the main accounts of the balance of payments?

2. What are Krugman’s criticisms of neo-classical economic thinking?

3. What are the differences between floating exchange rates and pegged exchange rate? Be sure to include government actions.

4. How and by what international mechanisms did the subprime market crisis spread to banks and financial institutions globally?

5. Identify and explain two causes of the housing market bubble according to Rosen.

6. What are Brad Delong’s four ways out? Which ones does he advocate utilizing and why?

7. Why does Eichengreen think that the US dollar will continue to be one of the world’s main reserve currency well beyond 2020? (Cite 5 reasons)

8. How and why do countries intervene in foreign exchange markets to influence the value of their currencies?

9. What is the sovereign debt crisis? How does a country get into this problem? What are the main arguments in the fiscal vs. austerity debate?

10. What parallels does Eichengreen draw between the problems and rigidities gold standard and the current euro system?

11. What is an optimum currency area? What are the advantages and disadvantages of adopting a common currency area? Is Europe an optimal or a suboptimal currency area?