

Monetary Theory and Policy

This course surveys the principle ideas that are used by economists to understand monetary phenomena and to inform central banking policy. An innovative feature of the course is the attempt to integrate insights from monetary historians and central bankers, as well as the more usual academics, and from financial economics as well as the more traditional monetary theory. The reason for taking this approach is, quite simply, the need to respond intellectually to the rising importance of financial and money markets in the modern world. Central bankers and financiers are closer to these changes than academics are, and monetary historians provide perspective less distorted by the unusual post-war decades.

The course is suitable for third-year and higher graduate students who have successfully completed the core theory sequence. The course is recommended for students preparing for field exams in macroeconomics, or finance, but the main focus is to introduce a range of potentially researchable dissertation topics.

Requirements: The course will be conducted in a combined lecture/seminar format. Grading will be based on a short written assignment, developed in consultation with me. There is no final exam.

Texts: In addition to the readings listed below, the following books are available for purchase at the Columbia Bookstore.

Marcia Stigum. The Money Market, 3rd ed. Irwin Professional Publishing 1990. The view of a market participant. The best introduction to how the money markets actually work.

Fischer Black. Business Cycles and Equilibrium. Basil Blackwell 1987. An extreme, but provocative, view from the perspective of modern academic finance.

John Taylor, ed. Monetary Policy Rules. University of Chicago Press 2001. State of the academic art of conversation with central bankers.

Alan Blinder. Central Banking in Theory and Practice. MIT Press 1997. Reflections of an academic turned governor.

Perry Mehrling. The Money Interest and the Public Interest, Harvard 1997. An interpretation of the development of American monetary thought 1920-1970.

Charles Goodhart and Gerhard Illing. Financial Crises, Contagion, and the Lender of Last Resort—A Reader. Oxford 2002.

SYLLABUS

Topic 1: What Is Monetary Economics About?

- Mehrling, P. "What is Monetary Economics About?" Mimeo, January 2, 2000.
Mehrling, P. "The State as Financial Intermediary." Journal of Economic Issues 34 No. 2
(June 2000): 365-8.

Topic 2: Inside and Outside Money

- Mehrling, P. "Note on the Optimum Quantity of Money." Journal of Mathematical Economics
24 (1995): 249-58.
Mehrling, P. "Idiosyncratic Risk, Borrowing Constraints and Asset Prices." Metroeconomica 49
No. 3 (October 1998): 261-283.
Mehrling, P. "The Distribution of Corporate Liquidity: Trends and Fluctuations, 1954-1991."
Working Paper (September 1994).
*Gurley, John G. and Edward S. Shaw. Money in a Theory of Finance, Brookings 1960.
*Patinkin, Don. Money, Interest, and Prices: An Integration of Monetary and Value Theory,
1956.
*Friedman, M. "The Optimum Quantity of Money." In The Optimum Quantity of Money and
Other Essays, 1969.

Topic 3: Central Banking Classics

- *Thornton, Henry. An Enquiry into the nature and effects of the paper credit of Great Britain,
1802.
*Wood, Elmer. English Theories of Central Banking Control, 1819-1858, 1939.
*Bagehot, Walter. Lombard Street; A Description of the [London] Money Market, 1873.
Hawtrey, Ralph. The Art of Central Banking, 1932.
*Goodhart, Charles. The Evolution of Central Banks, 1988.

Topic 4: Development of American Monetary Thought

- Mehrling, P. "Economists and the Fed: Beginnings." Journal of Economic Perspectives (Summer
2002) ^{Fall}
- *Mehrling, P. "Love and Death: The Wealth of Irving Fisher", 2001.
- Mehrling, P. "Mr. Goodhart and the EMU", 2001.
- Mehrling, P. "Don Patinkin and the Origins of Postwar Monetary Orthodoxy." EJHET (Summer
2002)
- *Mehrling, P. The Money Interest and the Public Interest, Harvard 1997.

Topic 5: Financial Crisis

- Mehrling, P. "The Vision of Hyman P. Minsky." Journal of Economic Behavior and Organization 39 No. 2 (June 1999): 129-158.
- Mehrling, P. "Minsky and Modern Finance, The Case of Long Term Capital Management." Journal of Portfolio Management 26 No. 2 (Winter 2000).
- Scholes, Myron. "Crisis and Risk Management." AEA Papers and Proceedings (May 2000): 17-21.
- Brimmer, Andrew F. "Central Banking and Systemic Risks in Capital Markets." Journal of Economic Perspectives 3 No. 2 (Spring 1989): 3-16.
- Goodhart, Charles and Gerhard Illing. Financial Crises, Contagion, and the Lender of Last Resort.
- *Kindleberger, Charles. Manias, Panics, and Crashes: A History of Financial Crashes, 4th ed, 2000.

Topic 6: New Analytical Perspectives: The Payments System

- *Timberlake, R. H. "The central banking role of clearinghouse associations." Journal of Money, Credit, and Banking 16 No. 1 (February 1984): 1-15.
- Lacker, Jeffrey. "Clearing, Settlement, and Monetary Policy." Journal of Monetary Economics 40 No. 2 (October 1997): 347-81.
- Albin, Peter and Duncan Foley. "Decentralized, Dispersed Exchange without an Auctioneer: A Simulation Study." Chapter 5 (pp. 157-180) in Peter S. Albin, Barriers and Bounds to Rationality; Essays on Economic Complexity and Dynamics in Interactive Systems. Princeton University Press, 1998.
- Farmer, J. Dooyne and Shareen Joshi. "The price dynamics of common trading strategies." Santa Fe Institute WP-00-12-069.

Topic 7: New Analytical Perspectives: Market Making

- *Hicks, John. A Market Theory of Money, 1989.
- *Grossman, Sanford and Merton Miller. "Liquidity and Market Structure." Journal of Finance 43(3) (July 1988): 617-34.
- Madhavan, Ananth. "Market Microstructure: A Survey." Journal of Financial Markets 3 (2000): 205-258.
- Black, Fischer. "Equilibrium Exchanges." Financial Analysts Journal 51 No. 3 (May/June): 23-29.

Topic 8: The Finance View

- Black, Fischer. "Banking and Interest Rates in a World without Money: The Effects of Uncontrolled Banking" and "How Passive Monetary Policy Might Work". Ch. 1 and 7 in Black, Business Cycles and Equilibrium, 1987.

Laffer, Arthur. "Trade Credit and the Money Market." Journal of Political Economy 78 No. 2 (March/April 1970): 239-267.

*Tooke, Thomas. An Inquiry into the Currency Principle, 1844.

*Fullarton, John. On the regulation of currencies, 1844.

*Mints, Lloyd. A History of Banking Theory in Great Britain and the United States, 1945. See especially Ch. 6-7.

Topic 9: The Taylor Rule

Clarida, Richard, Jordi Gali, and Mark Gertler. "The Science of Monetary Policy." Journal of Economic Literature 34 No. 4 (Dec 1999): 1661-1707.

Clarida, Richard, Jordi Gali, and Mark Gertler. "A Simple Framework for International Monetary Policy Analysis", NBER Working Paper 8870.

Woodford, Michael. "A Neo-Wicksellian Framework for the Analysis of Monetary Policy" Chapter 4 in Interest and Prices.

*Taylor, John. Monetary Policy Rules, 2001.

Blinder, Alan. Central Banking in Theory and Practice, 1998.

*Bernanke, Ben, Frederic Mishkin and Adam Posen. Inflation Targeting: Lessons from the international experience, 1999.

Topic 10: Central Banking Critics

Friedman, Milton. Money Mischief: episodes in monetary history. HBJ, 1992.

Cowen, Tyler and Randall Kroszner. Explorations in the new monetary economics, Blackwell 1994.

Hayek, Friedrich. Denationalisation of Money, The Argument Refined, 1990.

Davidson, Paul. Financial Markets, Money, and the Real World, Elgar 2002.

Selgin, George. The theory of Free Banking: money supply under competitive note issue, 1988.

White, Lawrence. Theory of Monetary Institutions, Blackwell 1999.