Syllabus for Econ 362 - International Finance

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We will meet twice a week: Mondays and Wednesdays, from 12.30-1.50pm in Tech LR4.

Office hours: Tuesdays 10.30am-12 noon in KGH 3493 (i.e. 'New Kellogg', 3rd floor). I'll have office hours for another class from 9-10.30am Tuesdays; you can turn up and take your chances then too. Otherwise get in touch.

The TA will announce his/her office hours separately. Discussion sections will be on Fridays at 12.30pm in Harris Tech LR4.

1 Evaluation

- Two assignments, due on Monday April 22nd and Wednesday May 22nd. (20% each)
- Midterm on Monday April 29th. (30%)
- Final exam at 12.30pm on Friday May 31st. (30%)

NOTE: the final is on the last day of class. Also, while the final will focus on the second half of the course, it may require students to draw on their knowledge of the earlier material.

2 Course Overview

This is essentially a course in open-economy macroeconomics, with a good helping of microeconomics thrown in. We will examine the nature and determinants of such things as international capital flows, exchange rates and currency crises. The aim will be to help students think clearly about these issues, using simple and widely applicable models. There will necessarily be a significant theoretical component to the course, but the aim will be to link the theory to real-world events whenever possible.

Prerequisites for the course are 201, 202, 281, 310-1, 311, Math 220, Stat 210. Near the start of the course we will be doing some micro-type exercises that involve maximising utility subject to a budget constraint. This will only require basic differential calculus, but if it sounds terrifying to you then perhaps you should wait before doing the course.

Should you desperately want a textbook, buy '*International Economics: Theory and Policy*' [7th edition] by Krugman and Obstfeld, hereafter **KO** (note that later editions, some with another co-author Marc Melitz, are fine, though the page numbers might differ a bit). Some of the reading may come from other sources such as articles. These, along with the slides from lectures, will be made available on Canvas where possible. The slides will in fact constitute the main resource for students, given that we will on occasion depart from the textbook analysis significantly. It is very possible to do the class without having the textbook. In fact I do not actively recommend that you buy it; the textbook readings are there for you solely as an optional resource. (My sense is that most people don't buy and don't regret this decision. I could be wrong.)

3 Lecture topics and references

The plan is to tackle the following subjects in order. If it looks like we're falling behind, certain sections will be abbreviated or even eliminated. I will keep students informed of potential adjustments to the syllabus as soon as they look likely. All readings are mandatory save those marked with an asterisk, which are optional (yes, I am aware that this currently describes all but one of the articles listed). Obviously you should only do the textbook readings if you have the textbook; the same material will be available on the class slides. There are 5 topics, and I expect to get through about 2.5 of them before the midterm.

3.1 Intertemporal trade and national income accounting

What do simple micro and macro tell us to expect of flows of goods and capital?

- 2-period intertemporal trade
- national income accounting and the balance of payments

Readings: **KO** Ch. 7 (pp.155-157 & 170-173) Ch. 12;
"U.S. Current Account Deficit: Causes and Consequences", Roger Ferguson
(http://www.federalreserve.gov/boarddocs/Speeches/2005/20050420/default.htm).

3.2 The foreign exchange and money markets

Interest rates and exchange rates.

- domestic money market equilibrium
- uncovered and covered interest parity
- exchange rate anomalies

Readings: **KO** Ch. 13 (inc. appendix), Ch. 14 (up to p.356);
* "Anomalies: Foreign Exchange", Ken Froot & Richard Thaler, Journal of Economic Perspectives, Summer 1990;
* "Perspectives on Exchange Rate Volatility", Kenneth Rogoff, in International Capital Flows, edited by Martin Feldstein (University of Chicago Press and the NBER), 1999, 441-53.

3.3 Exchange rate determination

Modelling exchange rates in the long run and the short run.

- purchasing power parity and the long run
- short-run rigidities and overshooting

Readings: **KO** Ch 15;
* "The Purchasing Power Parity Puzzle", Kenneth Rogoff, Journal of Economic Literature 34, June 1996, 647-68;
* "Dornbusch's Overshooting Model after 25 years", Kenneth Rogoff.

3.4 Exchange rate regimes

The fixed, the floating and the dirty.

- foreign exchange interventions
- currency crises

Readings: **KO** Ch. 17 (pp.447-454 & 460-463), Ch. 22 (pp. 619-627);
* "The Modern History of Exchange Rate Arrangements", Kenneth Rogoff & Carmen Reinhart, Quarterly Journal of Economics, May 2002;
* "Argentina and the Fund: From Triumph to Tragedy", Michael Mussa, Institute for International Economics, 2002;
*http://web.mit.edu/krugman/www/crises.html

3.5 Global 'imbalances' and capital flows

Is the international capital market working?

- risk sharing and diversification
- why doesn't capital flow to poor countries?
- US and China again

Readings: **KO** Ch. 21 (pp.576-580 & 591-598), Ch.22, Ch. 19 (box on pp.534-536);
* "Global Current Account Imbalances and Exchange Rate Adjustments", Maurice Obstfeld and Kenneth Rogoff, Brookings Institution, 2005;
* "Global Imbalances: A Saving and Investment Perspective", IMF World Economic Outlook, Chapter 2, September 2005;
* "The Global Saving Glut and the U.S. Current Account Deficit", Ben Bernanke, Sandridge Lecture, Virginia Association of Economics, March 2005. * "The Six Major Puzzles in International Macroeconomics: Is There a Common Cause?", Maurice Obstfeld and Kenneth Rogoff, NBER Working Paper #7777, 2000;
* "Why Doesn't Capital Flow from Rich Countries to Poor Countries?", Robert Lucas, American Economic Review 80, 1990, pp.92-96;

* “Why Doesn’t Capital Flow from Rich to Poor Countries? An Empirical Investigation”, Laura Alfaro et al., 2003;
* “Reversal of Fortune: Geography and Institutions in the Making of the Modern World Income Distribution”, Daron Acemoglu at al., Quarterly Journal of Economics, Nov. 2002, vol 117.

4 Comments, policies

- The midterm and final dates/times are not negotiable. There will be no early finals to accommodate family holidays, unfortunately-timed job interviews, internships, etc.
- Similarly for assignments. They must be handed in on time. Failure to do so, especially (but not only) with no prior warning, will result in points deducted.
- Should you miss an exam for *whatever* reason and I allow you to do a makeup exam (not guaranteed), then the score on the makeup exam will be capped at the score of the other exam. [For example, suppose your score for Exam A is 75%; if you do a makeup for Exam B and score 80%, then I will give you 75% for Exam B; if your makeup score for Exam B is 70%, then I will give you 70% for Exam B.]
- Students will often work together when solving the assignments. This is fine. However, you should write up the answers separately, as this is a good way to check you really understand the problem. Such understanding will be useful in the midterms and final. You certainly have to hand in separate answers. Any complaints along the lines of ‘I worked with Dave and he scored 3 points than me’ will be ignored.
- If you don’t understand something as we’re going through it, that’s fine. Just be sure to see me very quickly to sort things out. The nature of the course means that falling behind is a bad thing.
- There will be no explicit *ex post* reweighting of the relative contributions of assignments and exams to the final grade.
- Please ask questions in class if something is not clear.