

Econ 497
Finance and Financial Crises
SPRING 2007

Instructor: Barry W. Ickes, 618 Kern Building, email: bwickes@psu.edu.

Time and Location: T, Th 4:15-5:00, 413 Kern Building.

Office Hours: Tuesday 1:00 - 2:00
Wednesday 10:00 - 11:00.

Textbook: Bodie, Kane, Marcus, *Investments*. 7th edition, Irwin (BKM). Blustein, Paul, *And the Money Kept Rolling In*, Persius Books, 2005. Peter Bernstein, *Capital Ideas*, Free Press, 1993 (optional).

Course Website: The course website has an updated (continuously) syllabus, readings, lecture notes, and other stuff. The url is <http://econ.la.psu.edu/~bickes/497home.htm>.

Paper: There will be a term paper. The topic can be either a finance issue, a financial crisis issue, or some combination. Students must receive the approval of the instructor for the topic by week five of the semester. For students who have trouble finding a topic, one will be assigned by the instructor.

Grading: There will be periodic assignments, a midterm exam and a paper. They will count toward the grade as follows.

<i>Assignments</i>	20%
<i>Midterm</i>	25%
<i>Participation</i>	15%
<i>Paper</i>	40%.

Description of the Course

This course will focus on the causes and consequences of financial crises. We will study famous crashes from the South Sea Bubble to Long-Term Capital Management. We will also study international financial crises, such as the Asian Crisis of 1997-8 and the Argentine Crisis of 2001. Our goal is to understand why financial crises occur, how costly they are to the economies in question, and what policies can be undertaken to make them occur less frequently. In order to understand the nature and causes of crises we need to develop a framework of financial theory. The course will thus have a self-contained review of asset pricing theory, including the pricing of options. We will also examine the question of market efficiency and the theory of speculative bubbles.

In the crisis part of the course we will focus on both internal and international crises. We will start with historical crises: the South Sea Bubble, John Law and Tulipmania in the early 17th century. For a modern version we will examine the Black Tuesday episode of 1929, and the crisis regarding Long-Term Capital Management in the late 1990's. We will also examine the Asian Crisis, including the Russian default, and the Argentine Crisis of 2000-2001. The book by Blustein is especially relevant for Argentina. Our concern will be with both the history of the crises and the economic factors that are the fundamental causes. In particular, we wish to learn whether these crises were the inevitable outcome of speculative markets, or the result of regulatory error.

Readings (this is currently very partial):

Arbitrage

Varian, Hal, "The Arbitrage Principle in Financial Economics," *Journal of Economic Perspectives*, Vol 1, 2, Autumn 1987: 55-72. (JSTOR).

Miller, Merton, "The Modigliani-Miller Propositions After Thirty Years," *Journal of Economic Perspectives*, Volume 2, Number 4, Fall 1988: Pages 99-120

Asset Pricing and Portfolio Theory

BKM, chapter 5-7, 9.

John Y. Campbell, "Asset Pricing at the Millennium," *Journal of Finance*, August 2000. (JSTOR).

Cochrane, John, "Financial Markets and the Real Economy," mimeo, 2006 (Web).

Cochrane, John, "New Facts in Finance," *Economic Perspectives*, Federal Reserve Bank of Chicago, 23 (3), 36-58, 1999. (Web).

Fama; Eugene F. Kenneth R. French, "The Capital Asset Pricing Model: Theory and Evidence," *The Journal of Economic Perspectives*, Vol. 18, No. 3, Summer, 2004: 25-46. (JSTOR).

Market Efficiency

BKM, chapter 10.

Lamont, Owen A. and Richard H. Thaler, "The Law of One Price in Financial Markets," *Journal of Economic Perspectives*, Volume 17, 4, Fall 2003: 191-202. (JSTOR).

Options

BKM, chapter 20-21.

Rubinstein, Mark, "Derivative Assets Analysis," *The Journal of Economic Perspectives*, Vol. 1, No. 2. (Autumn, 1987), pp. 73-93.

Lecture Note on Options (web).

Early Bubbles

Garber, Peter, "Famous First Bubbles," *Journal of Economic Perspectives*, Vol. 4, 2, Spring 1990: 35-54. (JSTOR).

Velde, Francois, "Law's System," *AEA Meetings*, January 2007. (Web)

Financial Crises

Leland, Hayne and Mark Rubinstein, "Comments on the Market Crash: Six Months After," *The Journal of Economic Perspectives*, Vol. 2, No. 3. (Summer, 1988), pp. 45-50.

Roubini, Nouriel and Brad Sester *Bailouts or Bail-ins? Responding to Financial Crises in Emerging Markets*, Chapter 2, New Nature of Emerging-Market Crises, Aug 2004. (Web)

Chiodo, Abbigail J and Michael T. Owyang, "A Case Study of a Currency Crisis: The Russian Default of 1998," *Federal Reserve Bank of St. Louis Review*, November/December 2002, 84(6), pp. 7-17. (Web)

Pesenti, Paolo, and Cedric Tille, "The Economics of Currency Crises and Contagion: An Introduction," *Economic Policy Review*, 6, 3, September 2000. (Web)