Course Objective

This course covers the macroeconomic and monetary side of international economics. You will explore in detail the functioning of international financial markets. Other topics include the determination of the balance of trade and the balance of payments, and the effectiveness of monetary and fiscal policy in an open economy, and the nature and causes of currency crises. Macroeconomic models of open economies will be developed and applied to contemporary policy issues. We will also investigate the effectiveness of macroeconomic policy in the open economy, which depends heavily on the exchange rate regime. Our discussions of macroeconomic policy lead naturally into a discussion of the variety of exchange rate regimes, the evolution of debt crises, and the causes of currency crises.

Prerequisites

This course assumes that you have mastered an intermediate level course in macroeconomics and that you recall some basic statistics.

An intermediate level macroeconomics course (Econ-301, or equivalent) is prerequisite to this course; no exceptions. Basic Statistics (Stat-202, or equivalent) is strongly recommended. You will be expected to master some basic statistics and regression concepts. I also consider a commitment to upholding the Academic Integrity Code for American University to be prerequisite to participation in this course.

This course is part of the advanced sequence in international economics, which also includes a separate course on international trade (Econ-371). This course is intended primarily for Economics majors; non-majors are encouraged to take Econ-311 instead. Students who have taken Econ 311 are permitted to take this course, but there will be some overlap in the material covered. Only two of the three international economics courses (Econ 311, 371, and 372) may be counted toward a degree in economics.
Course Resources

All students are also expected to use BlackBoard, which provides access to the course website. The website will include links to detailed lecture notes for this course (in PDF format). There is also a class email list: econ-372-L. You must subscribe to the class email list, using its listname. (See my detailed subscription instructions.) All students are expected to monitor the class email list.

Required Texts


Grading

In order to obtain a grade of B, expect to spend at least two hours in study time outside of class for each hour of class time.

There will be two multiple-choice midterms (1 hour and 15 minutes each) and a comprehensive final exam (2 hours and 30 minutes). Each midterm grade constitutes 30% of the course grade, and the final constitutes the remaining 40%. However, I will "weight improvement" when it is marked.

Exams are taken without the aid of textbooks or of notes of any kind, and no collaboration is allowed on exams. I offer no extra credit, and there will be no makeup exams. (Exams may missed with a doctor's excuse, of course. The grade will then be calculated from the remaining exams.) Exams presume a thorough knowledge of all homeworks and required readings.

Ongoing study groups are highly recommended. Study groups are an excellent means of mastering the course material. Besides, they are fun. I encourage you to discuss the problem sets with others, but there are strict terms for such collaboration. You must cite all of your collaborators at the front of your submitted solutions. (Legitimate collaboration does not reduce your grade!) Also, you must write up solutions on your own. To repeat: your write-up of any problem solution must be entirely your own. The use of pre-packaged sources of solutions to the assigned problems is not permitted. You may neither copy solutions nor provide solutions to be copied. Plagiarism, cheating, and other anti-intellectual behavior will be dealt with severely and can lead to dismissal from the university.

Testing

MIDTERM EXAMINATIONS: 2 Oct. and 13 Nov.

FINAL EXAMINATION: See the AU final exam schedule, which always determines the date of the final. Always
check the schedule of classes.

The emphasis of my exams reflects the emphasis of my lectures, and lecture will sometimes cover ground not found in the readings. Be sure to take good notes, as they will be crucial to your performance on the examinations. I will also draw on required readings for exam questions. I therefore recommend attempting the end of chapter problems, when they are available.

In this course, I rely primarily on multiple-choice examinations. I write my own questions, and I look for evidence of deep, detailed understanding rather than cursory exposure. Despite some popular prejudices, empirical tests as well as my own experience indicates that this is a very effective examination procedure.\(^1\)
The order of the topics is indicated below. The exact timing however varies with the interests and abilities of the class. Exams are primarily based on lecture. Each topic also includes recommended readings. When a recommended reading is discussed explicitly in class, I am likely to develop exam questions based on the classroom discussion. Detailed citation information for the readings is in the following section. Note that most articles are available online. Textbook readings (KO = Krugman & Obstfeld) are required. Also required are Higgins (2005) and Pakko and Pollard (2003). All other readings are recommended.

<table>
<thead>
<tr>
<th>Topic</th>
<th>Readings</th>
<th>Session</th>
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<tbody>
<tr>
<td><strong>The Balance of Payments</strong></td>
<td>KO ch. 12;</td>
<td>1</td>
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<tr>
<td>Includes: stocks vs. flows, double-entry</td>
<td>BEA's BoP data</td>
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<tr>
<td>balance of payments accounting, financial</td>
<td>Holman (2001)</td>
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<td>programming, current account sustainability,</td>
<td>IMF (1996)</td>
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<td>Fieleke (1996)</td>
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<td>Seskin and Parker (1998)</td>
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<td></td>
<td>Bach (1999)</td>
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<tr>
<td><strong>Global Financial Markets</strong></td>
<td>KO ch.13;</td>
<td>2-3</td>
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<tr>
<td>Includes: spot and forward rates, interest</td>
<td>Cross (1998)</td>
<td></td>
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<tr>
<td>parity concepts, foreign exchange derivatives</td>
<td>Frankel (1993, ch.2)</td>
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<tr>
<td>(futures, options, swaps)</td>
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<tr>
<td><strong>Floating Exchange Rates I: Equilibrium</strong></td>
<td>KO ch.14;</td>
<td>4-6</td>
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<tr>
<td>Includes: monetary approach to floating</td>
<td>Frenkel (1976 ScanJE);</td>
<td></td>
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<tr>
<td>exchange rates, role of expectations,</td>
<td>Beaugrand (1997)</td>
<td></td>
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<td>temporary vs. permanent shocks, money/price-</td>
<td></td>
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<td>level correlations, Fisher effect,</td>
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<tr>
<td>evidence from hyperinflations</td>
<td></td>
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<tr>
<td><strong>Purchasing Power Parity</strong></td>
<td>KO ch.15;</td>
<td>7</td>
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<tr>
<td>Includes: commodity price parity, price</td>
<td>Pakko and Pollard (1996);</td>
<td></td>
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<tr>
<td>index construction, &quot;Big Mac standard&quot;,</td>
<td>Pakko and Pollard (2003);</td>
<td></td>
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<tr>
<td>Penn World Table, PPP-based national</td>
<td>Economist's Big Mac index, June 2005</td>
<td></td>
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<td>income comparisons, long-run PPP,</td>
<td></td>
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<tr>
<td><strong>Trade Balance and Exchange Rates</strong></td>
<td>KO ch.16, Appendix III</td>
<td>8</td>
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<tr>
<td>Balassa-Samuelson effect, Houthakker-Magee</td>
<td>Quiggin (2004 EV)</td>
<td></td>
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<tr>
<td>critique, &quot;classical&quot; Mundell-Fleming Model</td>
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<td></td>
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<tr>
<td><strong>Floating Exchange Rates II: Overshooting</strong></td>
<td>KO ch.16;</td>
<td>9-10</td>
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<tr>
<td>Includes: monetary and fiscal policy in the</td>
<td>Frankel (1979 AER);</td>
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<td>short run;</td>
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real interest differential model and evidence; 

Dornbusch (1976 JPE); 
Cavallo et al. (2004)

### Pegged Exchange Rates
Includes: gold standard; Bretton Woods; "elasticity approach" to BoP; "monetary approach" to BoP; "Keynesian" Mundell-Fleming model

KO ch.17,18

Bordo (1993)
Grabbe (1996)
Dueker and Fischer (2001)

### The Small Open Economy Model

KO ch.16-20;
Kouparitsas (2003);

### Monetary & Fiscal Policy in the Open Economy
Includes: "Keynesian" Mundell-Fleming model, regime-dependent policy effectiveness, optimum currency areas, EMU history

KO ch.17,22

Calvo and Mendoza (1996)
Bretton Woods Committee (2003)

### Balance-of-Payments Crises
Includes: capital flight, sterilized intervention, policy coordination, debt crisis and Brady plan, currency crisis and IMF stabilization; contagion

KO ch.21 + "postscript" pp.728ff

Calvo and Mendoza (1996)
Bretton Woods Committee (2003)

### Exchange Rates and Risk
Includes: financial market efficiency; evidence for a risk premium in foreign exchange market; mean-variance analysis; portfolio balance

KO ch.21 + "postscript" pp.728ff

### LDCs in the International Financial System

CFJ 9, 20;
Krugman 4, 9, 11, 13

Review and General Discussion
References


Cross, Sam Y., 1998, All About ... The Foreign Exchange Market in the United States http://www.newyorkfed.org/education/addpub/usfxm/


Frankel, Jeffrey A. On Exchange Rates (MIT Press, 1993)


International Monetary Fund, 1996, Balance of Payments Textbook (ISBN 1-55775-570-1)


We may also view the following instructional videos: Exchange Rates, Capital Flight, and Hyperinflation (VHS 2869), Billion Dollar Day (VHS 297), Managing Currencies and Policy Coordination (VHS 2868). We may not have time for these, but you may view them in the library if you wish. (This is not required.)
I am listing a few books that are not required but which I will refer to in lecture. If you borrow these from a library, please note that I consider any marking, underlining, or writing in pencil, pen, or highlighter on any library materials to be defacement of library property, a violation of academic integrity, and grounds for a reduction in your final grade. Please treat all library materials as precious intergenerational resources that you are privileged to share.


Study Strategies

1. Attend class and take good notes. Good notes will be crucial to your performance on the examinations. And studies indicate that attendance improves performance (Romer 1993 JEL).
2. Ask questions in class. Don't let your questions go unanswered!
3. Don't reserve your studying for the weekends. I suggest an hour per day. Daily exposure is much better than cramming.
4. Study at the library or someplace else that is not distracting.
5. Do the required reading. I draw on the required readings for exam questions.
   a. Don't read it just once.
   b. If you own the text, read with a highlighter or pencil.
   c. Outline the important points.
6. Do any end of chapter problems. I often develop exam questions based on these problems.
7. Discuss the readings and problems in a study group. Student who use them tell me that study groups are very helpful. Make up problems in your study group as part of exam preparation.
8. Discuss readings and problems on the course mailing list. Don't let your questions go unanswered!
9. If you feel timid about stating your question on the course email list, be sure to email it to me directly. Don't let your questions go unanswered!


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