Econ BC 3038 | BARNARD COLLEGE | A. Burgstaller
Fall 2020 | Department of Economics | ab411@columbia.edu

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 international flows of goods and services. Rather, it is driven by transactions of arbitrageurs and speculators, who are in charge of maximizing the rate of return on wealth holders' portfolios—that is, on *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 the foreign exchange market in order to trade them. In sum, the foreign exchange market proximately links national financial markets (money, bond, and stock markets), not national goods markets. According to this view, international imbalances in goods trade and real shocks such as changes in tariffs, the price of oil, or productivity affect nominal 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 (instead of the exchange rate) 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, as well as developments in the ongoing financial and economic crisis, to which reference will be made throughout the course.

Prerequisites:
Intermediate macroeconomics

Readings:
(1) Course textbook: P. Krugman, M. Obstfeld, and M. Melitz, *International Economics*, Pearson; any edition between the 8th [2008] and the 10th [2014] will do (do not buy the 11th [2017] edition).
Students should read the relevant chapter in the textbook (denoted K/O henceforth) before the corresponding lecture.
(2) Class notes: those marked with an asterisk in the course outline below are required. In them is summarized lecture material that goes beyond K/O and is essential to the course; though they are terse and not always self-explanatory, the class notes should be glanced over ahead of class.
(3) Frequent reference will be made to current economic events and it is imperative that students keep abreast of these by perusal of an appropriate daily (*FT, WSJ, NYT*) or weekly (*Economist*) periodical.
(4) Unlike K/O and asterisked class notes, which are required, other items listed in the course outline below are suggested only; they either provide an alternative textbook treatment (e.g. Isard, Levi) or constitute an accessible seminal contribution (e.g. Cassel, Keynes, Meade, Mundell).

Problem sets and recitation:

Assigned 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 discussed during the weekly recitation. The latter, run by the TA, will as well answer student questions raised by the lectures and help students prepare for the two course examinations.

Quizzes:

There will be some unannounced quizzes, with answers due in the subsequent class.

Grading:

Midterm exam 40%, final exam 45%, problem sets, quizzes, and class participation 15% (prorated at 5% each).

Schedule of topics and dates:

1. 9/8 Course Organization and Introduction
   K/O ch.1

2. 9/10 – 9/15 National Income Accounting and the Balance of Payments
   K/O ch. 13
   Class note ch. 13:* Notes on ch. 13 (formerly ch. 12)
   Levi, M.D. (2009), *International Finance*, 5th ed., Routledge, ch. 7
   Meade, J.E. (1952), *The Balance of Payments*, Oxford, chs. 1-3

3. 9/17 – 10/1 Exchange Rates and the Foreign Exchange Market
   K/O ch. 14 and appendix
   Class notes ch. 14:* A. Notes on ch. 14 (formerly ch. 13)
   B1. Rational expectations I: exchange rate dynamics – an example by Jiahui Shen
   B2. Rational expectations IIa: asset price dynamics – a glossary of terms
   B3. Rational expectations IIb: asset price dynamics – three exercises
   Isard, P. (1995), *Exchange Rate Economics*, Cambridge, ch. 2
   Keynes, J.M. (1923), *A Tract on Monetary Reform*, Macmillan, ch. 3
   Levi, M.D., *op. cit.*, chs. 2-4

4. 10/6 - 10/13 Money, Interest Rates, and Exchange Rates
   K/O ch. 15
   Class notes ch. 15:* A. Notes on ch. 15 (formerly ch. 14)
   B. On notational differences with Econ BC3033
   C. Determination of the long-run real interest rate (from Econ BC3033)
   Dornbusch, R. (1976), Expectations and exchange rate dynamics, *J. of Pol. Econ.*84: 1161-76
   Isard, P., *op. cit.*, chs. 5-7
   Levi, M.D., *op. cit.*, chs. 6, 9

5. 10/15 - 11/10 Price Levels and the Long-Run Exchange Rate

K/O ch. 16 and appendix

Class notes ch. 16 (as indicated, only A. through E. are required):

A.* What determines the long-run nominal exchange rate?

B.* The identity $E_{€}^{\$} \equiv \tilde{q} P_I^{US} \big/ P_I^{E}$ and its causal interpretation

C.* Price indices and the real exchange rate

D.* Inflationary dynamics

E.* The inflation tax

F. Real and nominal interest rates

G. Logarithms and money supply growth

H. Inflationary long run equilibrium

I. Inflation and deflation, benign and malign

J. Debt dynamics: the basics

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

Levi, M.D., *op. cit.*, ch. 5

6. 10/29 Midterm examination

7. 11/12 - 12/3 Output and the Exchange Rate in the Short Run

K/O ch. 17 and its three appendices

8. 12/8 - 12/10 Fixed Exchange Rates

K/O ch. 18 and its three appendices

Class note ch. 18:* Fixed exchange rates

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