The 2008 Financial Crisis in Perspective:  
What can 400 years of economic crises tell us about the current crisis?  
Spring 2010 FE486B

Ahmed Rahman  
Office: Nimitz G029  
Phone: 410-293-6897  
E-mail: rahman@usna.edu  
Office hours: Wed/Fri 2:30-3:30  
http://www.usna.edu/Users/econ/rahman/

Katherine Smith  
Office: Nimitz G039  
Phone: 410-293-6882  
E-mail: ksmith@usna.edu  
Office hours: Tues 11-12 or Fri. 1:30-2:30.  
http://www.usna.edu/Users/econ/ksmith/

“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 last year the US was seemingly 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 of economic and financial crises, 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 current U.S. 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: Major Financial Crises (Inflation/currency crashes/currency debasements/asset price bubbles/banking crisis/external debt crisis/domestic debt crisis)

1) The Market for Loan-able Funds (closed and open economies)
2) The IS-LM Model (closed economy)
3) The Mundell-Fleming Model (open economy)
4) The Diamond-Dybvig Banking Model

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

Readings: Refer to website
Quiz: Covers models presented in class (10% of grade)
Group presentation and paper: Analyze the Causes and Consequences of “Crisis X.” Details to follow. (20% of grade)

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

1) Gathering and organizing data
2) A quick primer on regression analysis

Readings: Refer to website
Group presentation and paper: Develop an empirical model of the determinants of “Crisis X.” (20% of grade)

Module III: The 2008 Financial Crisis (Second Great Contraction)

Defining and Sequencing the Crisis:
1) What Happened?
2) What types of sub-crises occurred (Banking-Currency-Asset Pricing-Housing Market-Macro-Global)?
3) What happened when?
4) How were these sub-crises linked?

Modeling the 2008 Crisis:
Readings: Refer to website
Assignment: Create your own timeline
Quiz: Covers models presented in class (10% of grade)
Group presentation and paper: Explore and analyze a particular sub-crisis. Details to follow. (20% of grade)
Module IV: What Have We Learned? Preventing Future Crises

1) Crises and Institutions
   - Role of the IMF
   - Role of the Central Bank
   - Role of the Government
   - Role of Cross Country Policy Coordination

2) The “R” Word-
   - Can further regulating our financial market help?
   - What types of regulations are likely to be more effective?

Readings: Refer to website
Group presentation and paper: Take one of the current regulatory changes being proposed and in context of a model discuss and analyze the likely impacts on the economy. (20% of grade)

Grades:

Quizzes: 10% (Total of 2)
Projects: 20% (Total of 4)

6-week grade includes Quiz#1 and Project#1
12-week grade includes Quiz#1, #2, Project #1, Project #2
<table>
<thead>
<tr>
<th>Episode</th>
<th>Type</th>
<th>Global financial center(s) most affected</th>
<th>At least two distinct regions</th>
<th>What happened?</th>
</tr>
</thead>
<tbody>
<tr>
<td>The crisis of 1825-1826</td>
<td>Global</td>
<td>United Kingdom</td>
<td>Europe and Latin America</td>
<td>Greece and Portugal defaulted, as did practically all of newly independent Latin America</td>
</tr>
<tr>
<td>The panic of 1907</td>
<td>Global</td>
<td>United States</td>
<td>Europe, Asia, and Latin America</td>
<td>Notably France, Italy, Japan, Mexico, and Chile suffered from banking panics</td>
</tr>
<tr>
<td>The Great Depression, 1929-1938</td>
<td>Global</td>
<td>United States and France</td>
<td>All regions</td>
<td>With the exception of high inflation, all crisis manifestations were present</td>
</tr>
<tr>
<td>Debt crisis of the 1980s</td>
<td>Multi-country (developing countries and emerging markets)</td>
<td>United States (affected, but crisis was not systemic)</td>
<td>Developing countries in Africa, Latin America, and to a lesser extent Asia</td>
<td>Sovereign default, currency crashes, and high inflation were rampant</td>
</tr>
<tr>
<td>The Asian crisis of 1997-1998</td>
<td>Multi-country, extending beyond Asia in 1998</td>
<td>Japan (affected, but by then it was five years into the resolution of its own systemic banking crisis)</td>
<td>Asia, Europe, and Latin America</td>
<td>Affected Southeast Asia initially. By 1998, Russia, Ukraine, Columbia, and Brazil were affected</td>
</tr>
</tbody>
</table>

*source: Reinhart and Rogoff (2009)*