American University
Econ 358/658, SIS 496/696, Spring 2010
Tuesdays 5:30-8:00 PM

FINANCIAL ISSUES IN LATIN AMERICA

Prof. Arturo C. Porzecanski, Ph.D.
Distinguished Economist-in-Residence
Office hours (Clark Hall #108): Tuesdays and Thursdays 2-5PM
Telephones 202-885-1602 and 917-526-3607; E-mail: aporzeca@american.edu

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 couple of years some Latin American country or other manages to get itself into serious financial trouble (e.g., the Dominican Republic in 2003-04, Belize in 2006, Ecuador and Venezuela in 2009). What explains the prevalence of macroeconomic instability in Latin America? We attempt 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, you will have a good 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.

The learning objective of this course, which will be tested in various ways, is familiarity with the essential vocabulary, analytical tools, theoretical concepts, practical applications, institutional features, and economic policy aspects of macrofinancial issues in Latin America.

Course requirements and grading

During most of each class, I will cover the main ideas conveyed by the assigned readings, and during the remainder I will answer questions and guide a class discussion of the topic at hand. In order to reap the benefits from the course, you should plan on attending every class and on doing all of the required readings before coming to class. To encourage reading ahead of class, there will be a few “surprise” quizzes handed out during the semester, at the start of some of the classes. There is no need to purchase any books; all the required readings are posted on Blackboard.
The other course requirements are two exams to take place on Tuesday, March 2 and May 4, respectively, and one essay of a \textit{maximum length of 2,000 words}, excluding footnotes and the bibliography, written on \textit{one} of the three topics specified at the end of this syllabus, to be delivered via e-mail by Noon on Friday, April 30\textsuperscript{th} at the latest. The quizzes (the three best out of four) will contribute to 10\% of the final grade; the exams will count for 25\% each; and the essay will account for the final 40\%.

You will compete for grades with your classmates, and to minimize grade inflation, grades are subject to the binding constraint that no more than one-third (1/3) of the class will receive an “A” or “A-” letter grade – no matter how high or low is the average score of the class in the individual assignments. If you score close to the class mean/median – whatever that turns out to be – you will be assigned a grade in the “B” range.

Being a member of the AU academic community entitles each of us to a wide degree of freedom in the pursuit of scholarly interests. With that freedom, however, comes a responsibility to uphold the high ethical standards of scholarly conduct. By registering in this course, you acknowledge your awareness of the Academic Integrity Code, and are obliged to become familiar with the rights and responsibilities therein. All work done in class or outside of class, whether oral or written, is governed by its provisions. Academic violations include, but are not limited to, plagiarism, inappropriate collaboration, dishonesty in examinations whether in class or take-home, dishonesty in papers, work done for one course and submitted for another, deliberate falsification of data, interference with other students’ work, and copyright violations. The adjudication process and possible penalties are listed in AU’s Academic Integrity Code, available on the AU website (at \url{www.american1.edu/academics/integrity/code.htm}).

In the event of a declared pandemic (influenza or other communicable disease), American University will implement a plan for meeting the needs of all members of the university community. Should the university be required to close for a period of time, we are committed to ensuring that all aspects of our educational programs will be delivered to you. These may include altering and extending the duration of the traditional term schedule to complete essential instruction in the traditional format and/or use of distance instructional methods. Specific strategies will vary from class to class, depending on the format of the course and the timing of the emergency. I will communicate class-specific information to you via AU e-mail and Blackboard, and you must inform me immediately of any absence due to illness. You are responsible for checking your AU e-mail regularly and for keeping yourself informed of emergencies. In the event of a declared pandemic or other emergency, you should refer to the AU Website (\url{http://www.american.edu/emergency/}) and the AU information line at (202) 885-1100 for general university-wide information, as well as contact me and your respective dean’s office for course and school/college-specific information.
Schedule and reading

January 12: Background on the role of financial issues in Latin America

Required readings:

January 19: The missing financial crisis in Latin America

Required readings:
1. ECLAC, Preliminary Overview of the Economies of Latin America and the Caribbean 2009 (Santiago, Chile: United Nations ECLAC, December 2009).

January 26: Fiscal fundamentals

Required readings:
February 2: Monetary and exchange-rate policies

Required readings:

February 9: Monetary and exchange-rate policies, cont’d

Required readings:

February 16: Banking crises

Required readings:
February 23: Role of capital flows

Required readings:

March 2: First Exam: Multiple-choice questions

March 9: No class meeting: Spring Break

March 16: Case study: Development of local bond markets in Mexico and beyond

Required readings:

March 23: Case study: Inflation targeting in Chile, Brazil and Peru

Required readings:

March 30: 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.

April 6: Case study: Banking crisis in Venezuela

Required reading:

April 13: Case study: Capital controls in Brazil and Chile

Required readings:
April 20: 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 (Cambridge, MA: MIT Press, 2006), Chapters 1, 2, 8 and 10.

April 27: No Class Meeting: Spring Study Day

April 30: E-mail versions of essay due by Noon

May 4: Second Exam: Multiple-choice questions

Instructions for the Essay Assignment

Choose from among the following three topics for your 2,000-word paper (excluding any footnotes, bibliography, tables or charts), which must demonstrate the application of concepts learned in class and should include citations to a bibliography of at least five (5) scholarly, academic or official sources beyond those listed in this syllabus. Citations to articles or other materials from newspapers, magazines (e.g., “The Economist” and “Foreign Affairs”), NGO websites and blogs, while permitted, do not count toward the minimum. Please use Word, specify single-line spacing, include your name in the file name, and send the essay via e-mail to me by the due date and time.

1. Your boss, the newly appointed Minister of Finance, suggests that since funding is so plentiful and interest rates are so low in the international capital markets relative to conditions prevailing in the domestic financial market, this may be a great time to finance the 2010 budget deficit abroad rather than at home. Write him 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 more forcefully that all countries in the region that have not done so already should now shift to a strict inflation-targeting regime. Before making this decision, however, she wants to hear a contrarian view, so write her a memorandum detailing the case against the universal adoption of inflation targeting in the region.
3. Your boss, the relatively inexperienced President of a central bank who is also the supervisor of the country’s banks, has been informed that there is a large bank that has seen its profitability erode rapidly and may soon start posting operating losses. He wonders out loud what few things he could do in the little time that may be left to help preserve the country’s financial stability – just in case the management of the bank in question comes knocking at his door asking for a bail-out. Write him a memorandum detailing what he should do *in the days and weeks ahead.*