

Revised September, 2010

ECO2305 H,F Topics in International Finance

Fall 2010

Course Meets Wednsdays, 9am-11am, room GE-100

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Office hours: by appointment

COURSE OBJECTIVES

The course is aimed at graduate students intending to do research in international finance or related areas, and/or wanting to understand thoroughly those models. The course will be theoretical, rather than empirical, but it should provide a basis for subsequent applied work. We will rigorously work through several key models that are the subject of active research in the following areas:

Currency crisis and contagion: the course will work through the details of first, second, and third generation models and consider their relevance for the currency crises of the 1990s. In addition, the models will be extended to consider contagion effects.

International policy coordination: the extent of cross-country spillovers determines the size of the gains from coordination: Nash and cooperative equilibria will be compared. However, in the face of other distortions, coordination can be welfare-decreasing. We will consider the prospects for international policy coordination of financial regulation in the context of the current financial crisis.

Currency unions: these models consider the interaction of monetary and fiscal policies in a monetary union, when sovereign countries share the same currency. The cases of the euro area and African monetary unions will be discussed.

Sovereign lending and conditionality: is international lending too low? Why do borrowers repay at all? Sovereign governments' policies contribute to whether they can repay their international lending, but inadequate enforcement or punishment mechanisms may restrict willingness to lend to them. The actual operation and *potential* role for international financial institutions will be discussed.

PREREQUISITES

The student should have taken and done well on an upper-level undergraduate or graduate international macro course. He or she should feel comfortable using calculus and game theory, and be interested in and able to manipulate economic models.

COURSE STRUCTURE AND MATERIALS

The textbook for the course is *Lectures in International Finance*, by Paul Masson, published by World Scientific in 2007. Copies are available at the UofT bookstore.

EVALUATION AND GRADING

There will be a mid-term exam on November 3rd and a final exam during exam period in December to be scheduled later. In addition, a major part of the grade will involve each student writing a paper that applies some of the models studied in the course to a particular financial crisis. Students will present their findings in class, and the assessment of the oral presentation will be part of the grade.

Mid-term exam	20 percent of grade
Class presentation/paper	40 percent of grade
Final exam	40 percent of grade

COURSE OUTLINE (references to Required Reading are to chapters of the assigned textbook; additional readings referred to below and in the textbook are generally available online through UofT library access)

Week 1 (September 15): Overview of the course, basic concepts, discussion of practical relevance of the models to be covered.

Required Reading: Introduction

Weeks 2-4 (September 22 and 29, and Oct. 6). Currency crisis and contagion models
Required Reading: chapters 1-3

Additional Readings:

Different generations of currency crisis models

K. Blackburn and M. Sola, "Speculative Currency Attacks and Balance of Payments Crises," *Journal of Economic Surveys*, vol. 7(2), 1993.

J. Rangvid, "Second Generation Models of Currency Crises", *Journal of Economic Surveys*, vol. 15, December 2001.

Unique or multiple equilibria

S. Morris and H.S. Shin, "Rethinking Multiple Equilibria in Macroeconomic Modeling" *NBER Macroeconomics Annual 2000*, and comments by A. Atkeson and H. Rey

G-M Angeletos and I. Werning, "Crises and Prices: Information Aggregation, Multiplicity and Volatility," NBER Working Paper 11015, December 2004.

C. Hellwig, A. Mukherji, and A. Tsyvinski, "Self-Fulfilling Currency Crises: The Role of Interest Rates," *American Economic Review*, vol. 96(5), pages 1769-1787, December 2006.

Contagion

P. Masson, "Contagion: Macroeconomic Models with Multiple Equilibria," *Journal of International Money and Finance*, vol. 18, pages 587-602, 1999 (copies to be handed out in class)

Marcello Pericoli & Massimo Sbracia, "A Primer on Financial Contagion," *Journal of Economic Surveys*, vol. 17(4), pages 571-608, 2003.

Weeks 5-6 (October 13 and 20). International Economic Policy Coordination

Required Reading: chapters 4-5

Additional Readings:

P. Masson and John Pattison, "Financial Regulatory Reform: Using Models to Evaluate Current Prospects for International Agreement," *Journal of Economic Asymmetries*, December 2009 (to be posted on Blackboard).

Weeks 7-8 (October 27 and November 10). Regional Currencies and Optimum Currency Areas

Required Reading: chapters 6-7

Additional Readings:

R. Beetsma and L. Bovenberg, "Monetary Union without Coordination May Discipline Fiscal Policymakers," *Journal of International Economics*, 1998

Z. Darvas, "Fiscal Federalism in Crisis: Lessons for Europe from the US," *Breugel Policy Contribution*, No. 7, July 2010 (to be posted on Blackboard).

Week 9 (November 3). Mid-term Exam (in class)

Week 10 (November 17). Presentations in class of student papers

Weeks 11-12 (November 24 and December 1). Sovereign Lending

Required Reading: chapters 8-9

Additional Readings:

Michael Bleaney, "The terms of trade, repudiation and default on sovereign debt," *Economics Bulletin*, vol. 6(22), pages 1-8, 2008.

Alfaro, Laura & Kanczuk, Fabio, "Sovereign debt as a contingent claim: a quantitative approach," *Journal of International Economics*, vol. 65(2), pages 297-314, March 2005.

J. Sachs, "Theoretical Issues in International Borrowing," *Princeton Studies in International Finance*, No. 54, July 1984.

Week 13 (December 8). International Financial Institutions and International Monetary System Reform

Required Reading: chapter 10

Additional Readings:

S. Marchesi and J. Thomas, "IMF Conditionality as a Screening Device," *Economic Journal*, March 1999.

Fischer, S., "On the need for an international lender of last resort" *Journal of Economic Perspectives* 1999

N. Roubini, "Do We Need a New Bankruptcy Regime?" *Brookings Papers on Economic Activity*, no. 1, 2002

P. Masson, "Exchange Rate Regime Transitions," *Journal of Development Economics*, vol. 64, pages 571-86, 2001 (to be handed out in class).