

Econ 3633.001 International Finance, Theory and Problems

Instructor: Firat Demir

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Class time: TR 10:30 - 11:45 Physical Sciences Center Rm.0321

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 first study the macroeconomic accounting system in an open economy framework using 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 will apply no arbitrage ideas to derive parity conditions for exchange rates. We will also explore the determinants of international capital flows, foreign exchange risk and 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. Overall, the subjects can be broken down into two sections: 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 theoretical knowledge regarding the functioning of international finance including a variety of methods and models used for this purpose.
- To locate, organize, and analyze international finance data to get insightful conclusions.
- To enable students to develop necessary skills to apply the methods and models to policy making as well as to current economic debates.

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) three midterm exams (20% each) and a non-comprehensive final exam (25%); b) homework assignments and quizzes (10%); e) attendance and class participation (5%).

4. Exam Structure

The exams are non-comprehensive. 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 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 applied as well as theoretical questions.

5. Policy on Make-up Exam

There are no make-up midterms. If you miss an exam because of *a valid reason* the weight of all other exams will be increased by 20 points. Otherwise you will obtain a score equal to zero.

6. Homework Assignments, Quizzes and Attendance Policy

For the homework assignments, you *can* work with a partner and form a group of maximum 2 people. In that case submit only one assignment under both names. There will be a total of 6 to 9 homework assignments during the semester. Late submissions will *not* be accepted. Also, you will have 9 quizzes, the lowest three of which will be dropped. Although attendance is voluntary, it is strongly recommended. I will take attendance every class and your overall attendance and class participation will count towards 5% of your final grade (I will drop 3 days of missing attendance from final grade).

7. Textbook and Additional Readings

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

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

Additional readings are available from the course website at learn.ou.edu.

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.

8. Term Paper

Optionally, you can write a 4000-5000 word research paper on a topic related to the course and using the concepts you learned. The paper will count towards 15% of your final grade, which will then consist of 15% from midterms 1 and 2, 20% from midterm 3 and 20% from the final exam, 10% from homework assignments and quizzes, and 5% from class participation. Alternatively, you may choose to substitute the term paper for the lowest of your three exams but there is no guarantee that your term paper grade will be higher than the lowest of those three (you need to make your decision by **September 20**). 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 20**), 2-4 page annotated description of the paper outline and sources (due **October 18**), and the final paper (due **December 4**) (all stages counts towards your final grade).

A 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 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>

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. For details refer to <http://drc.ou.edu/>

11. 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

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

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

12. 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. Chapter numbers refer to the Krugman and Obstfeld textbook.

Course Outline

I. Exchange Rates and Open-Economy Macroeconomics

1. National Income Accounting and the Balance of Payments, Ch. 12
2. Exchange Rates and the Foreign Exchange Market, Ch. 13
3. Money, Interest Rates, and Exchange Rates, Ch. 14

Exam 1: September 20

4. Price Levels and the Exchange Rate in the Long Run, 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, Ch. 16
 - [*Goldberg, P. and Knetter, M. \(1997\), Goods Prices and Exchange Rates: What Have We Learned? *Journal of Economic Literature* 35\(3\): 1243-72.](#)

Exam 2: October 18

II. International Macroeconomic Policy

6. Fixed Exchange Rates and Foreign Exchange Intervention, Ch. 17
7. The International Monetary System, 1870-1973, 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, Ch. 19
 - [*Obstfeld, M. and Rogoff, K. \(1995\), The Mirage of Fixed Exchange Rates, *Journal of Economic Perspectives* 9\(4\): 73-96.](#)

Exam 3: November 15

III. The Global Capital Market: Performance and Policy Problems

9. Costs and Benefits of Liberalization of Financial Markets, Ch. 21 (pp. 582-584)
 - Eatwell and Taylor, Ch. 2 (pp.36-53)

10. Developed Countries and the New Financial Order

- Eatwell and Taylor, Ch. 4 (pp.96-139)
- Setser, B. and Roubini, N. (2005), How Scary is the Deficit, *Foreign Affairs*, July/August.
- Obstfeld, M. (2005), America's Deficit, World's Problem, *Monetary and Economic Studies*, October: 25-35.
- 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, Ch.22 (pp. 602-629)

- Eatwell and Taylor, Ch. 5 (pp.140-179)
 1. Contagion
 2. Capital Market Integration and Financial Crisis:
 - a. Theory
- Stiglitz, J. E. (2000), Capital Market Liberalization, Economic Growth, and Instability, *World Development* 28(6): 1075-1086.
 - b. 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.
- *[Krugman, P. "Currency Crises." available on Krugman's website.](#)
- 3. Determinants of International Capital Flows: Pull vs. Push

12. International Regulation and Financial Infrastructure: Proposals to Reform the International Monetary System, Ch.21, Ch. 22 (pp.629-636).

- Eatwell and Taylor, Ch. 3 (pp. 54-95); 6,7 (pp.180-239)
- Tobin, J. (2000), Financial Globalization, *World Development*, 28(6): 1101-1104.

Final Exam: Wednesday, December 12 - 8:00 - 10:00 am

13. Tentative Schedule

Week	Date	Chapter/Section					
1	21-Aug	12					
	23-Aug	12					
2	28-Aug	12					
	30-Aug	13					
3	4-Sep	13					
	6-Sep	13					
4	11-Sep	14					
	13-Sep	14					
5	18-Sep	14					
	20-Sep	Exam 1					
6	25-Sep	15					
	27-Sep	15					
7	2-Oct	15					
	4-Oct	16					
8	9-Oct	16					
	11-Oct	16					
9	16-Oct	16&17					
	18-Oct	Exam 2					
10	23-Oct	17					
	25-Oct	17					
11	30-Oct	17					
	1-Nov	18					
12	6-Nov	18					
	8-Nov	19					
13	13-Nov	19					
	15-Nov	Exam 3					
14	20-Nov	9. Costs and Benefits of Liberalization of Financial Markets					
	22-Nov	Thanksgiving Holiday					
15	27-Nov	10. Developed Countries and the New Financial Order					
	29-Nov	10. Developed Countries and the New Financial Order					
16	4-Dec	11. Developing Countries and the New Financial Order					
	6-Dec	12. International Regulation and Financial Infrastructure					
17	12-Dec	Final Exam					