

International Finance

Fifth edition

Maurice D. Levi

Bank of Montreal Professor of International Finance
Sauder School of Business
University of British Columbia



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About the author

Since receiving his Ph.D. from the University of Chicago, Maurice Levi has taught and written research papers in a wide variety of areas of finance and economics. This broad range of research and teaching interests form the foundation for this book on international finance, a subject that he believes to be best treated as an application of financial and economic principles, rather than as a separate and isolated subject area.

Professor Levi has published research papers on financial market anomalies, the effectiveness of monetary and fiscal policy, the relationship between inflation and interest rates, the effect of taxes on international capital flows, and the link between inflationary expectations and unemployment, as well as in numerous areas of international finance that are reflected in this book. He has also written in the areas of econometric methods, macroeconomics, labor economics, environmental economics, money and banking, and regional economics. His papers have appeared in just about every leading research journal in finance and economics, including: *American Economic Review*; *Econometrica*; *Journal of Political Economy*; *Journal of Finance*; *Journal of Monetary Economics*; *Journal of Money, Credit and Banking*; *Journal of International Money and Finance*; *Journal of International Economics*; *Review of International Economics*; *Management Science*; *Ecological Economics*; and *Journal of Econometrics*. He is also the author of *Economics and the Modern World* (Heath, Lexington, MA, 1994), *Economics Deciphered: A Layman's Survival Guide* (Basic Books, New York, 1981), and *Thinking Economically* (Basic Books, New York, 1985), and the coauthor, with M. Kupferman, of *Slowth* (Wiley, New York, 1980).

Since joining the Sauder School of Business of the University of British Columbia, Professor Levi has held visiting positions at the Hebrew University of Jerusalem, the University of California, Berkeley, MIT, the National Bureau of Economic Research, the University of Exeter, University of New South Wales, and the London Business School. He has received numerous academic prizes and awards including Killam and Nomura Fellowships and the Bronfman Award.



Preface

This book is intended for use in business and economics courses in international finance at the masters or senior-undergraduate level. It is comprehensive, covering the financial markets, economic environment and management of multinational business. It is designed to be used in its entirety in courses that cover all areas of international finance, or selectively in courses dealing with only the financial markets and economic environment, or the financial management of multinational business. To facilitate the selective use of the book in the two major subdivisions of international finance, this fifth edition is divided into two self-contained segments.

The book is specifically designed for students who have taken introductory economics and finance, and who wish to build upon the basic economic and financial principles they have acquired. By assuming these fundamental prerequisites, this book is able to go further than competing texts in international finance. It is able to introduce the student to the new and exciting discoveries and developments in this dynamic and rapidly expanding field. These discoveries and developments, many of which have occurred during the last few years, are extensions of the principles of finance and economics.

With a growing component of commerce taking on international proportions, an increasing number of students have more than an academic interest in the subjects they take. After graduation, many will find they need to apply directly what they have learned. Consequently, a good textbook in international finance must cover practical managerial topics such as how to evaluate foreign investment opportunities, where to borrow and invest, how exchange rates affect cash flows, how to measure foreign exchange exposure and risk, what can be done to avoid exposure and risk, and the general financial management problems of doing business in the global environment. However, even these highly practical topics can be properly dealt with only by applying basic economic and financial principles that many other international finance textbooks appear reluctant to employ. As a result, despite adequate levels of preparation, the student often receives a rather shallow treatment of international financial applications that fails to build on the foundations of previous courses. For this reason, many senior-undergraduate- and masters-level students with solid backgrounds in, for example, the consequences of arbitrage or the principles of capital budgeting feel they stop short of the frontiers of international finance.

This book represents a major revision and updating of the fourth edition of *International Finance*. In the fourth edition a large amount of material on the international financial environment was covered separately in three lengthy chapters at the very end of the book. Only two short chapters on the balance of payments and on the simple supply and demand view of exchange rates were included early in the book. This meant that such matters as modern theories of the determination of exchange rates and the evolution of the international financial system were split into two disconnected parts. Instructors wanting to cover, for example, the case for fixed versus flexible exchange rates or the conditions for success of a common currency had to jump

between chapters. In response to requests by several instructors who preferred the organization in earlier editions of this book, all the material on the “big picture” of the international financial environment has been grouped together in one integrated section. This section now also includes a chapter on open economy macroeconomics that discusses the effectiveness of monetary and fiscal policy under fixed and flexible exchange rates. This international environment section comes after the markets have been discussed and before the section on the financial management of multinational business. However, care has been taken so that in courses taking a managerial finance perspective, all or part of the section on the international financial environment can be skipped without loss of continuity.

As with previous editions, a substantial revision has been necessary because the international financial developments that are occurring are nothing short of spectacular. For example, new markets and instruments are emerging at a frantic pace, in part as a response to exchange rates that at times have been so volatile they have grabbed the headlines, not of the business section of the newspaper, but of the front page. The day-to-day lives of people have been affected by events such as the introduction of the euro which represents an unprecedented experiment in international financial cooperation, and the emergence of new economic superpowers such as China and India. Liquidity crises such as that associated with the sub-prime mortgage situation have been linked to huge changes in exchange rates. Great fortunes have been made and lost in foreign exchange. News reports have also been full of exchange rate crises, and economic summits dealing with the architecture of the international economic system. At the same time, there has been an explosion of research in international finance. The revisions in this fifth edition of *International Finance* reflect the important recent developments and research that have sharpened the insights from studying this dynamic subject.

This book has evolved over a number of years while teaching or doing research at the Sauder School of Business at the University of British Columbia and also at the Hebrew University, Jerusalem; the University of California, Berkeley; the Massachusetts Institute of Technology; the London Business School; the University of New South Wales; and the University of Exeter. I am indebted to all these institutions, especially the Sauder School of Business, which has been my home base for over three decades.

An author's debts are a pleasure to acknowledge, and in the course of five editions of this book I have incurred many I would find difficult to repay. A large debt is owed to my colleague Ali Lazrak, who has provided valuable comments. The help offered by reviewers has also been immensely important in improving the final product. Only the anonymity of the individual reviews prevents me from apportioning the vast credit due to them. My wife, Kate, sons Adam and Jonathan, and daughter Naomi have provided professional and indispensable help in preparing the manuscript. Too numerous to mention individually but of great importance were the students in my MBA and undergraduate courses in international finance at the University of British Columbia, whose reactions have been a crucial ingredient in the revision of this text.

It is to my wife, Kate, that I owe my greatest thanks. In addition to playing a vital role in preparing and checking the manuscript she has provided the moral support and encouragement that have made this fifth venture a generally agreeable task.

Maurice Levi
Vancouver, B.C.