

Economics 5633.001
International Finance
MW 1:30-2:45 Physical Sciences Center Rm. 0363
Office Hours: TH 10:00-12:00 and by appointment

Firat Demir
Office: Hester Hall 324A
Tel. 325-5844
E-mail: fdemir@ou.edu

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. 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, 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 11**) (25%), and a comprehensive final exam (35%); b) a research paper (30%); c) homework assignments and class participation (10%). As a part of class participation, each student is required to present a review of at least one of the articles in the reading list in one of the assigned sessions, and serve as a discussant on another student's research paper.

3. 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 17, 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 two 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 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 16**), and the final paper (due **April 17**), and:

- Research presentation. Present your research paper's argument, evidence, and implications in a **20-minute** "conference-style" talk. Respond to questions.
- Serve as discussant/commentator on another student's research paper and presentation and write 2-3 pages of critical 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).

4. 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 Markets*, Cambridge University Press.

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

Gärtner, Manfred, *Macroeconomics under Flexible Exchange Rates* (1993).

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

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

Williamson, J. (1983), *The Open Economy and the World Economy*, Basic Books Inc.

Dornbusch, Rudiger (1988) *Exchange Rates and Inflation*, MIT Press. (E-book available).

Calvo, Guillermo (1996) *Money Exchange Rates and Output*, MIT Press. (E-book available).

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

Krugman, P. and Obstfeld, M., *International Economics: Theory and Policy*, 6-8th Ed., Addison-Wesley. (5 reserve copies available at Bizzell Library)

Melvin, M., *International Money and Finance*, 6-7th Ed. Pearson Addison-Wesley.

5. 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. For further information, refer to <http://www.ou.edu/honorcouncil/index.html>

6. Grading Scale

90-100	A	60-69:	D
80-89	B	< 60	F
70-79	C		

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

7. 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.

*IFS Introduction (reference for later use)

2. The Exchange Rate Market:

Melvin, Ch. 1; Krugman and Obstfeld, Ch. 13

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.

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

*IMF Balance of Payments Manual (5th and 6th Eds.); *IMF BOP Textbook; *IFS Country Notes 2006 (reference for later use).

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.

*Obstfeld, M. and Rogoff, K. (2000) "The Six Puzzles in International Macroeconomics: Is There a Common cause?" *NBER Working Paper 7777*.

b. Balance of Payments Adjustment

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

c. Non Traded Goods

Dornbusch (1980), Ch. 6

4. Devaluation, Elasticity and Absorption Approach, and Contractionary effects

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

Agenor and Montiel, Ch. 8, section 1 (based on Lizondo and Montiel, 1989).

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

*Bahmani-Oskooee, M. and Miteza1, I. (2003) Are Devaluations Expansionary or Contractionary? A survey article, *Economic Issues*, 8(2): 1-28.

*Lizondo, S. and Montiel, P. (1989) Contractionary Devaluation in Developing Countries: An Analytical Survey, *IMF Staff Papers*, March.

*Frankel, J.A., (2004), Contractionary Currency Crashes in Developing Countries, The 5th Mundell-Fleming Lecture, IMF Annual Research Conference.

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

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

*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

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.

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

Taylor, L. (1994), Gap Models, *Journal of Development Economics* 45: 17-34.

*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

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

Obstfeld, M., Shambaugh, J.C. and Taylor, A.M. (2005) The Trilemma in History: Tradeoffs among Exchange Rates, Monetary Policies and Capital Mobility *The Review of Economics and Statistics*, 87(3): 423-438

Gartner, *Macroeconomics under Flexible Exchange Rates*, Ch.1

- 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.](#)

Midterm Exam March 11

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.](#)

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

*Frenkel, J. and Mussa, M. (1988), Asset markets, Exchange rates and the Balance of Payments, in R.W. Jones and P.B. Kenen (eds), *Handbook of International Economics*

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.](#))

9. Analytical Issues in Stabilization and Structural Adjustment Programs (Round-table discussion)

- Shock Therapy vs. Sequencing Debate: Washington Consensus Revisited

Montiel, Ch.13-14

Williamson, J. (2003), An Agenda for Restarting Growth and Reform. In P. P. Kuczynski, 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. Kuczynski, and J. Williamson (Eds.), (pp..305-322 & 323-331).

Rodrik, D. (2006), Goodbye Financial Consensus, Hello Washington Confusion? A Review of the World Bank's Economic Growth in the 1990s: *Learning from a Decade of Reform*, *Journal of Economic Literature* 44: 973-987.

Easterly, W. (2005) What did Structural Adjustment Adjust? The association of policies and Growth with Repeated IMF and World Bank Adjustment Loans, *Journal of Development Economics* 76: 1- 22.

*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: NBER.

- Effects of Financial Liberalization (Round-table discussion)

Montiel, Ch.12

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

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

Tobin, J. (2000) Financial Globalization, *World Development* 28(6): 1101-1104.

Easterly, W. (2001) The Lost Decades: Developing Countries' Stagnation in Spite of Policy Reform 1980–1998, *Journal of Economic Growth*, 6: 135–157.

Fernandez-Arias, E. and Montiel, P. (2001) Reform and Growth in Latin America: All Pain, No Gain? IMF Staff Papers 48 (3).

* Levchenko, A.A., Rancièrè, R. and Thoenig, M. (2008) Growth and risk at the industry level: The real effects of financial liberalization. *Journal of Development Economics*, Forthcoming.

*Gourinchas, P., Jeanne, O. (2006) The Elusive Gains from International Financial Integration, *Review of Economic Studies* 73: 715–741.

II. The Global Capital Market: Performance and Policy Problems

10. Determinants of International Capital Flows (*Student Presentations*)

Agenor and Montiel Ch. 15

[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.](#)

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

Alfaro, L.; Kalemli-Ozcan, S. and Volosovych, V. (2008) Why Doesn't Capital Flow from Rich to Poor Countries? An Empirical Investigation *The Review of Economics and Statistics*, 90(2): 347–368.

* Papaioannou, E. (2009), What Drives international financial flows? Politics, Institutions and other Determinants *Journal of Development Economics* 88, 269–281.

Assignment 3

11. Capital Market Integration and Financial Crisis (Round-table discussion)

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

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

Agenor and Montiel Ch. 16

Krugman, P. (1996) “Are Currency Crises Self-Fulfilling?” in Ben Bernanke and J. Rotemberg (eds) *NBER Annual 1996*, Cambridge, MA, MIT Press, pp. 345-407.

Obstfeld, M. (1996), “Models of Currency Crises with Self-Fulfilling Features”, *European Economic Review* 40: 1037-47.

Calvo, G., (1995) Varieties of Capital-Market Crises, University of Maryland Center for International Studies Working Paper.

Calvo, G. (2005) Crises in Emerging Market Economies, A Global Perspective.

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

*Obstfeld, Maurice, (1986), Rational and Self-Fulfilling Balance of Payments Crises, *American Economic Review* 76: 72-81

b. Empirical Evidence

Agenor and Montiel Ch. 16.4

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

Kaminsky, G.L. and Reinhart, C. M. (1999) The Twin Crises: The causes of Banking and balance-of-payments problems, *American Economic Review* 89(3): 473-500.

Kaminsky, G.L. (2006) Currency crises: Are they all the same? *Journal of International Money and Finance* 25: 503-527.

Glick, R., Geo, X., and Hutchison, M. (2006), Currency Crises, Capital Account Liberalization and Selection Bias, *Review of Economics and Statistics* 88(4): 698-714.

*Eichengreen, B., Portes, R. (1987) The Anatomy of Financial Crises, NBER Working Paper No.2126

Assignment 4

c. Contagion

Kaminsky, G.L., Reinhart, C.M. and Vegh, C.A. (2003), The Unholy Trinity of Financial Contagion, *Journal of Economic Perspectives*, 17(4): 51-74.

Kaminsky, G.L. and Reinhart, C.M. (2000), On Crises, Contagion, and Confusion”, *Journal of International Economics*, June 2000; 51(1): 145-68.

Eichengreen, Barry, Rose, Andrew and Wyplosz, Charles (1996), Contagious Currency Crises: First Tests”, *Scandinavian Journal of Economics* 98(4): 463-84.

Gerlach, S. and Smets, F. (1995), "Contagious Speculative Attacks", *European Journal of Political Economy* 11: 5-63.

Glick, R. and Rose, A.K.. (1998), Contagion and Trade: Why Are Currency Crises Regional, NBER WP6806.

Calvo, G., and Mendoza, E. (2000), Rational Contagion and the Globalization of Securities Markets, *Journal of International Economics* 51(1): 79-113.

*Calvo, Guillermo (1999), “Contagion in Emerging Markets: When *Wall Street* is a Carrier”, unpublished, May. <http://www.bsos.umd.edu/econ/ciecrp8.pdf>

12. The Inter-Temporal Approach to Current Account

Obstfeld and Rogoff, Chapter 1-2.

Final Exam Tuesday, May 12 8:00 AM - 10:00 AM