

International Finance – Econ 3331
Dalhousie University, Fall 2011

Time: Monday, Wednesday, Friday 14:35–15:25
Place: Dunn 302
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Description

This course covers macroeconomic aspects of international finance, including theories of exchange rate determination; macroeconomic policies under alternative exchange rate regimes; the determination of the current account, the financial account, and foreign assets and liabilities; and surveys the history of global financial markets, foreign debt, and currency crises.

Accessibility

Students may request accommodation due to barriers related to disability, religious obligation, or any characteristic under the Nova Scotia Human Rights Act. Students who require academic accommodation for either classroom participation or the writing of exams should make their request to the Office of Student Accessibility and Accommodation prior to or at the beginning of each academic term. Please see www.studentaccessibility.dal.ca for more information and to obtain Form A - Request for Accommodation.

Academic Integrity

At Dalhousie University, we expect all members of the community to adhere to the values of academic integrity: honesty, trust, fairness, responsibility, and respect. As a student, you must read, understand and follow policies on academic integrity at Dalhousie (<http://academicintegrity.dal.ca/Policies/>) and at the Economics Department (<http://myweb.dal.ca/tiscan/courses/e3331/>).

Concerning the assignments in this course, while discussion with your fellow students is valuable, do **not** submit an assignment that is essentially identical to an assignment submitted by another individual.

Course Materials

There is no required textbook for this course. I will make my lecture notes available. There are several excellent textbooks, such as

Paul R. Krugman, Maurice Obstfeld. *International Economics: Theory & Policy*. Pearson.

Robert C. Feenstra, Alan M. Taylor. *International Macroeconomics*. Worth Publishers.

I would recommend using any of these textbooks to supplement the lecture notes. Required readings are listed in the course outline.

Resources

The lecture presentations and lecture notes will be posted on the course website. These are not substitutes for the lectures and required readings.

Ms. Joyline Makani is our resource person at the Killam Library. Electronic library resources for this course are available at <http://dal.ca.libguides.com/economics>.

Requirements

Pre-requisites and background. Intermediate Macroeconomics – Econ 2201 or equivalent with a grade of C– or better. Knowledge of basic algebra. The lecture content assumes that students have a good understanding

of the determination of income, the price level, the interest rate and the exchange rate at an intermediate level (e.g., Blanchard and Johnson, *Macroeconomics*). This includes the open economy version of the *IS-LM* (Mundell-Fleming) model.

Lectures and independent learning. Attendance to lectures is a requirement. Lectures will often include discussion, data, and material that are not necessarily included in your readings. At the same time, not all required readings will be covered in the lectures. Assignments involve research at the level appropriate for a third year course in economics, as outlined under “learning objectives and evaluation.”

Learning objectives and evaluation

You will be evaluated based on your knowledge, comprehension, application, and analysis of the material learned in this course. These include:

1. Problem-solving skills, model based reasoning, and application of macroeconomic knowledge to situations that are different from those presented in class.
2. Critical thinking: Appraising whether what appears to be evidence for a certain argument is really so; evaluating the validity of an argument; disentangling cause from effect.
3. Evidence based reasoning: Collecting, analyzing, and interpreting accurate and relevant data.
4. Effective written communication: Writing essays to analyze, evaluate and discuss issues.

Method of evaluation

| Evaluation | Weight | Date and Location |
|--------------------|--------|--|
| Assignments | 20% | 21 September, 28 September, 5 October, 19 October, 16 November |
| Exam 1 | 25% | 12 October (in class) |
| Exam 2 | 25% | 18 November (in class) |
| Final (cumulative) | 30% | TBA by the Registrar’s Office |

To pass the course, a D letter grade average on the exams is required.

The exams will cover all the material from the lectures, assignments, and required readings, including the exercise questions from the lecture notes (there will be no practice exams).

The correspondence between the total grade and letter grade is as follows.

| <u>Grade</u> | <u>Letter</u> | <u>Grade</u> | <u>Letter</u> | <u>Grade</u> | <u>Letter</u> | <u>Grade</u> | <u>Letter</u> |
|--------------|---------------|--------------|---------------|--------------|---------------|--------------|---------------|
| 90–100 | A+ | 75–79.9 | B+ | 62–64.9 | C+ | 50–54.9 | D+ |
| 85–89.9 | A | 70–74.9 | B | 58–61.9 | C | < 50 | F |
| 80–84.9 | A– | 65–69.9 | B– | 55–57.9 | C– | | |

Organization

Lectures are organized around the following topics:

1. Introduction
2. The short-run open economy IS–LM model
3. The medium run IS–LM model
4. The medium-run adjustment
5. Monetary and fiscal policies under fixed and floating exchange rates
6. Policy trilemma in open economies
7. International and supranational monetary systems
8. Intertemporal decision making under uncertainty and risk sharing in the international economy

Course Outline and Required Readings

Week 1. General introduction.

- 9 September 2011: Discussion of course requirements and learning objectives. Introduction to electronic databases at Dalhousie.
- Lecture notes, chapter 1.

The Open Economy IS–LM Model

Week 2. The short-run IS–LM model.

- Overview of the main themes and issues (1 lecture).
- Determination of output and the interest rate. (2 lectures)
- The effective exchange rate, the real exchange rate, and the effective real exchange rate.
- Lecture notes, chapter 2.

Week 3. The medium-run equilibrium.

- Determination of output, the interest rate and the exchange rate. (1 lecture)
- The monetary model of the exchange rate determination. (2 lectures)
- The purchasing power parity based exchange rate.
- Lecture notes, chapter 3 and section 5.1.

Week 4. The medium-run adjustment.

- Complete price adjustment. (1 lecture)
- Incomplete price adjustment and the Dornbusch overshooting model. (2 lectures)
- Empirical evidence on the uncovered interest parity condition.
- Lecture notes, chapter 4 and section 5.2.

Week 5. Empirical evidence. (2 lectures)

- Expectations. (1 lecture)
- Forward contracts, the forward rate, and the forward bias. (2 lectures)
- Exchange rate forecasting.
- Lecture notes, section 5.3.

Monetary and Fiscal Policy

Week 6. The balance of payments accounts.

- Exam 1: 12 October.
- The current account, the financial account, and the official settlements balance. (1 lecture)

Week 7. The fixed exchange rate regime.

- Sterilization. (1 lecture)
- Speculative attacks and currency crises. (2 lectures)

Lecture notes, chapter 6.

Matthew Higgins, and Thomas Klitgaard, 2004. Reserve accumulation: implications for global capital flows and financial markets. *Current Issues in Economics and Finance* 10 (September/October), number 10. http://www.newyorkfed.org/research/current_issues/2004.html.

World Bank, 1997. Capital flow sustainability and speculative currency attacks. *Finance and Development* (December), 8–11. Available at <http://www.imf.org/external/pubs/ft/fandd/1997/12/pdf/imfstaff.pdf>.

International Monetary Fund. *Global Financial Stability Report*. Washington, DC.
<http://www.imf.org/external/pubind.htm>.

Week 8. The floating exchange rate regime.

- Stabilization policy. (1 lecture)
- Shocks and propagation mechanisms. (2 lectures)

Lecture notes, chapter 7.

Soyoung Kim, and Nouriel Roubini, 2000. Exchange rate anomalies in the industrial countries: A solution with a structural VAR approach. *Journal of Monetary Economics* 45 (June), 561–586. doi:10.1016/S0304-3932(00)00010-6.

Week 9. Policy trilemma in open economies.

- Capital controls. (1 lecture)
- Optimal exchange rate regime. (2 lectures)
- History of exchange rate choices in small, open economies.

Lecture notes, chapter 8.

Week 10. International monetary system.

- 1870–1913: The gold-standard era. (1/2 lecture)

Barry Eichengreen, 2008. *Globalizing Capital: A History of the International Monetary System*. 2nd edition. Princeton University Press. A copy is available at the Killam Library Reserve (2 hour loan). Chapter 2.

- 1919–1939: Interwar chaos. (1/2 lecture)

Eichengreen, chapter 3.

- 1944–present: From Bretton Woods to the present. (1 lecture)

Eichengreen, chapters 4 and 5.

Week 11. Currency unions.

- Currency unions and optimum currency areas. (2 lectures)

Robert Mundell, 1961. A theory of optimum currency areas. *American Economic Review* 51, 657–665. <http://www.jstor.org/stable/1812792>.

- Exam 2: 18 March.

Risk Sharing in the International Economy

Week 12. Uncertainty and risk.

- Risk, return, asset pricing, and diversification. (3 lectures)

Lecture notes, sections 9.1–9.2.

Kenneth R. French, and James M. Poterba, 1991. Investor diversification and international equity markets. *American Economic Review Papers and Proceedings* 81 (2), 222–226. <http://www.jstor.org/stable/2006858>.

Stephanie E. Curcuru, Tomas Dvorak, and Francis E. Warnock, 2008. Cross-border return differentials. *Quarterly Journal of Economics* 123 (November), 1495–1530. <http://www.mitpressjournals.org/toc/qjec/123/4>.

Week 13. Intertemporal consumption smoothing.

- Intertemporal approach to national savings; saving-investment correlations. (2 lectures)
- International investment positions; net foreign assets. (1 lecture)

Lecture notes, section 9.3.

Martin Feldstein, and Charles Horioka, 1980. Domestic savings and international capital flows. *Economic Journal* 90 (June), 314–329. <http://www.jstor.org/stable/2231790>.

Philip Lane, and Gian-Maria Milesi-Ferretti, 2007. The external wealth of nations mark II: revised and extended estimates of foreign assets and liabilities, 1970-2004. *Journal of International Economics* 73 (November), 223–250. doi:10.1016/j.jinteco.2007.02.003.

Week 14. Recurrent uncertainty.

- Cross-country correlations and introduction to dynamic stochastic general equilibrium models. (2 lectures)

Lecture notes, section 9.4.