

Econ 5633.001 International Finance

Instructor: Firat Demir

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Class time: TR 12:00-01:15 am. Cate Center 0145

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 (**October 11**) (25%) and a comprehensive final exam (30%); b) a research paper (30%); c) homework assignments and class participation (15%). 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 *November 29*, 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/open economy macro), 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 **September 8**), and the final paper (due **November 29**), 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. 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://integrity.ou.edu/>

5. Major References

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

Agénor, Pierre and Montiel, Peter (1996/2010) *Development Macroeconomics*, Princeton University Press (2nd / 3rd Ed.).

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

Montiel, Peter (2003/2009) *Macroeconomics in Emerging Markets*, Cambridge University Press.

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

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.

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, Paul and Obstfeld, Maurice *International Economics: Theory and Policy*, any edition after 7th, Addison-Wesley (reserve copies available at Bizzell Library)/ or Krugman, P., Obstfeld, M., and Melitz, M. J. 2014. *International Finance: Theory and Policy*. 10th edition, Addison-Wesley.

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

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

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 (and optional *) readings. Additional readings may be assigned from time to time. (Krugman and Obstfeld refers to the 8th ed. For 9th move chapter numbers by 1, and for the 10th ed. subtract chapter numbers by 10).

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

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.

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

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).

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

Schröder, M. (2013). Should developing countries undervalue their currencies? *Journal of Development Economics* 105, 140–151*
 Krugman, P. and Taylor, L. (1978), Contractionary Effects of Devaluation, *Journal of International Economics* 8: 445-456.

Levy-Yeyati, E., Sturzenegger, F., and Gluzmann, P.A. (2013). Fear of appreciation. *Journal of Development Economics* 101, 233–247.

*Tille, C. (2008), Financial integration and the Wealth Effect of Exchange Rate Fluctuations. *Journal of International Economics* 75: 283–294.

*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.

5. Internal and External Balance

a. 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.

Rodrik, D. and Subramanian, A. (2009), Why Did Financial Globalization Disappoint? *IMF Staff Papers*, 56, 112–138.

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

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

*Swan, T. (1960), Economic Control in a Dependent Economy, *Economic Record* 36: 51-66.

6. a. 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

b. 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.](#) Read pp.1-26.

[Obstfeld, M. and Rogoff, K. \(1995\), The Mirage of Fixed Exchange Rates, *Journal of Economic Perspectives* 9\(4\): 73-96.](#) Read pp.73-81.

Midterm Exam: October 11

7. Flexible Exchange Rates, Stabilization Policy and Purchasing Power Parity

Dornbusch, Ch. 11, section 1

[McKinnon, R. \(1993\). The Rules of the Game: International Money in Historical Perspective, *Journal of Economic Literature* 31\(1\): 1-44.](#) Read pp.26-40.

[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.](#)

Chatterjee, A., Dix-Carneiro, R., Vichyanond, J. (2013). Multi-product firms and exchange rate fluctuations. *American Economic Journal of Economic Policy* 5(2), 77–110.

Ekholm, K., Moxnes, A., Ulltveit-Moe, K. (2012). Manufacturing Restructuring and the Role of Real Exchange Rate Shocks. *Journal of International Economics* 86, 101–117

*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.](#))

Meese, R.A., and Rogoff, K. (1983), Empirical Exchange Rate Models of the Seventies: Do they fit the sample? *Journal of International Economics* 14: 3-24.

Cheung, Y., Chinn, M. D., Pascual, A.G. (2005), Empirical Exchange Rate Models of the Nineties: Are any fit to survive? *Journal of International Money and Finance* 24: 1150-1175.

II. The Global Capital Market: Performance and Policy Problems

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

a. 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, D.C.: 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.

*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.

b. Effects of Financial Liberalization (*Round-table discussion & Student Presentations*)

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.

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

Levchenko, A.A. and Rancière, R. and Thoenig, M. (2008), Growth and risk at the industry level: The real effects of financial liberalization. *Journal of Development Economics* 89(2): 210-222.

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

Estevadeordal, A., and Taylor, A.M. (2013), Is the Washington Consensus Dead? Growth, Openness, and the Great Liberalization, 1970s–2000s, *Review of Economics and Statistics* 95(5): 1669-1690.

McMillan, M. and D. Rodrik (2011). Globalization, Structural Change, and Productivity Growth. NBER Working Paper 17143. NBER, Cambridge-MA.

10. Determinants of International Capital Flows (*Round-table discussion & 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.](#)

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

Aleksynska, M. and Havrylchuk, O. (2013), FDI from the South: The Role of Institutional Distance and Natural Resources, *European Journal of Political Economy* 29: 38–53.

11. Capital Market Integration and Financial Crisis

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

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

Agenor and Montiel Ch. 16.

Claessens, S. and Kose, M.A. (2013), Financial Crises: Explanations, Types, and Implications IMF Working Paper WP/13/28

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. and Rogoff, K. \(1995\). "The Mirage of Fixed Exchange Rates," *Journal of Economic Perspectives* 9\(4\): 73-96.](#) Read pp.81-96.

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

b. Empirical Evidence (*Round-table discussion & Student Presentation*)

Agenor and Montiel Ch. 16.4

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.

*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.

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

12. Issues on South – South Economic Integration

Dutt, A.K. (2012), South-South Issues from a North-South Perspective. Background paper #2 for “The Rise of the South and New Paths of Development in the 21st Century”. UNCTAD.

World Bank (2011), Multipolarity: The New Global Economy. Global Development Horizons 2011.

Jenkins, R., Peters, E. D., Moreira, M.M. (2008), The Impact of China on Latin America and the Caribbean, *World Development* 36(2): 235–253.

Amighini, A. and Sanfilippo, M. (2014), Impact of South–South FDI and Trade on the Export Upgrading of African Economies, *World Development* 64: 1-17.

Demir & Dahi Chs.3-5.

Berger, D., Easterly, E. Nunn, N., and Satyanath, S. (2013). Commercial Imperialism? Political Influence and Trade during the Cold War. *American Economic Review*, 103(2), 863-96.

Final Exam: Friday, December 16 1:30 pm - 3:30 pm