

Economics 5633
International Finance
MW 4:30-5:45 Kaufman Hall Rm. 0136

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Office Hours: TH 10:00-12:00 and by appointment

1. Course Objective:

This course is a graduate level introduction to international finance theory and applications and is designed to introduce students to both theoretical and empirical analysis of global financial markets and open economy macroeconomics. Traditionally, international economics can be divided into two broad subfields: the study of international trade and the study of international finance. International trade analysis focuses primarily on the *real* transactional economy, that is, on those transactions that involve a physical movement of goods or a tangible commitment of economic resources. International finance focuses on the monetary side of international economy, that is, on financial transactions such as foreign purchases of U.S. dollars. In doing this, international trade analysis primarily uses microeconomic theory while international finance uses macroeconomic theory.

The lectures are organized in two sections: a) exchange rates and open economy macroeconomics, where we will study the macroeconomic accounting system, balance of payments, foreign exchange market and the open economy macro theory, and b) the global capital market, performance and policy issues where we will apply the theoretical foundations from the first part to the current issues in international finance.

2. Course Structure:

The course is designed around lectures, assigned readings from various articles, and class discussions. The students are expected to come to each class after having read the assigned readings, and to participate in classroom discussions. The final grade will be based on your performance from: a) one midterm exam (**March 5**) (25%), and a comprehensive final exam (35%); b) a research paper (25%); c) homework assignments and class participation (15%).

3. Class Participation

In addition to active participation in class discussions, each student is required to present a review of at least one of the articles in the reading list in one of the sessions.

4. Term Paper

On a topic related to the course you will write an 8,000-10,000 word research paper that is due in class on April 18, or earlier. The research paper is on a topic of your choice with a well-focused question. You must make a clear argument and defend your claims rigorously and systematically with theoretical and empirical evidence. Here you have three options: a) You can use this as an opportunity to work further on your dissertation (as long as it is on international finance), b) You can re-produce the findings of an existing paper in international finance. The replication may follow the original paper one-to-one or may include adjustments such as data, country or methodology applied, c) You can choose a topic that is of interest to you and may possibly help you develop your dissertation ideas. The topic for the paper must be

approved in advance. The research paper is divided into several stages, including a one-page proposal (due **February 14**), and the final paper (due **April 18**), and:

- Research presentation. Present your research paper's puzzle, argument, evidence, and implications in a 15-minute "conference-style" talk. Respond to questions.
- Serve as discussant/commentator on another student's research presentation. Based on another student's research paper, write 2-3 pages of detailed but constructive comments, focusing on substantive arguments and evidence. Present these comments orally for 5 minutes after the subject's research presentation (counts towards your class participation).

All counts towards your final grade.

5. Textbook

**Major References:*

Dornbusch, R. (1980) *Open Economy Macroeconomics*, Basic Books, Inc. Publishers, New York.

Agénor, Pierre and Montiel, Peter. (1996) *Development Macroeconomics*, Princeton University Press.

Montiel, P. (2003), *Macroeconomics in Emerging Countries*, Cambridge University Press.

Obstfeld, M. and Rogoff, K. (1996) *Foundations of International Economics*, MIT Press.

Calvo, Guillermo (1996) *Money Exchange Rates and Output*, MIT Press.

Dornbusch, Rudiger and Helmers, F. Leslie C. H. (1988) *The Open Economy: Tools for Policymakers in Developing Countries*, Oxford: EDI series in Economic Development.

Kenen, Peter (1995) *Understanding Interdependence: The Macroeconomics of the Open Economy*, Princeton University Press, Princeton. 1995.

Williamson, J. (1983), *The Open Economy and the World Economy*, Basic Books Inc. Melvin, M. (2004) *International Money and Finance*, 7th edition, Pearson Addison-Wesley.

Dornbusch, Rudiger (1988) *Exchange Rates and Inflation*, MIT Press.

**For refreshing your undergraduate international finance class and for general reference:*

Krugman, P. and Obstfeld, M. (2006), *International Economics: Theory and Policy*, 7th edition, 2006, Addison-Wesley.

Melvin, M. (2004), *International Money and Finance*, Pearson Addison-Wesley.

Yarbrough, B. V. and Yarbrough, R. M. (2006), *The World Economy, Open-Economy Macroeconomics and Finance*, 7th edition, Thomson South-Western.

6. Academic Ethics:

Cheating on assignments and exams, or plagiarizing (misrepresenting as one's own anything done by another) is penalized by the University of Oklahoma. A student found in such a situation will be given an F in the class and will be brought to University of Oklahoma Honor Council for further penalties as defined under Academic Misconduct. For further information, refer to <http://www.ou.edu/honorcouncil/index.html>

7. Students with Disabilities

Any student who feels he or she may need an accommodation based on the impact of a disability should contact me privately as soon as possible to discuss his or her specific needs. For details refer to <http://drc.ou.edu/>

8. Grading Scale

90-100:	A	60-69.9:	D
80-89.9:	B	< 60	F
70-79.9	C		

I reserve the right to adjust this schedule of grade equivalents in the student's favor.

9. COURSE OUTLINE AND READING ASSIGNMENTS:

The following is a tentative list of topics and required readings. All readings should be completed (except those marked * which are optional). Additional readings may be assigned from time to time.

I. Exchange Rates and Open-Economy Macroeconomics

A. Background

1. National Income Accounting and the Balance of Payments

Melvin, Ch. 2.

Krugman and Obstfeld, Ch. 12;

Host-Madsen, P. (1967), *Balance of Payments', its Meaning and Uses*, International Monetary Fund, Washington, D.C., Pamphlet Series, no. 9.

Helmers, F. Leslie C. H. (1988), National Account Identities, in Rudiger Dornbusch and Leslie Helmers (Eds.), *The Open Economy: Tools for Policymakers in Developing Countries*, Oxford: EDI series in Economic Development, Appendix B, pp. 375-391.

2. The Exchange Rate Market:

Melvin, Ch. 1

Krugman and Obstfeld, Ch. 13

[BIS \(2005\), Triennial Central Bank Survey: Foreign exchange and derivatives market activity in 2004.](#)

Chinn, Menzie D. (2006) A Primer on Real Effective Exchange Rates: Determinants, Overvaluation, Trade Flows and Competitive Devaluation, *Open Economies Review* 17: 115–143.

Helmers, F. Leslie C. H. (1988), Real Exchange Rate Indexes, in Rudiger Dornbusch and Leslie Helmers (Eds.), *The Open Economy: Tools for Policymakers in Developing Countries*, Oxford: EDI series in Economic Development, Appendix B, pp. 392-397.

<http://www.imf.org/external/data.htm#data>

Assignment 1

B. Open Economy Macroeconomics

3. a. Introduction and Overview

Krugman, P. (1995), What do we need to know about the international monetary system? In P. Kenen (ed), *Understanding Interdependence: The Macroeconomics of the Open Economy*.

Dornbusch (1980), Chs. 1-2

Obstfeld and Rogoff, Preface and Introduction.

Williamson, Ch. 7

b. Balance of Payments Adjustment

Dornbusch (1980), Ch. 7 (sections 2-3)

*Williamson, Ch. 8

4. Devaluation, the elasticities, and absorption approach, and contractionary effects

Dornbusch (1980), Ch. 4 (sections 1-2)

Agenor and Montiel, Ch. 8, section 1.

*Krugman, P. and Taylor, L. (1978), Contractionary Effects of Devaluation, *Journal of International Economics*, 8: 445-456

*Edwards, S. (1986), Are Devaluations Contractionary? *Review of Economics and Statistics*, 68 (3): 501-508.

*Diaz Alejandro, C. (1964), *Exchange Rate Devaluation in a Semi-industrialized Country*, Ch. 2

*Williamson, Ch. 8

*Goldstein, M. and Khan, M. (1985), Income and price effects in foreign trade, in R.W. Jones and P.B. Kenen (eds), *Handbook of International Economics*.

*Laursen, S. and Metzler, L. (1950), Flexible exchange rates and the theory of employment. *Review of Economics and Statistics*, 32(4): 281-299.

Assignment 2

5. Internal and external balance

- Two-three gap models

Salter, W. (1959), Internal and external balance: the role of price and expenditure effects, *Economic Record*, 35: 226-38.

Bacha, E.L. (1990), A Three-Gap Model of Foreign Transfers and The GDP Growth Rate in Developing Countries, *Journal of Development Economics*, 32:279-296.

*Easterly, W. (1999), The Ghost of Financing Gap", *Journal of Development Economics* 60(2): 423-438.

*Williamson, Ch. 12

*Chenery, H. and Bruno M. (1962), Development Alternatives in an Open Economy: The Case of Israel, *Economic Journal*, 57: 79-103.

*Chenery, H. and Strout, A. (1966), Foreign Assistance and Economic Development, *American Economic Review*, 56: 679-733.

*McKinnon, R. (1964), Foreign Exchange Constraints in Economic Development and Efficient Aid Allocation", *Economic Journal*, 74: 388-409

*Swan, T. (1960), Economic control in a dependent economy, *Economic Record*, 36: 51-66.

6. Capital mobility and stabilization policy under fixed exchange rates

Dornbusch, Ch. 10

*Williamson, Chs.8, 9.

Obstfeld, M. (2001), International Macroeconomics: Beyond the Mundell-Fleming Model, p 1-14.

- The International Monetary System, 1870-1973

[McKinnon, R. \(1993\). "The Rules of the Game: International Money in Historical Perspective," *Journal of Economic Literature* 31\(1\): 1-44.](#)

[Obstfeld, M. and Rogoff, K. \(1995\). "The Mirage of Fixed Exchange Rates," *Journal of Economic Perspectives* 9\(4\): 73-96.](#)

*Williamson, Ch.15

Midterm Exam

7. Flexible exchange rates, stabilization policy and purchasing power parity

Dornbusch, Ch. 11, section 1

[Taylor, M. \(1995\), The Economics of Exchange Rates, *Journal of Economic Literature* 33\(1\): 13-47.](#)

*Williamson, Ch10

[Rogoff, K. \(1996\), The Purchasing Power Parity Puzzle, *Journal of Economic Literature* 34 \(2\): 647-668.](#)

8. Interest rate parity, expectations and exchange rate dynamics

Dornbusch, Ch. 11, section 2 (or, [Dornbusch, R. \(1976\), Expectations and Exchange Rate Dynamics, *Journal of Political Economy* 84: 1161-76.](#))

*Williamson, Ch10

9. Analytical Issues in Stabilization and Structural Adjustment Programs

- Inflation Stabilization and Credibility Issues
- On public sector balances
- Political economy of Macro Cycles and Policy Reform

Alesina A. and Drazen A. (1991), Why are Stabilizations Delayed, NBER Paper no: 3053.

Montiel, Ch.13

Navia, P. and Velasco, A. (2003), The Politics of Second-Generation Reforms. In P. P. Kuczynski, and J. Williamson (Eds.), *After the Washington Consensus: Restarting Growth and Reform in Latin America* (pp.265-303), Washington, D.C.: Institute for International Economics.

*Tabellini, A. and Alesina, A. (1990), Voting on the Budget Deficit, *American Economic Review*, 80(1): 37-49.

- Shock Therapy vs. Sequencing Debate: Washington Consensus Revisited

Montiel, Ch.14

Williamson, J. (2003), An Agenda for Restarting Growth and Reform. In P. P. Kucsyński, and J. Williamson (Eds.), *After the Washington Consensus: Restarting Growth and Reform in Latin America* (pp.1-19), Washington, DC.: Institute for International Economics.

Williamson, J. (2003), Summing Up & Our Agenda and the Washington Consensus. In P. P. Kucsyński, and J. Williamson (Eds.), *After the Washington Consensus: Restarting Growth and Reform in Latin America* (pp.305-322&323-331), Washington, DC.: Institute for International Economics.

*Edwards, S. (1984), [The Order of Liberalization of the Current and Capital Accounts of the Balance of Payments](#). NBER Working Paper no: 1507, Cambridge, MA: National Bureau of Economic Research.

- Effects of Financial Liberalization on Financial Structure and the Financial Markets

Montiel, Ch.12

II. The Global Capital Market: Performance and Policy Problems

10. Determinants of International Capital Flows (ST<): Pull vs. Push & Determinants of Country Risk

Agenor and Montiel Ch. 15

Montiel, P. and Reinhart, C.M. (2001), The Dynamics of Capital Movements to Emerging Economies During the 1990s. In S. Griffith-Jones, M.F. Montes and A. Nasution (Eds) *Short-Term Capital Flows and Economic Crises* p.3-29, Oxford University Press.

*[Calvo, G., Leiderman, L. and Reinhart, C. \(1996\), Inflows of Capital to Developing Countries in the 1990s, *Journal of Economic Perspectives* 10\(2\): 123-39.](#)

*Calvo, G. A., Leiderman, L. and Reinhart, C.M. (1992), Capital Inflows and Real Exchange Rate Appreciation in Latin America: The Role of External Factors, IMF Working Paper 92(62).

Fernandez-Arias, Eduardo (1996) The New Wave of Private Capital Inflows: Push or Pull? *Journal of Development Economics*, 48: 389-418.

Assignment 3

11. Capital Market Integration and Financial Crisis:

- a. Theory (1st, 2nd and 3rd Generation)

Agenor and Montiel Ch. 16

*[Krugman, P. Currency Crises.](#)

Krugman, P (1999), Balance Sheets, the Transfer Problem, and Financial Crises, *International Tax and Public Finance*, 6, 459-472.

Stiglitz, J. E. (2000), Capital Market Liberalization, Economic Growth, and Instability, *World Development* 28(6): 1075-1086.

Diaz-Alejandro, Carlos F. (1985), Good-Bye Financial Repression, Hello Financial Crash, *Journal of Development Economics*, 19(1-2): 1-24.

Bhagwati, Jagdish N. (1998), The Capital Myth: The Difference Between Trade in Widgets and Dollars, *Foreign Affairs*, May/June, pp.7-12

b. Empirical Evidence

Agenor and Montiel Ch. 16.4

Jayarusiya, K. and Rosser, A. (2001), Economic Orthodoxy and the East Asian Crisis. *Third World Quarterly* 22(3): 381-396.

Boratav, K. and Akyuz, Y. (2003), The Making of the Turkish Financial Crisis, *World Development* 31(9): 1549-1566.

Frenkel, R. (2003), Globalization and Financial Crisis in Latin America. Paper Presented at Working Group 2, Second Plenary Meeting, Inter-Parliamentary Forum of Americas: Panama 20-21 February.

Griffith-Jones, S., Montes, M.H. and Nasution, A. (2001), Managing Capital Surges in Emerging Economies. In S. Griffith-Jones, M.F. Montes and A. Nasution (Eds) *Short-Term Capital Flows and Economic Crises* p.263-290, Oxford University Press.

12. Volatility of Capital Flows and Effects on the real economy and income distribution in developing countries

FitzGerald, E.V.K. (2001), Short-term Capital Flows, the Real Economy, and the Income Distribution in Developing Countries. In S. Griffith-Jones, M.F. Montes and A. Nasution (Eds) *Short-Term Capital Flows and Economic Crises* p.29-51, Oxford University Press.

Unctad (2003), Trade and Development Report.

Assignment 4