

Econ 309A: International Finance & Open Economy Macroeconomics

Prof. Mark Hopkins
Glatfelter 108A

mhopkins@gettysburg.edu
337-6677

Course meets: TR 10:00am – 11:15am in McCreary 115

Office hours: MW 1:00 – 2:00 & W 10:00 – 11:00 or by appointment (no Fridays!)

Course Description:

“Globalization” of economic transactions are occurring in three markets: the goods market (international trade), the capital market (international finance), and the labor market (international migration). This course is concerned principally the second – international capital (asset) flows – although as we will see, trade & finance are necessarily inter-related phenomena. We will explore reasons why capital moves across borders, the impact this movement has on national economies and economic policies, the challenges that arise from such capital movements, and the institutions (such as the IMF) that have arisen to deal with these challenges. And we will explore that most exciting question of all: how to make a billion dollars in 24 hours...

Course structure:

There is an enormous range of topics that could be covered in this course, of which we have time to discuss only a fraction. The material covered in this course is designed to strike a balance between two important but competing objectives: offering a broad survey of the many topics that one can pursue in this area, while trying to attain a deeper understanding of a few key issues.

The material covered in this course is difficult by its nature, and it is important you be prepared for that fact. The topics are many, diffuse, and interrelated in ways that are difficult to understand even after a lifetime of study. While economists have many clever ideas about how the international economy operates, little consensus exists on the answer to even such seemingly fundamental questions as “what determines the exchange rate” or “how should countries respond to speculation against their currency?” As a result, this course will raise questions and discuss how to think about them, but will rarely offer a single clear answer you can “file away” for the test. As with most questions in economics, what your answer *is* matters less than *how* you got it.

As a way of organizing the various material covered, **this course adopts a three-part structure**. In the first third, we look at *why there are international financial markets* from the standpoint of economic theory. In the second third, we take the view of a Wall Street investor and ask *how we can use international financial markets for our personal gain?* In the third, we take the view of a national government and show *how the existence of international financial markets affects our decisions regarding economic policy*.

Prerequisites:

Econ 243 (Intermediate Macro) is **required** for this course, and it will be assumed that you are familiar with this material. If you are a bit rusty, you may find it useful to review your text from that course from time to time. In addition, you may find it **useful** to have had Econ 251 (International), Econ 267 (Finance), and/or Econ 241 (Statistics). Mathematics is the language of economics and modern business, and a basic literacy and facility with mathematics and statistics is **assumed** (for instance knowing terms like *mean*, *standard deviation*, and *regression analysis*). While the use of more advanced mathematics like calculus will be avoided (or at least kept to a minimum) in class, it does

appear in several of the more advanced readings. I will do my best to guide you through this material in a clear and non-technical fashion, but I do not think it will hurt to have an opportunity to familiarize yourself with “real” (i.e. professional-level) economics and finance within a “safe” environment.

Course Goals:

By the end of this class, you should be adept at each of the following three skills:

- *Understanding*. You should be able to understand the topics and issues involving international finance and macroeconomics discussed in newspaper articles and by the professional economic and business community at large.
- *Analysis*. You should be able to perform independent analysis and arrive at your own independent judgments regarding the above set of issues.
- *Effective Communication*. You should be able to communicate effectively your understanding and analysis of these issues through speech and writing.

These goals will be achieved via a combination of the following means:

- *Reading* the Financial Times newspaper, popular books, and scholarly journal articles
- *Analyzing* specific problems given in homeworks and exams
- *Writing* regular analytical summaries of current events and participating in class discussions.

Readings:

There are three assigned texts, the first two of which are available for purchase at the bookstore:

- Husted and Melvin, *International Economics*, 6th edition. (**IE**).
- Krugman, Paul, *The Return of Depression Economics* (**RDE**).
- *The Financial Times* newspaper (**FT**)

You may purchase a 15-week subscription to the *Financial Times* newspaper at a special student rate (\$29), by going to https://www.ftnewspaper.com/cgi-bin/ftusa.cgi/fess/vanity_us_student. The *FT*, based in London, is the foremost source of international business and economic news in the world. In addition to the assigned readings on the syllabus covering events of the past, we will be keeping up with current events in the international economy using the *FT*. Each class you will be able to write an “international roundup” on one topic of interest to you going on in the world that week.

In addition to the three main texts, there are several readings that can be found on-line or on reserve. Some of these have a star (*), which means they are more difficult articles – usually an important journal article – that I have included to help you become familiar with the discourse of professional economics. I expect you to attempt to read them as best you can so that we can discuss them in class, but in these cases you will be only be responsible for what we actually discuss in class, not the article itself. Reserve readings will be available on electronic reserve at the library when not available on-line. Direct links to on-line readings are available through the electronic version of this syllabus, which you will find on Blackboard.

Requirements & Grading:

Preparing for, attending, and participating in class regularly is a requirement for a good grade in this class, since you are very unlikely to do well (or to enjoy the class!) if you do not. This class will involve both complicated, technical economic theory and spirited discussion of economic policies and current events. If you have not prepared for class by reviewing the required material, you may have difficulty following the discussion and are likely to fall behind. You also may not recognize material on the exams. If you miss classes and fall behind, you will have difficulty catching-up.

Grades for the course will be assigned on the following basis:

Homeworks	15%
International Roundups (up to 20)	15%
Participation	10%
Three exams (including final)	60% (10% allocated for lowest score; 25% each for other two)

- *Homeworks* are designed to help you follow along with the material in the course. Economics is a learning-by-doing affair, and working through problems is critical to learning the material. Homeworks will be evaluated on a scale of 1 to 5. You will receive an additional 5 points for turning them in on time, at the start of class (with one point taken off for each additional hour).
- *International Roundups* are one-paragraph analytical summaries of current events related to international macroeconomics. These should be written from the standpoint of an economic advisor to the President of the U.S. They should summarize all the important information and provide key analytical insight to explain its importance. Examples of possible topics include announcements by foreign governments and central banks regarding interest rate or exchange rate policy, releases of important reports or economic data, or other important events. I (“the President”) am **not** interested in the fact that Vodaphone had good 2nd quarter earnings, or that Comcast has announced plans to start providing internet phone service. (The former is not worth the attention of the President, and the second is not international!). Roundups will be graded on a check, check-plus, and check-minus basis. You may turn in one per class, and your roundup grade will be based on having at least 20 “checks” over the course of the semester (note: there are roughly 30 classes, so you can miss several, but should have one to turn in most days)
- The two exams will draw from the readings, homeworks, and in-class discussions. They will in general consist of a few short answer questions, a few technical problems (usually related to those seen in the homeworks), and an essay question. It is unlikely that you can do well on the exams if you do not attend class regularly.
- The final for this class is scheduled for **Saturday, May 7 at 8:30 a.m.** This is the last day of exams: make sure you will be here for it!

Course Outline & Reading List

PART I : THE VIEWPOINT OF AN ECONOMIC THEORIST

1. Introduction

a. Defining “Globalization”: Causes

- *RDE*, Introductions (pp. vii – xxii).
- John Williamson, *Globalization: The Concept, Causes and Consequences* (on-line)
 - <http://www.iie.com/publications/papers/williamson1298-2.htm>

- Handout: “Schools Brief: One World?” *The Economist*, October 18, 1997
- *IE*, Chapter 1

b. Defining “Globalization”: Consequences

- *RDE*, Chapter 1: “July 1, 1997”
- Handout: “World Ills are Obvious, the Cures Much Less So” (*New York Times*, 2/18/99)

2. Why do Goods Cross Borders? International Trade and “Competitiveness”

- Handout: “Schools Brief: The Miracle of Trade” *The Economist*, January 27, 1996
- Handout on comparative advantage & “competitiveness”

3. The Balance of Payments and the Market for Foreign Exchange

- *IE*, Chapter 11

a. International Transactions Accounting

- *IE*, Chapter 12 (can skip pp. 321-327 for now)

b. The Exchange Rate and the Balance of Payments

- Handout on “International Money”

c. The Law of One Price, Purchasing Power Parity & the “Real Exchange Rate”

- *IE*, Chapter 14
- Handout on “Exchange Rate Theory #1: The Trade Balance”
- *The Economist*, [The Big Mac Index Page](#) and [Burgernomics \(on-line\)](#)
- (*) Charles Engel and John H. Rogers, “[How Wide Is the Border?](#)” *The American Economic Review*, Vol. 86, No. 5. (Dec., 1996), pp. 1112-1125. (on-line)

4. Why Does Capital Cross Borders?

- Handout on inter-temporal trade
- *RDE*, Chapter 2: “A short course in miracles”
- (*) Martin Feldstein; Charles Horioka, “[Domestic Saving and International Capital Flows.](#)” *The Economic Journal*, Vol. 90, No. 358. (Jun., 1980), pp. 314-329. (on-line)

5. Types of Capital Flows

- *IE*, Chapter 10, pp. 294-299
- *IE*, Chapter 12, pp. 321-328

a. Portfolio Investment

- *IE*, Chapter 16, pp. 401-404.

b. **Foreign direct Investment**

- *IE*, Chapter 16, pp. 404-414.
- Handout on Foreign Direct Investment

FIRST EXAM: Tuesday, February 22nd

PART II : THE VIEWPOINT OF A WALL STREET INVESTMENT BANKER

6. **The market for foreign exchange**

- *IE*, Chapter 13
- Sam Y. Cross, “[Structure of the Foreign Exchange Market.](#)” Chapter 3 in *The Foreign Exchange Market in the United States* (Federal Reserve Bank of New York). (on-line)
- Optional: additional details on the <http://www.newyorkfed.org/education/addpub/usfxm/>

7. **Assets and Exchange Rates: The interest parity condition (a.k.a. the “Box”)**

Application 1: covered interest parity arbitrage: *IE*, Chapter 15

Application 2: Speculation & “selling short”: *RDE*, Chapter 7 (particularly pp. 118 – 123)

Application 3: Exchange rate volatility (“overshooting”) : *IE*, Chapter 18, pp.454 – 464.

- (*)Rudiger Dornbusch, “[Expectations and Exchange Rate Dynamics](#),” *The Journal of Political Economy*, Vol. 84, No. 6, Dec., 1976 pp. 1161-1176 (on-line)

8. **International Banking, Sovereign Debt and Country Risk**

- *IE*, Chapter 16 (pp. 392-398) and Chapter 20
- Handout on Sovereign Debt

9. **Understanding Exchange Rates: Volatility, Forecasting, and the Random Walk Hypothesis**

- *IE*, Chapter 16, p.398 – 401 and Chapter 18
- Sam Y. Cross, “[The Determination of Exchange Rates.](#)” Chapter 11 in *The Foreign Exchange Market in the United States* (Federal Reserve Bank of New York). (on-line)
- Jeffrey Frankel & Kenneth Froot, “[The Rationality of the Foreign Exchange Rate: Chartists, Fundamentalists, and Trading in the Foreign Exchange Market](#)” *The American Economic Review*, Vol. 80, No. 2, (May, 1990), pp. 181-185.
- Gregory Hopper, “[What determines the exchange rate: economic factors or market sentiment?](#)” *Business Review* (Philadelphia Federal Reserve) (Sep. 1997) 17-29. (on-line)

SECOND EXAM: Thursday, March 18th

PART III: THE VIEWPOINT OF A NATIONAL GOVERNMENT

10. Introduction to Open Economy Macroeconomics

- **RDE**, Chapter 3 “Warning Ignored: Latin America, 1995”
- **IE**, Chapter 16, pp. 407-413 (
- **IE**, Chapter 21 (An Open-Economy Keynesian model)
 - a. Fixed vs. Floating Exchange Rate Regimes: Bretton-Woods and Beyond
 - **IE**, Chapter 19
 - Sam Y. Cross, “[Evolution of the International Monetary System](#).” Chapter 10 in *The Foreign Exchange Market in the United States* (Federal Reserve Bank of New York). (on-line)
 - b. The Mundell-Flemming IS/LM/BoP Model with Floating Exchange Rates
 - **RDE**, Chapter 4 “The Future that Didn’t Work”
 - c. The Mundell-Flemming IS/LM/BoP Model with Fixed Exchange Rates
 - **RDE**, Chapter 5 “All Fall Down: Asia’s Crash”

11. Choice of exchange rate regime

- a. Fixed or Floating? The pros and cons
 - Francesco Caramazza and Jahangir Aziz, “[Fixed or Flexible? Getting the Exchange Rate Right in the 1990s](#)” (IMF, April 1998). (on-line)
- c. The euro & Latin American “dollarization”: Who should use a common currency?
 - **IE**, Chapter 19, pp. 481 – 494.
 - Robert Mundell, “[A Theory of Optimum Currency Areas](#)” *The American Economic Review*, Vol. 51, No. 4. (Sep., 1961), pp. 657-665.

11. The Economics of Emerging Markets

- **RDE**, Chapters 6 – 9.

a. Latin American crises of the 1980s & The Canonical Model

- (*) Paul Krugman, "[A Model of Balance of Payments Crises](#)" *Journal of Money, Credit and Banking*, Vol. 11, No. 3. (Aug., 1979), pp. 311-325. (on-line)

b. ERM attacks, Soros, and Obstfeld

- (*) Maurice Obstfeld, "[Rational and Self-Fulfilling Balance-of-Payments Crises.](#)" *The American Economic Review*, Vol. 76, No. 1. (Mar., 1986), pp. 72-81. (on-line)

c. Asian crisis, and the "balance sheet" effect

- IMF Staff, "[The Asian Crisis: Causes and Cures,](#)" *Finance and Development*, June 1998, pp. 1-8.
- Chang, Roberto, and Andrés Velasco, "[Financial Crises in Emerging Markets: A Canonical Model,](#)" NBER Working Paper No. 6606, June 1998.
- *The Economist*, Sept.25th-Oct. 1st, 1999, pp. 17-18; supplement: pages: 13-26.

d. The Role of the IMF

- Allan Meltzer, "[Asian Problems and the IMF](#)" Statement before the U.S. Congress, Joint Economic Committee, February 24, 1998.
(Also look at the into to his [IFIAC \(Meltzer Commission\) Report](#))
- A critique of the Meltzer report by [Brad DeLong](#) of UC-Berkeley

12. Conclusions

- Maurice Obstfeld, "[The Global Capital Market: Benefactor or Menace?](#)" (in Symposium: Globalization in Perspective)" *The Journal of Economic Perspectives*, Vol. 12, No. 4. (Autumn, 1998), pp. 9-30.

FINAL EXAM: Saturday, May 7th at 8:30 a.m.