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8. Unless otherwise determined by the Board or exempted by the terms of paragraphs 6 and 7, a copy of this resolution shall be printed in each NBER publication as described in paragraph 2 above.

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## Abstracts

### **1 Free Flows, Limited Diversification: Openness and the Fall and Rise of Stock Market Correlations, 1890–2001**

*Dennis Quinn and Hans-Joachim Voth*

Using a new data set on capital account openness, we investigate why equity return correlations changed over the last century. On the basis of a new, long-run data set on capital account regulations in a group of 16 countries over the period 1890–2001, we show that correlations increase as financial markets are liberalized. These findings are robust to controlling for both the Forbes-Rigobon bias and global averages in equity return correlations. We test the robustness of our conclusions and show that greater synchronization of fundamentals is not the main cause of increasing correlations. These results imply that the home bias puzzle may be smaller than traditionally claimed.

### **2 The End of Gatekeeping: Underwriters and the Quality of Sovereign Bond Markets, 1815–2007**

*Marc Flandreau, Juan H. Flores, Norbert Gaillard, and Sebastián Nieto-Parra*

We provide a comparison of salient organizational features of primary markets for foreign government debt over the very long run. We focus on output, quality control, information provision, competition, pricing, charging, and signaling. We find that the market setup experienced a radical transformation in the recent period, and we interpret this as resulting from the rise of liability insurance provided by rating agencies. Underwriters have given up their former role as gatekeepers of liquidity and certification agencies to become aggressive competitors in a new speculative grade market.

### **3 The Feldstein-Horioka Fact**

*Domenico Giannone and Michele Lenza*

This paper shows that general equilibrium effects can partly rationalize the high correlation between saving and investment rates observed in OECD countries. We find that if we control for general equilibrium effects, the saving-retention coefficient remains high in the 1970s but decreases considerably since the 1980s, consistent with the increased capital mobility in OECD countries.

### **4 Can Parameter Instability Explain the Meese-Rogoff Puzzle?**

*Philippe Bacchetta, Eric van Wincoop, and Toni Beutler*

The empirical literature on nominal exchange rates shows that the current exchange rate is often a better predictor of future exchange rates than a linear combination of macroeconomic fundamentals. This result is behind the famous Meese-Rogoff puzzle. In this paper we evaluate whether parameter instability can account for this puzzle. We consider a theoretical reduced-form relationship between the exchange rate and fundamentals in which parameters are either constant or time varying. We calibrate the model to data for exchange rates and fundamentals and conduct the exact same Meese-Rogoff exercise with data generated by the model. Our main finding is that the impact of time-varying parameters on the prediction performance either is very small or goes in the wrong direction. To help interpret the findings, we derive theoretical results on the impact of time-varying parameters on the out-of-sample forecasting performance of the model. We conclude that it is not time-varying parameters, but rather small sample estimation bias, that explains the Meese-Rogoff puzzle.

### **5 International Reserves and Underdeveloped Capital Markets**

*Kathryn M. E. Dominguez*

International reserve accumulation by developing countries is just one example of the puzzling behavior of international capital flows. Capital should flow to where its return is highest, which ought to be where capital is scarce. Yet recent data suggest the opposite—net capital flows from developing countries to industrialized countries. This paper examines the role of financial market development in the accumulation of international reserves. In countries with underdeveloped capital markets, the government's accumulation of reserves may substitute

for what would otherwise be private-sector capital outflows. Effectively, these governments are acting as financial intermediaries, channeling domestic savings away from local uses and into international capital markets, thereby offsetting the effects of domestic financial constraints that lead to excessive private-sector exposure to potential capital shortfalls.

## **6 The Nontradable Goods' Real Exchange Rate Puzzle**

*Lukasz A. Drozd and Jaromir B. Nosal*

The paper studies empirically and theoretically the decomposition of the real exchange rates into tradable and nontradable components, in the spirit of Charles Engel. Empirically, we find that the contribution of the nontradable component is at best modest—confirming the results from the literature. Theoretically, we establish that this finding is a puzzle for the standard models in which the fluctuations of the tradable component are driven by the relative price movements of differentiated home and foreign tradable goods, and the law of one price holds.

## **7 External Balance in Low-Income Countries**

*Lone Christiansen, Alessandro Prati, Luca Antonio Ricci, and Thierry Tresselt*

This paper offers a coherent empirical analysis of the determinants of the real exchange rate, the current account, and the net foreign assets position in low-income countries. The paper focuses on indicators specific to low-income countries, such as the quality of policies and institutions, the special access to official external financing, and the role of shocks. In addition to more standard factors, we find that domestic financial liberalization is associated with higher current account balances and net foreign asset positions, whereas capital account liberalization is associated with lower current account balances and net foreign asset positions and with more appreciated real exchange rates. Negative exogenous shocks tend to raise (reduce) the current account in countries with closed (opened) capital accounts. Finally, foreign aid is progressively absorbed over time through net imports and is associated with a more depreciated real exchange rate in the long run.