

## INTERNATIONAL MONEY AND FINANCE

The course is an introduction to balance of payments and exchange rate theory. It is built around a single organizing idea--the idea that the foreign exchange market (in which national currencies are traded and exchange rates determined) is *not* governed by payments for flows of goods and services traded across national borders. Rather, it is driven by financial transactions of arbitrageurs and speculators, who are in charge of maximizing the rate of return on existing *stocks of financial assets*. In an open economy with capital mobility, these financial assets comprise instruments denominated in different currencies--hence the need to pass through currency markets in order to trade them. In sum, the foreign exchange market proximately links national financial markets (money, bond, and stock markets), not national output markets. According to this view, international imbalances in goods trade, shifts in national macroeconomic policies, and "real" economy shocks such as oil price and productivity changes affect exchange rates only to the extent that they manage to alter the arbitrage opportunities and speculative expectations of actors in international financial markets. A parallel argument applies to a system of exchange rates fixed by central banks, in which case it is a country's money supply that is dictated by financial market behavior.

It is with this theoretical perspective in mind that we will approach the topics listed in the course catalogue description--namely international financial markets, capital mobility and expectations, internal and external adjustment under flexible and fixed exchange rates, international policy coordination, optimum currency areas, and the history of the international monetary system.

### *Prerequisites:*

Intermediate macroeconomics (e.g. Econ BC 3033)

### *Readings:*

(1) Course textbook: Krugman, P. and M. Obstfeld (2003), *International Economics*, 6<sup>th</sup> ed., Addison-Wesley

Goldberg, L. S. et al. (2003), *Study Guide to International Economics*, Addison-Wesley

Both are available at Labyrinth. It is expected that students will have read the relevant chapter in Krugman/Obstfeld (henceforth K/O) before coming to class. Since during the lectures reference will be made to K/O diagrams, students should always take the textbook along.

(2) Class notes, to be printed out from *Courseworks* <<https://courseworks.columbia.edu>> and taken to the lectures:

These summarize analytical material that goes beyond K/O and that is covered in the lectures.

Though the class notes are not always self-explanatory, students should go over them and their notation before coming to class.

(3) Frequent reference will be made to current economic events and students should keep abreast of these by perusal of an appropriate daily (*FT*, *WSJ*, *NYT*) or weekly (*Economist*) periodical.

(4) Unlike K/O and the class notes, which are required readings, the other items listed in the course outline below are suggested only; they either provide an alternative textbook treatment (e.g. Isard) or constitute an accessible seminal contribution (e.g. Cassel, Friedman, Keynes, Mundell).

(5) You may also want to consult, for additional resources and relevant links, the K/O website <[http://www.aw.com/krugman\\_obstfeld](http://www.aw.com/krugman_obstfeld)>.

*Problem sets and recitation:*

Assigned largely, but not exclusively, from the end-of-chapter questions in K/O, problem sets will be due approximately every other week. Answers will be made available on *Courseworks* and/or discussed during the weekly recitation. The latter, run by the course TA (Mr. Loran Chollete), will as well answer student questions raised by the lectures and help students prepare for the two course examinations.

*Grading:*

Midterm exam 40%, final exam 45%, problem sets and class participation 15%.

*Schedule of topics and dates:*

1. 1/20 Course Organization and Introduction  
K/O ch.1
2. 1/22-1/27 National Income Accounting and the Balance of Payments  
K/O ch. 12  
Class notes ch. 12  
Howard, D.H. (1989), Implications of the U.S. current account deficit, *J. of Econ. Perspectives* 3 (Fall): 153-65  
Meade, J.E. (1952), *The Balance of Payments*, Oxford, chs.1-3
3. 1/29-2/5 Exchange Rates and the Foreign Exchange Market  
K/O ch. 13 and appendix  
Class notes ch. 13  
Isard, P. (1995), *Exchange Rate Economics*, Cambridge, ch. 2  
Keynes, J.M. (1923), *A Tract on Monetary Reform*, Macmillan, ch. 3  
Levich, R.M. (1998), *International Financial Markets: Prices and Policies*, McGraw-Hill, chs.3-8
4. 2/10-2/17 Money, Interest Rates, and Exchange Rates  
K/O ch. 14  
Class notes ch. 14  
Dornbusch, R. (1976), Expectations and exchange rate dynamics, *J. of Pol. Econ.* 84: 1161-76  
Isard, P., *op. cit.*, chs. 5-7
5. 2/19-2/26 Price Levels and the Long-Run Exchange Rate  
K/O ch. 15 and appendix  
Class notes ch. 15  
Cassel, G. (1928), *Post-War Monetary Stabilization*, Columbia  
Dornbusch, R. (1992), Purchasing power parity, *The New Palgrave Dictionary of Money & Finance*, vol.3, Stockton Press, pp. 236-244  
Isard, P., *op. cit.*, ch. 4

6. 3/2-3/23 Output and the Exchange Rate in the Short Run  
K/O ch. 16 and three appendices  
Class notes ch. 16
7. 3/11 Midterm examination
8. 3/25-4/1 Fixed Exchange Rates  
K/O ch. 17 and three appendices  
Class notes ch. 17  
Balbach, A. (1978), The mechanics of intervention in exchange markets, *Federal Reserve Bank of St. Louis Review* 60 (February), pp.2-7  
Mundell, R.A. (1963), Capital mobility and stabilization policy under fixed and flexible exchange rates, *Canadian J. of Economics and Political Science* 29: 475-85; reprinted in his *International Economics*, Macmillan 1968
9. 4/6-4/8 History of the International Monetary System  
K/O ch. 18  
Eichengreen, B. (1996), *Globalizing Capital: A History of the International Monetary System*, Princeton  
Isard, P., *op. cit.*, ch. 2  
McKinnon, R. (1993), The rules of the game: International money in historical perspective, *J. of Econ. Lit.* 31:1-44  
Spahn, H.-P. (2001), *From Gold to Euro: On Monetary Theory and the History of Currency Systems*, Springer
10. 4/13-4/15 Stabilization Policy and Coordination under Flexible Exchange Rates  
K/O ch. 19 and appendix  
Friedman, M. (1953), The case for flexible exchange rates, in his *Essays in Positive Economics*, Chicago, pp. 157-203  
Isard, P., *op. cit.*, chs.11-12  
Obstfeld, M. (1995), International currency experience: New lessons and lessons relearned, *Brookings Papers on Economic Activity* (1): 119-220
11. 4/20-4/22 Optimum Currency Areas  
K/O ch. 20  
Mundell, R.A. (1961), The theory of optimum currency areas, *American Economic Review* 51: 657-65  
Kenen, P.B. (1995), *Economic and Monetary Union in Europe*, Cambridge
12. 4/27-4/29 The Global Capital Market  
K/O ch. 21  
Friedman, M. (1969), The Euro-Dollar market: Some first principles, *Morgan Guaranty Survey* (October), pp. 4-14  
Obstfeld, M. (1998), The global capital market: Benefactor or menace?, *J. of Econ. Perspectives* 12: 9-30