



ELSEVIER

Contents lists available at [ScienceDirect](http://www.sciencedirect.com)

## Journal of International Money and Finance

journal homepage: [www.elsevier.com/locate/jimf](http://www.elsevier.com/locate/jimf)



### Editorial

## Overview of special issue 30th anniversary of the Journal of International Money and Finance

In April 1982 in the first issue of the *Journal of International Money and Finance*, founding editor Michael R. Darby wrote that *JIMF* would have a preference "... for papers which make a significant contribution to the knowledge of ourselves and our readers." Darby then went on to issue a challenge of sorts: "Brave words are cheap and can only be redeemed by action; so let us begin" (Darby, 1982, p. 1).

In 1986, James R. Lothian and Michael Melvin took over the editorial reins from Darby. Those "brave words" got redeemed with 30 volumes, 160 issues, and 1660 research articles in over 50,000 pages of *JIMF* in the years that followed its inception. In the process, the Journal became a major leader in the study of international finance and open economy money/macro.

On October 26, 2012, the Fordham University Graduate School of Business, Fordham's Frank J. Petrilli Center for Research in International Finance and *JIMF* co-sponsored a conference at Fordham to celebrate the Journal's thirtieth anniversary. The papers in this special issue are refereed versions of the papers presented at that conference. They weave together history of economic thought, economic history, and empirical analysis of a number of key issues in international money and finance. We believe they will make a fine contribution to the knowledge of our readers.

In "I Discovered the Peso Problem: Irving Fisher and the UIP Puzzle," James R. Lothian, Rachel A.J. Pownall and Kees G. Koedijk, 2013, show that Irving Fisher was the first economist to identify both the concept of uncovered interest parity (UIP) and what has now become known as the peso problem. The authors take the opportunity provided by Fisher's unique data for two instances where bonds were issued by a single government in two different currencies to re-examine his findings using today's UIP models. The first dataset is for 1870 to 1896 yields on long-term U.S. bonds payable in gold and long-term U.S. bonds payable in paper currency. The second dataset is for yields on long-term Indian bonds payable in sterling and long-term Indian bonds payable in silver rupees both of which were traded in London between 1865 and 1894. When the authors examine whether these data support UIP, like Fisher, they find mixed results. For the US data from 1870 to 1878, when paper money was not redeemable for gold, "...the yield differential was consistent with the direction of exchange-rate movement but not the magnitude." (Lothian et al., 2013, p. 5). Between the January 1, 1879 when specie payments were resumed and the campaign period prior to the 1896 Presidential election, the yield differential became small enough to argue that UIP held. The authors new look at the Indian bond yields, like Fisher's earlier results, are somewhat more supportive of the theory of UIP but show that there were learning periods that produced lags in the adjustment of the yields.

Since Fisher's data could not be extended, Lothian et al. go on to study Fisher's theory of UIP using annual data for United States and United Kingdom government bond yields and for the dollar-sterling exchange rate for the period 1801 to 2011 as well as monthly data for 23 countries for the floating

exchange-rate period, 1976 to 2011. Both sets of data, particularly in the form of averages, provide substantial support for UIP and suggest that the episodic phenomena in the form of peso-type problems and learning that Fisher identified were in fact important sources of disturbance.

The next paper in this special issue, "Recession, Growth and Banking Crises," by [Gerald P Dwyer, John Devereux, Scott Baier and Robert Tamura, \(2013\)](#) continues a *JIMF* tradition of looking at current economic problems using evidence from long historical data sets. In this paper, the authors use annual data from 1890 to 2009 for 21 countries to examine the relationship between banking crises and economic growth. Under three definitions that separate banking crises from other financial crises, they find that while contraction of the economy generally accompanies a banking crisis that is not always the case. For their data, real GDP per capita did not decline in the year of the crisis or in the two years that follow the crisis for 25% of the bank crises that occurred. This finding is accompanied by evidence of wide variations in the behavior of real GDP per capita in the years around bank crises. By using a difference in difference approach, with the world economy as the control group, the authors go on to examine the relationships between a banking crisis and differences in the growth rate of output per worker, of physical capital and of human capital before and after the crisis. The authors look at the difference in inputs and output for 10 years before and 10 years following a banking crisis within countries and compared to the world economy. They find very diverse outcomes for economic growth following a banking crisis. A further highly interesting result is that their study provides evidence of Zarnowitz's Law – the larger the decline in real GDP per capita after a banking crisis the faster the rate of recovery.

Divergence in the macroeconomic conditions of economies following financial crisis is explored further by [Joshua Aizenman and Ilan Noy, 2013](#) in their paper, "Macroeconomic Adjustment and History of Crises in Open Economies." They use panel cross-country data for banking crises from 1980 to 2010 from the updated database of [Laeven and Valencia \(2012\)](#) to explore two aspects of the differential adjustment hypothesis. The first aspect is the degree to which past banking crises affect the probability of future crises; the second aspect is the degree to which past crises increase the saving rates of the affected households. To investigate the question of whether countries learn from past crises, Aizenman and Noy estimate a multivariate probit model of the likely occurrence of a banking crisis for different time periods and different income groups. This approach is particularly helpful because the history of banking crises is very limited for high-income countries and the character of the crises have changed over time for middle-income countries.

They find no evidence of a learning process. A past occurrence of a banking crisis, on average, does not reduce the probability of future crises. In fact they find the opposite, that middle-income countries that have already experienced one banking crisis generally have a higher likelihood of experiencing another crisis. The authors also study the learning process by examining whether the depth of a banking crisis is affected by the experience of having a previous banking crisis. To do this, the authors use three proxies for the depth of banking crises. These measures are the output loss, the fiscal cost and the amount of non-performing loans. Estimating a model for each measure separately and including a binary variable for the occurrence of a previous banking crisis as an explanatory variable, the authors find that the depth of the crisis does not appear to be affected by the previous historical experience with crisis events.

The second aspect of the differential adjustment hypothesis that Aizenman and Noy examine is the degree to which past banking crises increases the saving rates of the affected households. They construct four alternative measures of an exposure to an "income catastrophes" index, EIC, for income catastrophes going back to 1900 and examine whether this index is correlated with domestic saving. They focus on middle-income countries and find that for countries facing considerable political risk, the experience of past banking crises does increase the private savings rate.

As *JIMF*'s title indicates, a major subject matter of the Journal is monetary economics. The first issue of *JIMF* featured a paper by Milton Friedman and Anna J. Schwartz on the monetary and other relationships linking the United States and the United Kingdom ([Friedman and Schwartz, 1982](#)). Over the 30 years that followed the role of money and monetary policy has been a recurrent theme in *JIMF* papers.

In "Friedman's Monetary Economics in Practice," Edward Nelson, 2013, reviews the compatibility of five major policy responses by the Federal Reserve during the Great Recession of the 2000s with Milton

Friedman's monetary policy proposals. The five major policies identified by Nelson as implemented by the Federal Reserve in response to the Great Recession, are: "1) the discount window lending that was provided to the financial system, at rates that were low in relation to the market rates prevailing before the crisis; 2) the Fed's adjustment of its holdings of government securities with the aim of putting downward pressure on the path of several important interest rates for a given path of short-term rates; 3) the extension of deposit insurance to help insulate the money stock from credit market disruption; 4) assistance to the commercial banking system via a recapitalization program with existing equity holders bearing losses; and 5) the introduction of a system of interest payments on bank reserves" (Nelson, 2013, p. 59)".

Nelson draws on a wider body of Friedman's writings and public statements than have been used in previous literature and he brings in some "... lesser-known aspects of Friedman's monetary economics." (Nelson, 2013, p. 59). Nelson distinguishes between Friedman's view of the transmission of monetary policy under ideal conditions and how it works when responding to a financial crisis. He begins his analysis of how the five recent policies responses fit with Friedman's monetary economics by highlighting Friedman's crucial distinction between money and credit and the central banks "... commanding position over money but not total credit." (Nelson, 2013 p. 59). He then shows how in Friedman's view "the central bank can maintain the money stock in the face of credit market disruption" and limit the damage to the economy from destabilization in the credit market (Nelson, 2013 p. 59). He shows further how the Fed's policy responses operate in Friedman's framework in a zero short-term nominal interest rate environment and how those responses are consistent with Friedman's identification of portfolio effects of open market operations.

In "Fiscal Spillovers in the Euro Area," [Guglielmo Maria, Caporale and Alessandro Girardi, 2013](#), use quarterly data from 1998:Q1 to 2010:Q4 for bond markets in 11 Euro-area countries to assess the dynamic effects of fiscal imbalances in given EMU member states on the borrowing costs of other member states. Their results show strong links between euro-denominated government bond yields in the 11 countries.

To investigate these links, the authors use a two-step procedure to estimate a Global VAR (GVAR) model. In the first step, they estimate a country-specific Vector Error Correction (VEC) model for each of the countries. In the second step, they stack these VEC models to estimate the GVAR model and use the model to perform dynamic simulation exercises. Caporale and Girardi show a strong link between the long-term yields for euro-dominated government securities of EMU countries with foreign shocks accounting for the largest percentage of variability in the domestic markets. They find further that the quality of government debt plays a role in the dynamics of long-term yields. If the government issuing the debt has a high credit rating, then increasing its debt tends to reduce yields. If the government is already highly indebted or the country is a peripheral economy, the risk factors dominate liquidity effects and real interest rates rise. In addition, their results imply that unanticipated flight-to-quality leads to higher debt financing cost for the economies with the weakest macroeconomic fundamentals.

In their paper, "Exchange Rate Regimes and Asset Prices," [Harris Dellas and George Tavlas](#) consider how asset prices might have been different if during the last decade China's currency had been under a floating exchange-rate regime. The underlying question here is the extent to which the international monetary regime has encouraged asset price inflation.

During the last decade, U.S. asset prices experienced sustained upward movements, as did asset prices in other industrial countries. Even after a temporary retreat during the financial crisis, asset prices, with the exception of real estate prices, have continued to climb. At the same time, real long-term interest rates have been quite low and the United States has run current account deficits, particularly vis-à-vis the East Asian countries. Central banks in those countries, in turn, have accumulated substantial holdings of U.S. dollar reserves. Are these phenomena linked? Do they have anything to do with the prevailing international monetary arrangements? In particular, would the situation have been different if China had let the renminbi float?

The authors model a world with only two countries, two intermediate goods and one final good. Their model includes a portfolio structure for each country that is intended to capture the asymmetry observed in the portfolios of the United States. (The home country) and China (the foreign country). They then explore the impact of shocks, such as increases in foreign productivity and increases in

demand for safe assets, on asset and goods prices under a unilateral peg and under a flexible exchange rate regime.

The authors find that the two shocks that have figured prominently in recent studies – an increase in the effective labor supply in China and an increase in the appetite of LDCs for U.S. safe assets – do lead to a decrease in US real interest rates and an increase in asset prices. However, the differential impact across exchange rate regimes for these two shocks is quite limited. They find further that monetary and public debt expansion in the United States can exert a powerful and persistent effect on equity prices in the United States, even under flexible prices and that this effect is considerably more pronounced under a flexible exchange-rate regime. Their bottom line with regard to China pegging of the USD/RMB rate is that it does not appear to have made much difference for asset price inflation in the United States.

“The Market Microstructure Approach to Foreign Exchange: Looking Back and Looking Forward,” by Michael R. King, Carol Osler and Dagfinn Rime presents a comprehensive interpretative overview of the literature on FX microstructure. For anyone interested in the behavior of FX, including anyone teaching this topic, this paper offers important insights into how the FX market has operated in the floating exchange-rate era and in the period following the introduction of the Euro.

As the authors point out, *JIMF* has been the leader in the publication of articles in this area, by their calculations publishing 30 articles on FX microstructures during the period 1982 to 2012 compared to only 7 each for the next two leading journals.

In their article, King et al. explain how microstructure models were developed using surveys of market participants. They show how the information created by these surveys propelled the these models into the study of trading flows and how that in turn has provided economists with new perspectives on the FX market. They show how the microstructure models are able to differentiate market participants along the lines of size, motivation and the information they have available. These models then show how the interaction of these participants can explain market behavior. The authors provide a particularly, good summary of the [Evans and Lyons \(2002\)](#) three-rounds FX trading model and are able to outline the findings of a broad set of FX microstructure literature using this framework.

They conclude that: “The new insights from the FX microstructure literature have their own inherent scientific value and are proving valuable in achieving the field’s original goal: understanding macro-level exchange-rate puzzles” ([King et al., 2013, p. xx](#)). They finish with a discussion of the dramatic changes in the structure of FX markets that have taken place in recent years and highlight a number of areas that they regard as potentially fruitful focal points for future research.

## References

- Aizenman, J., Noy, I., 2013. Macroeconomic adjustment and history of crises in open economies. *J. Int. Money Finance* 38, 41–58.
- Caporale, G.M., Alessandro Girardi, A., 2013. Fiscal Spillovers in the euro area. *J. Int. Money Finance* 38, 84e1–84e16.
- Darby, M.R., 1982. Editorial. *J. Int. Money Finance* 1, 1–2.
- Dellas, H., Tavlas, G., 2013. Exchange rate regimes and asset prices. *J. Int. Money Finance* 38, 85–94.
- Evans, M.D.D., Lyons, R.K., 2002. Order flow and exchange rate dynamics. *J. Polit. Econ.* 110 (1), 170–180.
- Friedman, M., Schwartz, A.J., 1982. Interrelations between the United States and the United Kingdom, 1873–1975. *J. Int. Money Finance* 1, 3–19.
- Gerald, Dwyer P., Devereux, John, Baier, Scott, Tamura, Robert, 2013. Recession, growth and banking crises. *J. Int. Money Finance* 38, 18–40.
- King, M.R., Osler, C., Rime, D., 2013. The market microstructure approach to foreign exchange: looking back and looking forward. *J. Int. Money Finance* 38, 95–119.
- Laeven, L.A., Valencia, F.V., 2012. Systemic Banking Crises Database: An Update. IMF Working Paper 12/163.
- Lothian, J.R., Pownall, R.A.J., Koedijk, K.G., 2013. I discovered the peso Problem: Irving Fisher and the UIP puzzle. *J. Int. Money Finance* 38, 5–17.
- Nelson, E., 2013. Friedman’s monetary economics in Practice. *J. Int. Money Finance* 38, 59–83.

Cornelia H. McCarthy\*  
*SUNY Maritime College, 6 Pennyfield Avenue, Throggs Neck, NY 10465, United States*

\* Tel.: +1 347 583 3648.

E-mail address: [cmccarthy@sunymaritime.edu](mailto:cmccarthy@sunymaritime.edu)