Course objective: To learn the theory and practice of international finance and its application to business and economic policy. Primarily a lecture course, students will present solutions to several Harvard Business School Cases on cross border valuation and investment, as well as on global mergers and acquisitions.

Description: *International Finance* provides a working knowledge of international financial issues, theories, concepts and practice. The first part of the course examines the mechanics of the foreign exchange market, reviewing spot, forwards, futures and options. The second part of the course constructs the four building blocks of international finance: interest rate parity (covered and uncovered interest rate arbitrage), purchasing power parity, the international Fisher (expectations) effect, and asset market equilibrium (money market and exchange market equilibrium). The role of the money supply in exchange rate and price level determination according to interest rate parity is stressed. The case for common currencies is reviewed. In the third part of the course, currency risk management is explored in detail. We then analyze Ponzi schemes and other fraudulent financial practices. We conclude with a review of financial leverage, moral hazard and the financial crisis of 2008-2009.

Instructor: Michael Connolly michael.connolly@duke.edu.


Outline of topics:

1. Features of international finance
   - Currencies 1
   - Accounting rules 2
   - Stakeholders 3
   - Legal framework 3
   - Institutional framework 4
   - Language 5
   - Taxation 6
   - Regulatory framework 7
   - Political risk 10
   - Intellectual property rights 11

2. History of money, finance and seigniorage
   - Prerequisites of good money 15
   - Money and exchange rates 16
   - History of monies 17
   - Foreign exchange history 23
   - Banks and banking 25
   - The Federal Reserve System 26
   - The international monetary institutions 27
   - History of the stock exchanges 29
3. The foreign exchange market

- A floating exchange rate system 42
- A fixed exchange rate system 45
- The Euro—"irrevocably fixed" exchange rates 53
- The Chinese yuan 57
- The SWIFT international clearing system 60
- Theories of the long-run movement of exchange rates 61
- Purchasing power parity 61
- The monetary approach to the exchange rate 66
- The IMF's real effective exchange rate 70
- Foreign currency futures versus forward contracts 71
- Forwards and futures in commodities 74
- Arbitrage determination of the spot and future rates 78
- Exchange rate forecasting 87
- Random investing 89

4. Hedging foreign exchange risk

- Hedging defined 113
- Credit ratings 116
- Default risk premium 121
- Hedging foreign exchange transactions exposure 123
- Related techniques for hedging foreign exchange risk 133
- Hedging operating exposure 135
- Foreign currency swaps 140
- Back-to-back (parallel) loans 141
- Accounting exposure 142
- Financial Accounting Standards Board—FASB 52 142
- Hedge accounting 143
- Trade finance 144
- Hedging interest rate exposure 145
- Reference rates 146
- Forecasting forward interest rates 147
- The yield curve 147
- A strip of the yield curve 148
- Appendix: Risk and Insurance 155
5. Money and Financial Management
   - Capital structure 167
   - Cross-listing on foreign stock exchanges 170
   - International liquidity and market integration 171
   - Transfer pricing 171
   - International taxation 175
   - Working capital management 178
   - International mergers and acquisitions 180
   - Offshore banking 187
   - An international business plan - the Azteca Café 194
   - Optimal investment analysis 196

6. International financial scams and swindles
   - Pyramids: an international perspective 221
   - Corporate governance failures 231
   - The Sarbanes-Oxley Act of 2002 237
   - Lessons learned 256

7. Financial leverage, moral hazard and counterparty risk
   - The financial crisis of 2007-2009
     - Financial leverage 262
     - Securitization 265
     - Leveraged households 267
     - The role of the government: Fannie Mae and Freddie Mac 268
     - Rising and falling home equity 269
     - Strategic default 274
     - Counter-party risk 280
     - Leveraged financial institutions 281
     - The bankruptcy of Lehman Brothers 283
     - The macro-economic impact of the financial crisis 288
     - The Volcker Rule 292
     - The Dodd-Frank Regulatory Bill 295

8. Appendix. The time value of money 300

9. Solutions to problems 316
About the instructor

● **Education**
  Ph.D., Economics, University of Chicago  
  Doctoral thesis advisor: Robert A. Mundell 1999 Nobel Prize Laureate  
  B.A., Economics, *Phi Beta Kappa*, UC Berkeley

● **Current positions and honors**
  Professor of Economics, University of Miami  
  Professor of Finance, Hunan University, Changsha, PRC  
  Honorary Doctorate, Universidad Norbert Wiener, Lima, Perú.  
  Author of over 50 articles, three books authored and four edited.  

● **Recent publications**

● **Fulbright Teaching Awards:**
  *Instituto de Economía de Lisboa*, Portugal, 1996

● **Other teaching:**
  *Université de Cocody*, Abidjan, Ivory Coast (in French) (2003-13)  
  *Université de Yaoundé*, Cameroon (in French) (2003-05),  
  *University of Uppsala*, Sweden (1974),  
  *Université de Genève*, Switzerland (1972-73)  
  *The Johns Hopkins Bologna Center*, Italy. (1962-63)  

● **Business experience:**