

DARTMOUTH COLLEGE  
Department of Economics

Economics 29  
International Finance and Open-Economy Macroeconomics

Professor Nancy Marion  
Fall 2006

## Syllabus

### The Course

This course is an introduction to international finance and open-economy macroeconomics. It helps students develop analytical methods and simple models in order to gain insights about international economic phenomena. Topics covered include the foreign exchange market, the behavior of exchange rates, the international financial system, and the effects of policies and disturbances in the open economy. Students will confront a number of important policy questions related to such issues as financial crises in emerging markets, the volatility of international capital markets, global trade imbalances, and the single currency in Europe.

### Readings

The text for the course is:

Paul Krugman and Maurice Obstfeld, *International Economics*, 7<sup>th</sup> edition (2005).

You are encouraged to use the 7<sup>th</sup> edition, but if you already have a copy of the 6<sup>th</sup> edition, you may use that edition instead. The text covers both international trade and finance, so only the second part of the text is assigned for this course. Students are cautioned that the course does not rely heavily on the text, so whether you purchase the text or rely on a reserve copy is up to you. There are many good substitutes for the Krugman-Obstfeld text, so you are free to use an alternative text if you like. Two recommended ones are Pugel and Lindert, *International Economics*, and Caves, Frankel and Jones, *World Trade and Payments*. The Krugman-Obstfeld text is accompanied by MyEconLab, an online homework and tutorial system that is optional but may prove helpful for some students. An optional Study Guide that accompanies the text is also available.

Class discussions will deal with current economic events, so please read the economic news from *The Economist* magazine or from a major newspaper (online) on a regular basis. An online subscription to *The Economist* comes bundled with the 7<sup>th</sup> edition of the text.

Occasionally, supplementary readings are assigned. Some can be downloaded from the web using the designated link in the syllabus. Others are posted on blackboard.

Recommended books in Units VIII-IX are on reserve at Baker-Berry Library, as is a copy of the text. Handouts will be distributed in class and posted on blackboard.

### **Prerequisites**

Students should complete Economics 22 before taking this course. Students interested in taking Economics 39 may take that course either before or after taking Economics 29.

In Economics 29, concepts are introduced using graphs, though occasionally some simple algebra or calculus is used.

### **Grades**

There will be two midterm exams, one covering material in sections I-IV of the syllabus and the other covering material in sections V-VII. There is no final exam. A short 5-7 page paper is due at the end of the term. The paper will be on assessing an emerging market's vulnerability to a financial crisis (section VIII of the syllabus). The specific paper assignment is posted on blackboard. Problem sets and data exercises will be assigned throughout the term. They will be collected, monitored for effort and completeness, but not graded. Solutions to the problem sets will be distributed with a lag.

Each exam will be preceded by an optional evening review session.

#### *Performance evaluation*

First exam	30%
Second exam	30%
Paper	35%
Problem Sets	5%

There is a strong correlation between final grades and the effort you make to keep up with the material. On average, you will perform better if you attend class, participate in class discussions (ask questions!) and work through the problem sets/data exercises in a timely fashion.

#### *Honor code.*

The honor code strictly applies. The following points relate to this course:

The exams must reflect individual effort only.

The paper must reflect individual effort, although you may share source materials and discuss general ideas with others. Cite sources appropriately.

You may work with others on the problem sets and data exercises, but the answers you submit should be written in your own words.

### **Administrative Matters**

Course documents, such as announcements, class slides, handouts, data exercises, problem sets and answer keys will be posted on Blackboard. You may access Blackboard by going to <http://www.dartmouth.edu/~blackboard>.

Professor Marion's office is 325 Rockefeller Center. Her email address is [nancy.marion@dartmouth.edu](mailto:nancy.marion@dartmouth.edu) and her office phone is 646-2511. Office hours are Mondays and Wednesdays 1:45 p.m.-3:30 p.m. and by appointment.

The Dartmouth College Academic Skills Center offers a range of services for students, including academic skills workshops, private tutoring, assistance for students with learning and physical disabilities, and more.

Students with learning, physical, or psychiatric disabilities enrolled in this course that may need disability-related classroom accommodations are encouraged to make an office appointment to see Professor Marion by October 16. All conversations are confidential, although the Academic Skills Center must verify the documentation of the disability.

Some students may wish to take part in religious observances that occur during this academic term. Should you have a religious observance that conflicts with your participation in the course, please come speak with Professor Marion before September 29 to discuss appropriate accommodations.

### **Important Dates:**

Midterm 1: Tuesday (X-hour) Oct 17  
Midterm 2: Tuesday (X-hour) Nov 7  
Paper: Due Dec 6

No classes: Mon, Oct. 9; Wed, Oct 11; Mon, Nov 20;  
X-hours: Tuesday, Sept 26; plus the two exam X-hours

### **Schedule**

The next page shows the schedule of class meetings and topics. Chapter numbers refer to the Krugman-Obstfeld text, 7<sup>th</sup> edition. Relevant page numbers are also noted for those using the 6<sup>th</sup> edition. The number of class meetings per topic is approximate.

## READING LIST

### I. The Foreign Exchange Market (3 classes)

Topics: Introduction; characteristics of foreign-exchange markets; spot and forward transactions; hedging using forward contracts, the international money markets, and options.

Text: Ch. 13, first half (pp. 306-323). [6<sup>th</sup> edition: Ch. 13, pp. 324-341]

Handouts: The Foreign Exchange Market: Terms and Concepts (Blackboard)  
Options (Blackboard)

### II. A Simple Model of the Exchange Rate (2 classes)

Topics: Covered interest parity; exchange-rate risk and uncovered international parity; the evidence about parity conditions; a simple model of the exchange rate.

Text: Ch. 13, second half (pp. 323-331); Ch. 13 appendix.  
[6<sup>th</sup> edition: Ch. 13, pp. 341-351, plus appendix]

Handouts: Testing Uncovered Interest Parity (Blackboard)  
Uncovered Interest Parity and the Exchange Rate (Blackboard)

"How Mr. Sores Made a Billion Betting Against the Pound," *The Times*, October 26, 1992. (Blackboard)

### III. Adding the Money Market to the Exchange-Rate Model (3 classes)

Topics: Interest rates, expectations and exchange rates; money and exchange rates; exchange-rate overshooting.

Text: Ch. 14. [6<sup>th</sup> edition: Ch. 14]

### IV. More on the Relationship Between Money, Prices and Exchange Rates (2 class)

Topics: Purchasing power parity; links between money, prices and exchange rates in the long run.

Text: Ch. 15 (no appendix). [6<sup>th</sup> edition: Ch. 15, no appendix]

"McCurrencies", *The Economist*, May 27, 2006. (Blackboard)

V. Adding the Output Market to the Model (3 classes)

Topics: The joint determination of output, interest rates and exchange rates; monetary and fiscal policies in the open economy with flexible exchange rates; case studies: the Japanese economy in the 1990s, German reunification.

Handouts: The Open-Economy Macro Model  
Monetary and Fiscal Policies in the Open Economy

Text: Ch. 16 (only pp. 407-414, 434-438, Appendix 2)  
[6<sup>th</sup> edition: Ch. 16 (only pp. 433-439, 464-466, Appendix 3)]

VI. Modifying the Model for Fixed Exchange Rates (3 classes)

Topics: Interest-rate parity under fixed exchange rates; international reserves and the money supply; monetary and fiscal policies in the open economy with fixed exchange rates; the economic consequences of delayed devaluation; the historical experience with fixed exchange rates.

Handout: The Open-Economy Model with Fixed Exchange Rates

Text: Ch. 17 (only pp. 447-456, 460-462); Ch. 18 (only pp. 491-501, 506-509)  
[6<sup>th</sup> edition: Ch. 17 (only pp. 481-493, 502-505; Ch. 18 (only pp. 537-551, 556-561)]

"A Fading Prospect," *The Economist*, June 10, 2003. (Britain's decision not to join the Euro) (Blackboard)

"Fear of Floating," *The Economist*, July 10, 2003. (Blackboard)

VII. The Balance of Payments (3 classes)

Topics: The balance-of-payments accounts; saving, investment and the current account; today's global imbalances.

Text: Ch. 12; Ch. 19 (only box on pp. 534-536)  
[6<sup>th</sup> edition: Ch. 12]

"Wise Men at Ease," *The Economist*, April 28, 2005. (Blackboard)

Summers, Larry, "The U.S. Current Account Deficit and the Global Economy, Per Jacobsson Lecture, 2004, [Link to Paper](#)

Obstfeld, Maurice, "America's Deficit, The World's Problem", September 2005. [Link to Paper](#)

### VIII. Crises in Emerging Markets (6 classes)

Topics: Types of crises (currency crises, banking crises, sovereign and corporate debt crises); causes of crises; case studies; data that highlight vulnerabilities to crisis.

Text: Ch. 22; Ch. 21 (only pp. 585-591); Ch. 17 (only Appendix 2).

[6<sup>th</sup> edition: Ch. 22; Ch. 21 (only pp. 647-654), Ch. 17 (only Appendix 3)]

Flood, Robert and Nancy Marion, "Perspectives on the Recent Currency Crisis Literature," *International Journal of Finance and Economics*, Vol. 4 No. 1, 1-26, 1999.

[Link to Paper](#)

Edwards, Sebastian, "The Mexican Peso Crisis: How Much Did We Know? When Did We Know It?" NBER Working Paper No. 6334, December, 1997.

[Link to Paper](#)

Krugman, Paul, "What Happened to Asia?" [Link to Paper](#);

"Analytical Afterthoughts on the Asian Crisis," [Link to Paper](#)

"Balance-sheet Effects, the Transfer Problem and Financial Crises," [Link to Paper](#)

Calvo, Guillermo, Alejandro Izquierdo, and Ernesto Talvi, "Sudden Stops, the Real Exchange Rate and Fiscal Sustainability: Argentina's Lessons," NBER working Paper No. 9828, July 2003. [Link to Paper](#)

Hausmann, Ricardo and Andres Velasco, "Hard Money's Soft Underbelly: Understanding the Argentine Crisis," July 2002, forthcoming in *Brookings Trade Forum*. [Link to Paper](#)

Feldstein, Martin, "Argentina's Fall: Lessons from the Latest Financial Crisis," *Foreign Affairs*, March/April 2002. (Blackboard)

<http://www.rgemonitor.com> (Category: emerging markets) (14-day free subscription, so access this source near the end of the term.)

Roubini, Nuriel and Brad Setser, *Bailouts or Bail-Ins? Responding to Financial Crises in Emerging Markets*, Washington, D.C.: Institute for International Economics, 2004. (on reserve)

Rubin, Robert, *In an Uncertain World*, New York: Random House, 2003, Ch. 1 (Mexican crisis), Ch. 8-9 (Asian crisis), Ch. 10 (Russian crisis). (on reserve)

Mishkin, Frederic, *The Next Great Globalization*, Princeton, N.J.: Princeton

University Press, 2006, Ch. 5 (Mexican crisis), Ch. 6 (South Korean crisis), Ch. 7 (Argentine crisis). (on reserve)

Blustein, Paul, *And the Money Kept Rolling In (and Out): Wall Street, the IMF, and the Bankruptcy of Argentina*, New York: Public Affairs, 2005. (on reserve)

IX. Financial Globalization: Some Key Issues (2 classes)

Topics: Trends in the globalization process; benefits and costs of financial globalization; bailouts, moral hazard, and market shutdowns.

Text: Sections of Ch. 19 (only case studies in boxes): Ch. 20.  
[6<sup>th</sup> edition: Ch. 19 (only case studies in boxes); Ch. 20]

Mishkin, Frederick, *The Next Great Globalization*, Princeton, N.J.: Princeton University Press, 2006, Ch. 1-3. (on reserve)