

Economics 3633  
International Finance, Theory and Problems  
MWF 12:30-1:20 Dale Hall Classroom Bldg Rm.0112

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Office Hours: TTH 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 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 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. 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 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.

## 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 (25% each) and a final exam (30%); b) homework assignments (10%); d) class participation and quizzes (10%).

### **4. Exam Structure:**

The 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 and knowledge 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 applied as well as theoretical questions.

### **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 25 points. Otherwise you will obtain a score equal to zero.

### **6. Homework Assignments**

The class will be divided into groups of two people for homework assignments. There will be 6 to 9 homework assignments (10% of final grade). Late submissions will not be accepted. Also, you will have 13 quizzes and attendance-checks, the lowest three of which will be dropped (that is, you may miss maximum 3 classes) (10% of final grade).

### **7. Textbook and Additional Readings**

Required: - Krugman, P. and Obstfeld, M. (2006) International Economics: Theory and Policy, 7<sup>th</sup> 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 from the course website at [learn.ou.edu](http://learn.ou.edu).

Major References:

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

Melvin, M. (2004) International Money and Finance, 7<sup>th</sup> edition, Pearson Addison-Wesley.

## 8. Term Paper

*Optionally*, you can write a 5000-7000 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 20% from two midterms each, 25% from final, 10% from homework assignments, and 10% from class participation and quizzes. 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 **February 12**), 2-4 page annotated description of the paper outline and sources (due **March 14**), and the final paper (due **April 23**) (all counts towards your final grade).

You may find following journals useful in preparing your papers or in choosing the topic: 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, 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/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/>

## 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 on the left.

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 (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 Thaler, R.. \(1990\), Anomalies: Foreign Exchange, \*Journal of Economic Perspectives\* 4\(3\): 179-92.](#)
3. Money, Interest Rates, and Exchange Rates
  - Krugman and Obstfeld, Ch. 14

##### **Exam 1 February 14**

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 Knetter, M. \(1997\), 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 March 16**

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

### 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.
- 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

- 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

3. Capital Market Integration and Financial Crisis:

a. Theory (1<sup>st</sup>, 2<sup>nd</sup> and 3<sup>rd</sup> Generation)

- 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.
- \*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.](#)

4. Determinants of International Capital Flows (ST&LT): 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.](#)

12. 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): 1101-11-4.

**Final Exam**