

**Course Syllabus
Spring Semester 2012**

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“The essence of this-time-is-different syndrome is simple. It is rooted in the firmly held belief that financial crises are things that happen to other people in other countries at other times; crises do not happen to us here and now. We are doing things better, we are smarter, we have learned from our past mistakes. The old rules of valuation no longer apply. Unfortunately, a highly leveraged economy can unwittingly be sitting with its back at the edge of a financial cliff for many years before chance and circumstance provokes a crisis of confidence that pushes it off.” Reinhart & Rogoff (2009)

Course Description:

While many emerging and developed economies had been hit by severe financial crisis in the last several decades, until a couple of years ago the U.S. appeared crisis-proof. Then, in 2008, the sub-prime mortgage debacle crippled the U.S. financial markets causing the largest worldwide economic recession in eighty years. This course explores in depth the causes and consequences of economic and financial crises in general, the contagion of such crises into other countries, and the policies used or proposed to prevent similar crises in the future. To help us gain a broader perspective on the causes and “fixes” of the U.S. crisis of the last couple of years and of the current European crisis, we will examine numerous historical crises in hopes of drawing parallels that may help to guide future economic policy. After completion of this course you will have a fuller understanding of what really happened. You will be able to critically examine comments made by so called "market experts" concerning the crisis and the government's response. And, you will have a framework for understanding future crises when they inevitably occur (Those are the goals anyway!).

Course Outline: FOUR MODULES

Module I: *Theoretical Foundations for Studying Financial Crises*

- 1) Introduction to the Financial System
- 2) Asset Prices and Interest Rates
- 3) Securities Markets
- 4) Banking
- 5) The IS-LM Model (closed economy)
- 6) The Mundell-Fleming Model (open economy)
- 7) The Diamond-Dybvig Banking Model
- 8) Models of Asset Price “Bubbles”

Much of the material will be synopsized in a series of slides. These slides will be posted on the class website.

After reviewing these theories and supporting material, there will be an exam which will test your knowledge of the theoretical material.

We will first review these theories, and then use them to analyze various crises in history.

Readings: Refer to website

Exam: Covers models presented in class (25% of grade)

Module II: This Time is Different: *Historical Study of Financial Crises*

Your extensive knowledge of the various theories covered in Module I will allow you to better analyze actual crises in history. To that end, you will team up in pairs and prepare a brief (6-7 pages in length) concerning an actual crisis in history. You should address questions like what happened, what country-specific institutions helped or hindered economic recovery, and what you as a policy-maker would have done differently.

Readings: Refer to website

Group presentation and paper: Analyze the causes and consequences of “Crisis X.”
Details to follow. (15% of grade)

Module III: This Time is Different: *Empirical Study of Financial Crises.*

Here we will do what economists love to do – bring our ideas to the data. You will get down and dirty with a panel dataset, spanning 200 years and over 80 countries. Again in groups of two, you and a partner will develop an empirical model, test the model, create estimates and write up your results in a brief (6-8 pages). Some of our tasks include:

- 1) Gathering and organizing data
- 2) A quick primer on panel regression analysis
- 3) Producing and interpreting results

Readings: Refer to website

Group presentation and paper: Develop an empirical model of the determinants of financial crises (20% of grade)

Module IV: *All Together Now* - The 2008 Financial Crisis (Second Great Contraction)

We are still in the midst of the worst economic contraction since the Great Depression of the 1930s. Why? Does the crisis of 2008 account for our current economic pain? What policies would you recommend to prevent such a disaster from occurring again? Here you will utilize all your insights garnered from the first three modules to answer these critical and challenging questions. The outline of our approach is as follows:

- 1) Defining and Sequencing the Crisis:
 - a) What happened?
 - b) What types of sub-crises occurred (banking, currency, asset, debt, etc.)?
 - c) What happened when?
 - d) How were these sub-crises linked?
- 2) The Role of Institutions (the IMF, central banks, governments, etc.)
- 3) What regulations should be imposed to help us deal with future crises?

Readings:

“The Aftermath of Financial Crises” by Carmen Reinhart and Kenneth Rogoff

“Barack Obama and the Bush Tax Cuts” by Matthew Weinzierl and Eric Werker

“The Financial Crisis of 2008” by Gunnar Trumbull

“U.S. Subprime Mortgage Crisis: Policy Reactions (B)” by Laura Alfaro and Renee Kim

“Financial Crisis in Asia: 1997-1998 (Abridged)” by Huw Pill and Rafael Di Tella

Group paper: Analyzing the Financial Crisis of 2008. Details to follow (15% of grade)

Exam: Covers the whole shebang, with particular emphasis on Module IV (25% of grade)

Grades:

Exams: 50% (Total of 2)

Projects: 50% (Total of 3)

6-week grade includes Exam#1 and Project#1

12-week grade includes Project #2

Examples of Global or Multi-country Economic Crises in History

Episode	Type	Global financial center(s) most affected	At least two distinct regions	What happened?
The crisis of 1825-1826	Global	United Kingdom	Europe and Latin America	Greece and Portugal defaulted, as did practically all of newly independent Latin America
The panic of 1907	Global	United States	Europe, Asia, and Latin America	Notably France, Italy, Japan, Mexico, and Chile suffered from banking panics
The Great Depression, 1929-1938	Global	United States and France	All regions	With the exception of high inflation, all crisis manifestations were present
Debt crisis of the 1980s	Multi-country (developing countries and emerging markets)	United States (affected, but crisis was not systemic)	Developing countries in Africa, Latin America, and to a lesser extent Asia	Sovereign default, currency crashes, and high inflation were rampant
The Asian crisis of 1997-1998	Multi-country, extending beyond Asia in 1998	Japan (affected, but by then it was five years into the resolution of its own systemic banking crisis)	Asia, Europe, and Latin America	Affected Southeast Asia initially. By 1998, Russia, Ukraine, Columbia, and Brazil were affected

source: Reinhart and Rogoff (2009)