The course explores the theory and practice of Western monetary arrangements. Topics are indicated by the titles below. Grades will be based on the best three scores from four exams including the (comprehensive) final. The exams will be part objective and part short-essay questions. The exams are scheduled for February 18 (Tue), March 17 (Tue), April 23 (Thursday), and (the final exam) May 11 (Mon).

Section I of the course introduces some basic mechanics of banking and interest rates which is followed by a discussion of the current debt crisis and the theory of indexation. Section II focuses on the demand for and neutrality of money, especially as the concepts evolved during the monetary controversies of the late 19th century and 1930s. Section III of the course concerns the evolution of Western monetary arrangements (from the gold standard through Bretton Woods, managed floating and European Monetary Union). The course concludes with a discussion of alternative future monetary arrangements. The text for the course is a packet (330 pages) at Campus Copies written by the instructor. Other readings are on reserve in Norlin.

As part of a new experiment, written study questions will be distributed every week or two and they will be discussed in class. The intention is to create exam questions from the study questions. The first several questions are posted on back of this sheet.

I. Banking, Debt Instruments, Indexation & Money Demand
   Central And Commercial Bank Liabilities
     Program for Monetary Stability Milton Friedman pp. 65-76
     Yields, Capitalization Theory, Present Values And All That
     Causes and Consequences of the Debt Crisis
     How Might Disinflation Interact with Debt to Produce Depression?
     “Debt for Nature Swaps” Jose Castaneda 1990
     Secrets Of The Temple, William Greider pp. 86-123
     “Agony of the Federal Reserve” Sanford Rose Fortune
     Indexation And The Government “Deficit”
     “Using Escalators to Help Fight Inflation” Fortune Milton Friedman
     What Is The Demand For Money?
     What Is The Demand For Money? – Further Reflections

II. Money Demand, Neutrality, and Historical Controversy
   The Role Of Money Demand Versus Neutrality In Monetarist Thought
     Program for Monetary Stability Milton Friedman Ch. 1
     Late Nineteenth Century US Monetary Controversy
     Development Of The Asymmetric Gold-Exchange Standard
     Keynes Lecture to the Institute of Bankers 1922
     “The Economic Consequences of Mr. Churchill” Keynes 1925
     Keynes’ Views On External Monetary Conditions And Great Depression
     Purchasing Power Parity
     Reconsideration Of Roosevelt’s 1933 Devaluation Of The Dollar
     The Great Contraction Milton Friedman
     Gold, Debt And The Great Depression
     “Debt–Deflation Theory of the Great Depression” Irving Fisher (1933)
     Debts and Recovery: 1929-1937, 20th Century Fund, Ch 8 (1938)
III. Evolution Of Monetary Arrangements

Evolution Of Money
“Free Exchange Rates” in Friedman’s Dollars & Deficits
Devaluation Under The GS vs The GES
Are We Going To Return To Fixed Exchange Rates?
The Monetary Approach To Exchange Market Pressure
The Invariance Of The Own Rate On Money
What’s Money?
“Optimum Quantity of Money” Milton Friedman, 1969
“Profit Maximizing Monetary Policy” EForum
Islamic Banking and Money Market Funds EForum
How To Eliminate Sustained Inflation
Substitutable Monies And The Monetary Standard
Competitive Monies And A Real Standard

Initial Study Questions

1. Derive the money-supply multiplier. Show, by numerical illustration, the inverse relation between the C/D and R/D ratios and the M/H ratio. What does the a central bank have to do each Christmas to keep M on its targeted growth path? Why? Can C/D and/or R/D go to zero and/or infinity? What is the relation between the “liquidity trap” and the X/D ratio of the ‘thirties? What would happen to the multiplier if the Chicago (Great Depression) plan for 100% reserves were implemented? (See Friedman’s Program ... ). What is the “inherent instability of fractional reserve banking”?

2. Give a step-by-step, verbal explanation of how a banking panic causes a fall in M if H remains unchanged.

3. The supply of money is often thought to depend on market interest rates and this relation is usually written as $M^* = M(i, H) = u(i)H$ which indicates that, since $u = u(R/D, C/D)$, one or both ratios are a function of market interest rates. How might market rates influence R/D and/or C/D and, thereby, u and $M^*$?

4. How was the failure of the FRS to enhance its earnings related to the discovery of open market operations? Why was the Fed so broke then and so rich now? How could an institution, which has a monopoly over the printing press, be “broke”? What does the Fed do with most of its earnings? What is the source(s) of its "earned income”? Approximately how large is the Fed’s earned income relative to the US federal government budget? When the value of the Fed’s assets appreciate, does H increase? How does an appreciation in the value of its assets show up in its balance sheet?

5. When a central bank engages in an open market sale, is it borrowing money? Can the Fed issue or sell Treasury notes? What is the distinction between government debt and government deficit? What is the relation between the Treasury and the Fed? How is that related to the distinction between monetary and fiscal policy?

6. What is the difference between coupon rates and yields-to-maturity? Between interest rates and interest payments? What formula applies to one-period yields versus holding-period yields? What formula applies to traditional Treasury bonds vs Treasury strips?

7. Derive the multi-period capitalization formula and explain, verbally, each term in each step of the derivation. Using the multiple period formula, derive the perpetuity formula.

8. What are the etymologies of the words “central” (in the phrase “central bank”) and the word “rediscoun”t”? Would we more likely speak of a central bank rediscouting a bill or a bond?

9. Explain the relation between the price of a capital asset, like houses, and the anticipated slope of the price path of that asset in the context of the appropriate capitalization formula. Does Q influence $Q$ or vice versa or does causation go in both directions?