SYLLABUS

One of the most salient facts of the 21st century is the global mobility of capital. International mutual funds have become commonplace. American investors can buy shares in Britain, Europe, Japan, China or even India with relative ease. Conversely, many traditional American brands are now wholly or partly foreign-owned. Household names like Budweiser (now owned by Belgian-Brazilian conglomerate InBev), GE Appliances (bought by China-based Qingdao Haier), and the Waldorf Astoria Hotel (now owned by the Chinese firm Anbang Insurance) are just a few examples.

Is this a good thing, or a bad thing? Is this cause for concern? Like most questions in economics, the answer is “Yes and No.” “No” in the sense that with increased capital mobility, money is able to seek its most efficient use. “Yes” in the sense that, with any financial crisis or downturn, the damage is not confined within a single boundary. The risk of contagion becomes very real. A downturn stemming from the subprime mortgage market in the U.S. reverberates throughout the financial markets in Europe and Asia. A slowdown in the Chinese economy can send American and European markets reeling.

The objective of this course is to give students some of the background and tools to analyze the interconnections of global finance. We will discuss exchange rates, the
financial dimension of the balance of payments, and the impact of international capital movements in a country's loanable funds market. Connections between interest rates, exchanges rates, and capital flows will be explored. One of the most important ideas in this regard is the interest parity condition, and we will examine this idea in some detail.

Unanticipated movements in exchange rates and capital flows can leave firms in a radically different financial situation than they had anticipated. Indeed, the economy of an entire country or region can be adversely affected. The late twentieth and early twenty-first century are replete with examples of this phenomenon. The Mexican peso crisis of 1995, the Asian currency crisis of 1997 – 1998, the Eurozone crisis which began in 2009 (but had roots going back, arguably, to the foundation of the EMU) – all are examples of the chaos attendant upon severe international financial disruptions. We will study possible responses on both the micro and macro level. In terms of the former, we will see how firms can, to some extent, shield themselves from some of the worst consequences of international financial turmoil. On the macro level, we will attempt to isolate the most important causes of instability, and see what can be done by countries and international organizations to mitigate it after it happens, and prevent it from happening again.

It is my hope that students will take away a solid understanding of the international financial system, an appreciation of its fragility, and a basis for the evaluation of some of the proposals for its melioration.

Readings

Most of the reading assignments are drawn from the textbook, *International Finance: Theory and Policy (10th ed.)*, by Paul Krugman, Maurice Obstfeld and Marc Melitz. The majority of the reading in the book reinforces material you'll learn in class, but some of the topics we cover may not appear in the book. Conversely, some of the assigned reading is for background, and will not be covered explicitly in class.

The rest of the reading will be drawn from recent newspaper and magazine articles and other books. These will announced as we consider the relevant topics, and *all* be available on the course Canvas site.
Course Requirements

- Exams

There will be two exams given in the course—a midterm and a final. The dates of the exams are:

**Midterm:** Thurs., Oct. 13 (covering the material from Aug. 30 through Oct. 6)

**Final:** Fri., Dec. 16, at 9 AM

*The final will be cumulative, but weighted 60% toward material covered after the midterm.*

Please Note:

- It is your responsibility to plan your travel ahead around exam dates. In particular, the date of the final exam is determined by the Registrar and cannot be changed for any reason.

- No makeup midterms will be given.

- Please see the section below on “Grading” to understand how your semester grade will be determined if you must miss the midterm *for any reason.*

- Problem Sets

There will be eight problem sets assigned in during the term. The problem sets will be available in the “Problem Sets” folder on the class Canvas site.

*Problem sets must be completed and submitted at the start of class on the dates detailed in the course calendar below.*

*The due date on problem sets cannot be extended for any reason.* However, the lowest two of the eight problem set scores will be dropped from the calculation of each student’s semester grade. So, if you cannot do one of the psets some week, that will just be one of the scores that gets dropped.
Grading

Your semester grade will be the higher of:

- 30% problem set scores
- 30% midterm exam
- 40% final exam

or

- 30% problem sets
- 70% final exam

So, if you do poorly on the midterm, **or are unable to take it for any reason**, your final exam will automatically be reweighted to be 70% of your semester grade, with the problem sets constituting the remaining 30%. We will make these calculations automatically for each student—you don’t have to “opt in” or “opt out” of one or the other weighting. We will make certain you receive the highest grade to which you are entitled.

**Requests for problem set or midterm exam re-grades must be submitted to the grader no later than one week after your work has been returned.** In order to allow for a timely and orderly response to your request, we must adhere to this policy **without exception**. We cannot accept re-grade requests made after these deadlines.

**Grading Mechanics: Assigning Letter Grades Based on a Curve**

Semester grades are determined by a curve. The nature of a curve is that your grade is based on your performance **relative to all other students in the class**. It does not involve an “absolute standard,” e.g., 90 – 100 = A, 80 – 90 = B, etc., which you may be used to from some other courses. I believe that a curve is ultimately the fairest way to determine grades, since it does not set some arbitrary absolute standard, but evaluates students on their performance relative to their peers.

With a curve, your grade is based on your percentile rank in the class, i.e., the percentage of students in the class who scored below you. If you are in the 60th percentile, for example, that means that 60% of students had scores equal to or below yours, while 40% of students had scores above yours.

**Calculation of Total Semester Points**

Your problem set average (dropping the two lowest) will be out of 100 pts. possible; your midterm will be out of 100 pts. possible; and your final will be out of 133.33 points possible. Alternatively, we will calculate your total semester points based on 100 pts. possible on the problem set average, and 233.33 pts. possible on the final. These two methods yield the two alternative weightings mentioned in the first paragraph of this
section. For each student, we will use whichever weighting results in a higher semester point total for that student.

For example, suppose you average 83/100 on your highest problem sets (dropping your lowest two) and 93/100 on your midterm. Now, let’s say there are 240 pts. possible on the final, and your score is 200/240 pts. Note that 200/240 = .833 (Meaning, you got 83.3% of the possible points on the exam). We would then multiply .833 by 133.33, and by 233.33, to calculate your total points using the two possible weightings on the final.

This would give you \( .833 \times 133.33 = 111.11 \) pts. weighting the final at 40%, and \( .833 \times 233.33 = 194.44 \) pts weighting the final at 70%.

So, for the semester, your total points would be \( 83 + 93 + 111.11 = 287.11 \) pts using the 30/30/40 weighting. Using the 30/70 weighting, your total points would be \( 83 + 194.44 = 277.44 \). So, we would use the 30/30/40 method, since it gives you higher total points.

**The Curve Used in Assigning Your Letter Grade for the Semester**

To determine your semester grade, we will employ the (very generous) curve given below:

<table>
<thead>
<tr>
<th>Letter Grade</th>
<th>Percentile Rank Range of Letter Grade</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>80th Percentile – 100th Percentile</td>
</tr>
<tr>
<td>A-</td>
<td>70th Percentile – 80th Percentile</td>
</tr>
<tr>
<td>B+</td>
<td>55th Percentile – 70th Percentile</td>
</tr>
<tr>
<td>B</td>
<td>45th Percentile – 55th Percentile</td>
</tr>
<tr>
<td>B-</td>
<td>35th Percentile – 45th Percentile</td>
</tr>
<tr>
<td>C+</td>
<td>25th Percentile – 35th Percentile</td>
</tr>
<tr>
<td>C</td>
<td>15th Percentile – 25th Percentile</td>
</tr>
<tr>
<td>C-</td>
<td>10th Percentile – 15th Percentile</td>
</tr>
<tr>
<td>D</td>
<td>5th Percentile – 10th Percentile</td>
</tr>
<tr>
<td>E/F</td>
<td>0th Percentile – 5th Percentile</td>
</tr>
</tbody>
</table>

To return to our example above: recall that your hypothetical semester point total is 287.11/333.33, and suppose that 43% of students had semester point totals higher than
yours (i.e. above 287.11), and therefore 57% had semester point totals less than or equal to yours (i.e. at or below 287.11). This means that you are in the 57th percentile overall. Your semester grade, then, would be a B+.

**Academic Integrity**

**Boston College takes matters of academic honesty very seriously.** While you may discuss problem sets with your classmates, you must write up your own answers. Use of old course materials, including problems sets and exams, and any other internet resources, is prohibited unless made available to all students by the instructor.

Examples of unacceptable conduct include plagiarism, copying and pasting answers from the internet, downloading answers to problem sets or exams from other students or the internet, collaborating on examinations, etc.

You should consult the website [http://www.bc.edu/offices/stserv/academic/integrity.html](http://www.bc.edu/offices/stserv/academic/integrity.html) to familiarize yourself with the College’s policies regarding academic integrity and possible serious consequences of academic dishonesty.

*In short, all work on problem sets and exams MUST be your own.*

**Accessibility**

Boston College is committed to providing an accessible academic environment. The Accessibility Office offers a variety of accommodations and services to students with documented disabilities. Please visit

[http://www.bc.edu/offices/dos/subsidiary_offices/disabilityservices.html](http://www.bc.edu/offices/dos/subsidiary_offices/disabilityservices.html)

for more information and resources for students with accessibility issues.
COURSE CALENDAR

Tues., Aug. 30  Introduction to International Finance
Course Overview

Thurs., Sept. 1  The Balance of Payments Accounts
The Current and Financial Accounts
Net Foreign Investment (NFI)
The Equality of Net Exports (NX) and Net Foreign Investment
Krugman, Obstfeld and Melitz:  pp. 24 – 35

Tues., Sept. 6  Open Economy Macroeconomics of Savings and Investment
The Loanable Funds Market
Private Savings, Public Savings, Investment and Capital Flows
Equilibrium in the Loanable Funds Market
Krugman, Obstfeld and Melitz:  pp. 11 – 24

Thurs., Sept. 8  Open Economy Macroeconomics of Savings and Investment (cont.)
The Feldstein-Horioka Hypothesis

Problem Set 1 Available on Course Canvas Site

The Mexican Peso Crisis of 1995
The Asian Currency Crisis of 1997 – 98

Thurs., Sept. 15  Exchange Rates and the Forex Market
Exchange Rates and Relative Prices
Spot Rates and Forward Rates
The Role of Arbitrage
Krugman, Obstfeld and Melitz:  pp. 40 – 48
Tues., Sept. 20  Equilibrium in the Foreign Exchange Market
Interest Parity
The Role of Expectations
The Carry Trade

Krugman, Obstfeld and Melitz:  pp. 59 – 74

Thurs., Sept. 22  Assets and Asset Returns
Risk and Liquidity
Interest Rates
Exchange Rates and Asset Returns

Krugman, Obstfeld and Melitz:  pp. 40 – 58

**PS 1 Due**
*Problem Set 2 Available on Course Canvas Site*

Tues., Sept. 27  Foreign Exchange Derivatives
Options
Calls and Puts
Intrinsic Value and Time Value
Hockey Stick Diagrams

Krugman, Obstfeld and Melitz:  pp. 49 – 50

Thurs., Sept. 29  Foreign Exchange Derivatives (cont.)
Options (cont.)
Forward Contracts
Futures Contracts
Swaps

**PS 2 Due**
*Problem Set 3 Available on Course Canvas Site*

Tues., Oct. 4  Money, Interest Rates and Exchange Rates
Money Demand and Money Supply
Interest Rate Determination:  Equilibrium in the Money Market
The Money Supply and the Exchange Rate in the Short Run

Krugman, Obstfeld and Melitz:  pp. 77 – 91
Thurs., Oct. 6  Money, the Price Level and the Exchange Rate in the Long Run
Inflation and Exchange Rates

Krugman, Obstfeld and Melitz:   pp. 92 – 106

**PS 3 Due**
*Problem Set 4 Available on Course Canvas Site*

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Tues., Oct. 11  No Class: Review Video for the Midterm

**PS 4 Due**

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Thurs., Oct. 13  Midterm  (covering the material from Aug. 30 to Oct. 6)

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Tues., Oct. 18  Price Levels and the Exchange Rate in the Long Run
Purchasing Power Parity (PPP)
A PPP-based Model of Exchange Rates
Problems with PPP

Krugman, Obstfeld and Melitz:   pp. 111 – 129

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Thurs., Oct. 20  A General Model of Long-Run Exchange Rates
International Interest Rate Differences and the Real Exchange Rate
Real Interest Parity

Krugman, Obstfeld and Melitz:   pp. 130 – 146

*Problem Set 5 Available on Class Canvas Site*

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Tues., Oct. 25  Output and the Exchange Rate in the Short Run
Aggregate Demand
Asset Market Equilibrium
Short-run Equilibrium for an Open Economy
Monetary and Fiscal Policy

Krugman, Obstfeld and Melitz:   pp. 149 – 175
Thurs., Oct. 27  Macroeconomic Policies and the Current Account
Trade Flow Adjustment and Current Account Dynamics
The J-Curve

Krugman, Obstfeld and Melitz:  pp. 175 – 193

**PS 5 Due**
*Problem Set 6 Available on Course Canvas Site*

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Tues., Nov. 1  Exchange-Rate Regimes
Fixed Exchange Rates
  Central Bank Intervention and the Money Supply
  Fixed Exchange Rate Mechanics
  Stabilization Policies Under a Fixed Exchange Rate Regime

Krugman, Obstfeld and Melitz:  pp. 193 – 207

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Thurs., Nov. 3  Equilibrium in the Forex Market with Imperfect Asset Substitutability

Krugman, Obstfeld and Melitz:  pp. 207 – 233

**PS 6 Due**
*Problem Set 7 Available on Course Canvas Site*

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Tues., Nov. 8  International Monetary Systems: An Historical Overview
International Macro Policy Under the Gold Standard
The Bretton Woods System
Policy Options for Reaching Internal and External Balance

Krugman, Obstfeld and Melitz:  pp. 236 – 265

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Thurs., Nov. 10  The Case for Floating Exchange Rates

Krugman, Obstfeld and Melitz:  pp. 266 – 292

**PS 7 Due**
Tues., Nov. 15  The International Capital Market and the Gains from Trade
International Banking and the International Capital Market

Krugman, Obstfeld and Melitz:  pp. 295 – 309

Thurs., Nov. 17  Multinational Banking
Regulatory Issues
Questions of Efficiency

Krugman, Obstfeld and Melitz:  pp. 310 – 327

Tues., Nov. 22  The Theory of Optimal Currency Areas
Optimal Currency Areas
The Euro
Crises in the Euro Area

Krugman, Obstfeld and Melitz:  pp. 332 – 363

Tues., Nov. 29  The Euro (cont.)
Crises in the Euro Area

*Problem Set 8 Available on Class Canvas Site*

Thurs., Dec. 1  International Finance in the Age of Crisis and Terrorism

Tues., Dec. 6  Review Session for the Final Exam

Thurs., Dec. 8  Review Session for the Final Exam

*PS 8 Due*

Fri., Dec. 16  Final Exam (*cumulative; weighted 60% on material since the
9:00 – 11:00  midterm, 40% on material covered by the midterm*)