International Finance: Issues and Analysis
ITF-346

OVERVIEW
This is an advanced course on international finance and macroeconomics for students who have a good background in micro and macroeconomic theory, econometrics, and mathematical techniques for economic analysis (in particular multivariate calculus and static and dynamic optimization). The objective of the course is to develop expertise with economic models used for the analysis of policy issues in international finance and macroeconomics. The course relies on economic research to develop a substantive understanding of policy issues as well as a facility with the models themselves. Issues of interest to developing countries receive special attention.

The course is designed to appeal to two groups of students: MPAID and other Kennedy School students with excellent backgrounds in micro and macroeconomics and quantitative methods, and Ph.D. students (in economics, public policy, and PEG) with substantive interests in international finance and macroeconomics.

READINGS
Readings are drawn from the current economics literature. They will be technical and mathematically sophisticated, requiring close attention. Starred articles indicate required reading. No single text is required for the course, but useful treatments of almost all the topics can be found in M. Obstfeld and K. Rogoff (OR), Foundations of International Macroeconomics, 1996, the Handbook of International Economics (GO), Vol. 3, G. Grossman and K. Rogoff (eds.), June 1995, and Development Macroeconomics by Pierre Richard Agenor and Peter Montiel (AM), 2nd edition, 1999. Classic if outdated general references are R. Dornbusch, Open Economy Macroeconomics (OEM), Basic Books, 1980, and Handbook of International Economics (HIE) Vol. 2, R. Jones and P. Kenen (eds), 1985. In addition to the readings, we will use handouts which lay out the basic theoretical model for each section. These handouts will be at the center of class discussions, but they should not be viewed as a substitute for reading the original articles.

PREREQUISITES
Macroeconomic theory at the intermediate level and multivariate calculus and dynamic optimization (rudiments of control theory and dynamic programming) are necessary. Previous exposure to upper level international finance is useful but not required. The course freely uses the techniques of dynamic optimization in continues time. Some tips will be provided at the start. As background reading I highly recommend a close reading of the math appendix of OR and of “Dynamic Optimization in Continuous-Time Economic Models (A Guide for the Perplexed),” by Maurice Obstfeld of Berkeley, at http://emlab.Berkeley.EDU/users/obstfeld/e202b/e202b.html.

GRADING
Grading will be based on a midterm to be administered in class (30%), 4 problem sets (30%), and a final (40%). The midterm will take place early in March.
COURSE CONTENTS

I. Basic Relationships (this section will not be discussed in class; you should review the materials on your own)

Dornbusch, R. (1980) Open-Economy Macroeconomics, Ch. 1


II. Optimizing Models of the Current Account

1. The Open-Economy Ramsey Model


OR, Chs. 1 and 2


2. Application: Temporary Policies and Intertemporal Distortions


First problem set

III. Non-Traded Goods and the Real Exchange Rate

1. Traditional Models


2. Dynamic Behavior

*AM, Ch. 7.


*OR, Ch. 4.


IV. Exchange Rate Determination and Macroeconomic Balance under Flexible Prices

1. The Monetary and Asset Market Approaches


OR, Ch. 8.


2. **Optimizing Models with Money**


OR, Ch. 8.


**Second problem set**

**V. Exchange Rate Determination and Macroeconomic Balance under Sticky Prices**

1. **The Classics**


2. More Modern Classics


3. The “New” Open-Economy Macroeconomics

OR, Chs. 9 and 10.


VI. Stabilization Policies

1. Background


*AM, Ch. 10, 12.


Sargent, T. "The Ends of Four Big Inflations" in Rational Expectations and Inflation, 1986.

2. Credibility


3. Sticky Inflation and Real Exchange Rate Overshooting

*OR, Ch. 9.


Buiter, W. and M. Miller (1981) "Real Exchange Rate Overshooting and the Output Costs of Bringing Down Inflation" in International Macroeconomics J. Frenkel (ed.).

VII. Exchange Rate Regimes

1. Regime Characteristics


2. **Shocks and the Insulating Properties of Alternative Regimes**


*HIE, Chapter 17, especially sections 5 and 6.


3. Credibility, Flexibility and Discipline


OR, Ch. 9, sections 9.4 and 9.5.


4. Imperfect Financial Markets and Monetary Policy


**Midterm**
VIII. Monetary and Fiscal Policy in the Open Economy

1. Basic Relations


*AM, Ch. 5

2. Fiscal Policy in the Open Economy Ramsey Model


3. Fiscal Policy and Monetarist Arithmetic


* AM, Ch. 5.3.2

OR, Ch. 8, section 2.


IX. Speculative Attacks and Currency Crises

1. Speculative Attacks: Background

*AM, Ch. 16.4

2. Speculative Attacks: First Generation

*OR, Ch. 8

* AM, Ch. 16.1

Garber, P. and L. Svensson, "The Operation and Collapse of Fixed Exchange Rates" in GR.


Third problem set

3. Speculative Attacks: Second Generation


*AM, Ch. 16.2


4. Speculative Attacks: Third Generation


Fourth problem set
X. **Capital Flows, Debt Maturity and Banks**

1. **The Problem**


*AM, Ch. 15


2. **Debt Maturity**


3. **The Role of Banks**


