

Economics 3633
International Finance, Theory and Problems
TTH 10:30-11:45

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

1. Course Objective:

This course is an introduction to international finance and is designed to introduce students to both theoretical and empirical analysis of global financial markets. In this era of globalization no student of economics, finance or any other field can fully understand current economic and political developments without a strong background in international finance.

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. It should also be pointed out that while international trade analysis primarily uses microeconomic theory, international finance uses macroeconomic theory.

We will start by studying the macroeconomic accounting system in an open economy framework, by understanding the balance-of-payments accounts. Next we will cover the foreign exchange market. Once these corner stones are in place we will study the past and present international monetary arrangements, and we will apply no arbitrage ideas to derive parity conditions for exchange rates. We will also explore the determinants of international investment and capital flows, foreign exchange risk and the financial derivatives as well as different theories of exchange rate determination. We will conclude by visiting the current challenges and dilemmas faced by the existing international financial order. All of the materials may be broken down into two parts: open economy macroeconomics (Chapters 12 through 17) and the applications of the theory to international monetary policy (Chapters 18 through 22).

Briefly, the main objectives of the course are:

- To provide students with the theoretical knowledge behind the functioning of international finance including a variety of methods and models used for this purpose.
- To introduce existing debates and controversies in international finance to the students by examining different theoretical approaches.
- To enable students to develop necessary skills to apply the methods and models to policy making as well as to current economic debates.
- To locate, organize, and analyze international finance data to get insightful conclusions.

2. Course Structure:

The course is designed around lectures, assigned readings from the textbook(s) and 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 topics covered in the lectures will overlap the materials found in the textbook. However, the lectures and discussions will, on occasion, cover some materials that are not found in the textbook or in the assigned readings. Students will be responsible on examinations for ALL ASSIGNED MATERIALS. Note, since each examination will include some material that is not in your textbook, it is strongly recommended that you attend the formal lectures.

3. Course Requirements:

The final grade will be based on your performance from: a) two midterm exams (20% each) and a comprehensive final exam (30%); b) a research paper (15%); c) homework assignments and quizzes (10%); d) class participation (5%).

4. Exam Structure:

Unlike the final exam the two midterm exams are non-comprehensive, covering the materials done before the date of each exam. However, all three parts of the course are closely related and therefore you need to have a good understanding of the previous material in order to understand the later parts. The questions are closely related to the lectures, the assignments, and the textbook. The purpose of exams is twofold: to enhance your understanding of fundamental theories and concepts, and to encourage you to apply the theories to the real world. Therefore you may expect application questions as well as theory or technical questions in exams.

5. Policy on Make-up Exam

There are no make-up midterms and your midterm grades will be calculated on the basis of the midterms you are present. If you miss a midterm because of a valid reason the weight of your final will be increased by 15 points. If you do not take a midterm without providing a valid justification you will obtain a score equal to zero.

6. Homework Assignments

The class will be divided into groups of two people for homework assignments and for the term paper. There will be 6 to 9 homework assignments. Late submissions will not be accepted.

7. Textbook and Additional Readings

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

Eatwell, J. and Taylor, L (2000/or 2001), Global Finance at Risk: the Case for International Regulation, The New Press: New York.

Additional required readings are available through course website.

Major References:

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

Melvin, M. (2004) *International Money and Finance*, 7th edition, Pearson Addison-Wesley.

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

Salvatore, D. (2004) *International Economics*, 8th edition, Prentice Hall.

8. Term Paper

On a topic related to the course and using the concepts of the course, you will write a 6000-8000 word research paper that is due in class on November 30, 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 evidence. The topic for the paper must be approved in advance. The research paper is divided into several stages, including a one-page proposal (due **September 21**), 2-4 page annotated description of the paper outline and sources (due **October 26**), and the final paper (due **November 30**) (all counts towards your final grade).

You may find following journals useful in preparing your papers or in choosing the topic: *The World Economy*, *Journal of International Economics*, *Review of International Economics*, *Economic Development and Cultural Change*, *Journal of Money, Credit and Banking*, *Journal of Development Economics*, *World Development*, *Journal of Development Studies*, *Review of Radical Political Economy*, *Third World Quarterly*, *Challenge*. The major data may be found from: *International Financial Statistics Yearbook* (various years), *Global Financial Development*, *World Economic Outlook*, or *Balance of Payments Statistics* by International Monetary Fund (IMF); *World Development Report* or *Global Development Finance* (various years) by World Bank; *World Investment Report* by UNCTAD; *World Economic and Social Survey* by UN; or BIS. A more detailed list of data sources and related web links together with more detailed information on the structure of the paper will be available from course web page.

9. 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/integrity.htm>

10. 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. The University of Oklahoma will reasonably accommodate otherwise qualified individuals with a disability unless such accommodation would pose an undue hardship, would result in a fundamental alteration in the nature of the service, program or activity or in undue financial or administrative burdens. For details refer to <http://www.dsa.ou.edu/ods/policies.htm>

12. Grading Scale

97.5-100:	A+	77.5-79.9:	C+
95-97.49:	A	72.5-77.49:	C
90-94.49:	A-	70-72.49:	C-
87.5-89.9:	B+	67.5-69.9:	D+
82.5-87.49:	B	62.5-67.49:	D
80-82.49:	B-	60-62.49:	D-
		less than 60	F

Yet, your final grade will follow the University of Oklahoma's grading scale, that is A, B, C, D, and F without the intermediate grades above.

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

13. COURSE OUTLINE AND READING ASSIGNMENTS:

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

International Finance Course Outline

I. *Exchange Rates and Open-Economy Macroeconomics*

1. National Income Accounting and the Balance of Payments
 - Krugman and Obstfeld, Ch. 12
2. Exchange Rates and the Foreign Exchange Market
 - Krugman and Obstfeld, Ch. 13
 - [*Froot, K. and R. Thaler. 1990. "Anomalies: Foreign Exchange," *Journal of Economic Perspectives* 4\(3\): 179-92.](#)
 - [*Taylor, M. 1995. "The Economics of Exchange Rates," *Journal of Economic Literature* 33\(1\): 13-47.](#)
3. Money, Interest Rates, and Exchange Rates
 - Krugman and Obstfeld, Ch. 14
 - [*Frenkel, J. and M. Mussa. 1980. "The Efficiency of Foreign Exchange Markets and Measures of Turbulence," *American Economic Review* 70\(2\): 374-81.](#)
 - [*Dornbusch, R. 1976. "Expectations and Exchange Rate Dynamics," *Journal of Political Economy* 84: 1161-76.](#)

Exam 1 September 21 (Deadline for Paper Proposal)

4. Price Levels and the Exchange Rate in the Long Run
 - Krugman and Obstfeld, Ch. 15
 - [*Rogoff, K. 1996. "The Purchasing Power Parity Puzzle," *Journal of Economic Literature* 34 \(2\): 647-668.](#)
5. Output and the Exchange Rate in the Short Run
 - Krugman and Obstfeld, Ch. 16

- [*Goldberg, P. and M. Knetter. 1997. "Goods Prices and Exchange Rates: What Have We Learned?" *Journal of Economic Literature* 35\(3\): 1243-72.](#)
6. Fixed Exchange Rates and Foreign Exchange Intervention
- Krugman and Obstfeld, Ch. 17

Exam 2 October 26 (Deadline for Annotated Bibliography)

II. *International Macroeconomic Policy*

7. The International Monetary System, 1870-1973
- Krugman and Obstfeld, Ch. 18
 - Eatwell and Taylor, Ch.1 (pp.1-28); Ch.2 (pp.30-36)
 - [*McKinnon, R. 1993. "The Rules of the Game: International Money in Historical Perspective," *Journal of Economic Literature* 31\(1\): 1-44.](#)
8. Macroeconomic Policy and Coordination Under Floating Exchange Rates
- Krugman and Obstfeld, Ch. 19
 - [*Obstfeld, M. and K. Rogoff. 1995. "The Mirage of Fixed Exchange Rates," *Journal of Economic Perspectives* 9\(4\): 73-96.](#)
 - [*Francesco Caramazza and Jahangir Aziz. 1998. "Fixed or Flexible? Getting the Exchange Rate Right in the 1990s," *Economic Issues* No. 13.](#)

III. *The Global Capital Market: Performance and Policy Problems*

We will ask 3 questions: 1. Has capital account liberalization led to systemic failures? 2. Has it helped cause the decline in trend growth and investment rates in both developed and developing countries? 3. What framework of international institutions and regulations are needed to produce the most efficient outcomes in terms of growth, employment and living standards?

9. Expected Benefits from Liberalization of Financial Markets and Comparison of Economic Performance under Liberalized Financial Markets
- Eatwell and Taylor, Ch. 2 (pp.36-53)
 - Krugman and Obstfeld, Ch. 21 (pp. 582-584)
10. Developed Countries and the New Financial Order
- Eatwell and Taylor, Ch. 4 (pp.96-139)

- Setser, B. and Roubine, N. (2005), How Scary is the Deficit, *Foreign Affairs*, July/August.
- Weisbrot, M. , Rosnick, D. and Baker, D. Going Down With the Dollar: The Cost to Developing Countries of a Declining Dollar, CEPR Issue Brief.

11. Developing Countries and the New Financial Order

- Eatwell and Taylor, Ch. 5 (pp.140-179)
- Krugman and Obstfeld, Ch.22 (pp. 602-629)

1. Contagion

2. Financialization of the World Economy and Rise of Rentier Income

- *Crotty, J. (2005), The Neoliberal Paradox: The impact of destructive product market competition and ‘modern’ financial markets on nonfinancial corporation performance in the neoliberal era. In G. Epstein (ed) “Financialization and the World Economy”. Political Economy Research Institute, Edward Elgar.

3. Capital Market Integration and Financial Crisis:

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

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

b. Capital Market Integration and the Rise of Financial Crisis: Empirical Evidence

- Taylor, L. (2001), Argentina: A poster Child for the Failure of Liberalized Policies? *Challenge* (November-December).
- *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,.
- *Jayarusiya, K. and Rosser, A. (2001), Economic Orthodoxy and the East Asian Crisis. *Third World Quarterly* 22(3): 381-396.
- *[Krugman, P. "Currency Crises." available on Krugman's website.](#)

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

4. Determinants of International Capital Flows (ST<): Pull vs. Push

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

13. International Regulation and Financial Infrastructure: Proposals to Reform the International Monetary System, The Washington Consensus Revisited?

- Eatwell and Taylor, Ch. 3 (pp. 54-95); 6,7 (pp.180-239)
- Krugman and Obstfeld, Ch.21, Ch. 22 (pp.629-636)
- Tobin, J. (2000), Financial Globalization, *World Development*, 28(6): 1101-1114.

Term Paper November 30

Final Exam