

**Instructor:** Romain Ranciere  
**Office:** KAP 360  
**Office Hours:** TBA  
**Contact Info:** ranciere@usc.edu

### **Course Description**

The purpose of this course is to understand the key facts and basic mechanisms concerning financial crises and related topics. The course will first lay down some foundations by studying empirical evidence about financial crises as well as the basic crisis mechanisms (bank runs, sovereign default decision, currency collapse). The empirical facts will provide a perspective on the recurrence of different types of financial crises (banking crises, currency crises, and sovereign debt crises). Students will study their causes, their resolutions, and their long-run consequences. The crisis mechanisms will be introduced through very simple canonical models, with emphasis on intuition and insight over model technicalities. Once these foundations are in place, the course will open up on a series of topics with mixed themes – such as crises and long run growth; inequality and crises; crises, stabilization and reforms – and an in-depth study of major crises episodes, such as the Great Depression, the US Financial Crises of 2007-2008 and the Euro Crisis.

The material covers both theoretical and empirical aspects. On the theoretical side, the presentation will be intuitive with a minimum number of equations. On the empirical side, interactions through open class discussion about causes and consequences of crises will be encouraged. For this reason, background reading before the class will be useful. For the final project regular meetings will take place with students. During those meetings, I will provide guidance, but I will also insist on students taking initiative and to showing an independent attitude.

### **Learning Objectives**

- Students will have a long run and cross-country historical perspective on a variety of crises.
- Students will understand basic analytical concepts critical to thinking about economic crises. These include: bank runs, multiple equilibria, bubbles, currency collapse, bailout and crisis resolution, crisis prevention and macro-financial regulation.
- Students will appreciate the interactions between the financial system and economic variables such as growth, income distribution, investment, and housing prices.
- Students will understand the political economy of crisis resolution and stabilization: how different actors have different objectives and the outcome of their

interactions? How economic and political (in)stability interact?

- Students will learn how to manipulate large datasets, and use Stata to carry out econometric analysis on topics such as the determinants of crises and the output costs of crises.
- Students will appreciate the distinction between run-of-the-mill economic fluctuations – such as business cycles and extreme events such as financial crisis.
- Students will learn how to decipher economic newspaper articles about current financial crises, about risk of future economic crises, or about policies to prevent or to respond to crises.
- Students will learn how to extract the gist and intellectual insight of research papers even without necessarily understanding all their analytical contents.
- Students will learn to present an economic analysis in a coherent and economically sound manner.

**Prerequisite(s):** none

**Co-Requisite/Concurrent Enrollment:** none

**Recommended Preparation:** none

## Course Notes

The material covers both theoretical and empirical aspects. On the theoretical side, the presentation will be intuitive with a minimum number of equations. On the empirical side, interactions through open class discussion about causes and consequences of crises will be encouraged. For this reason, background reading before the class will be useful. For the final project regular meetings will take place with students. During those meetings, I will provide guidance, but I will also insist on students taking initiative and to showing an independent attitude. A course website will be set up on which class notes and additional readings will be posted prior to each lecture.

## Required Readings and Supplementary Materials

### *Required Reading*

- Charles Kindleberger, *Manias, Panics, and Crashes: A History of Financial Crises*
- Carmen Reinhart and Ken Rogoff: *This Time Is Different: Eight Centuries of Financial Folly*

### *Background reading (Recommended reading)*

The class will work better if students have some background knowledge of related material. It is suggested that students read one or more of the following books. Each is either a history of some topic related to crises, or an analysis of some aspect of the crisis. These will help deepen knowledge of the crisis and broaden the class discussion.

- Gary Gorton: *Misunderstanding Financial Crises: Why We Don't See Them Coming*
- Simon Johnson, *13 Bankers*
- Paul Krugman, *The Return of Depression Economics*
- Michael Lewis, *The Big Short*
- Raghuram Rajan, *Fault Lines*
- Robert Shiller, *Irrational Exuberance*

***Additional References (not required unless specified)***

- Allen, Franklin & Douglas Gale, 1998. "Optimal Financial Crises," *Journal of Finance*, American Finance Association, vol. 53(4), pages 1245-1284, 08.
- Diamond, Douglas W & Dybvig, Philip H, 1983. "Bank Runs, Deposit Insurance, and Liquidity," *Journal of Political Economy*, University of Chicago Press, vol. 91(3), pages 401-19, June.
- Freixas and Rochet, 2008, *The Microeconomics of Banking*, 2<sup>nd</sup> Edition, Princeton University Press
- Keister, T., 2009, "Bank Runs and Institutions: The Perils of Intervention", *American Economic Review*.
- Olivier Jeanne & Romain Rancière, 2011. "The Optimal Level of International Reserves For Emerging Market Countries: A New Formula and Some Applications," *Economic Journal*, Royal Economic Society, vol. 121(555), pages 905-930, 09.
- Laeven, L. and Valencia F., 2012. "Systemic Banking Crises Database: An Update," IMF Working Papers 12/163, International Monetary Fund.
- Morris, S. and H. S. Shin (1998), "Unique Equilibrium in a Model of Self-Fulfilling Currency Attacks," *American Economic Review*, 88, 587–597
- Rancière, Romain & Aaron Tornell & Frank Westermann, 2008. "Systemic Crises and Growth," *The Quarterly Journal of Economics*, MIT Press, vol. 123(1), pages 359-406, 02.
- Stein, Jeremy. 2012. Monetary Policy as Financial-Stability Regulation. *Quarterly Journal of Economics* 127, no. 1: 57-95.
- Tirole, Jean. 2012. "Overcoming Adverse Selection: How Public Intervention Can Restore Market Functioning." *American Economic Review*, 102(1): 29-59.

**Description and Assessment of Assignments**

The grade will be based on three components.

- (1) Short presentations: students will be assigned short presentation (15') in team of two.
- (2) Check your understanding quizzes. Two quizzes will test students' understanding of the material covered (20%)
- (3) Team final project (60% comprised of 30% on the quality of the paper and 30% on effectiveness of the presentation). Students will work in team of 2 to prepare a topic for a final project after 3 weeks, meeting with the instructor

regularly for discussion and updates. A special session at the end of the course will be dedicated to student presentations of final projects which should include a half an hour presentation via slides as well as a background paper of 5-10 pages.

### **Grading Breakdown**

Short Presentations: 20 points (20% of Grade)

Quizzes: 20 Points – 10 points for each Quizz (20% of Grades)

Final Project and Presentation: 30 Points (60% of Grades)

### **Assignment Submission Policy**

The background paper associated with the final presentation should be submitted no later than the last day of the term.

### **Additional Policies**

None

## Course Schedule: A Weekly Breakdown

**Note: a short student presentation will take place in the first 15' of every lecture except in Week 1 and in Week 15.**

### Weeks 1 and 2. Financial Crises throughout history

- **Key Issue: how often do we see crises of each type? What are their costs in the short and in the long run?**
- Definitions: banking crisis, currency crisis, and sovereign debt crises.
- 800 hundred years of financial crisis: the Reinhart and Rogoff (2009) facts
- Systemic Banking Crises: the Laeven and Valencia (2012) facts
  - Frequency and Costs of Banking Crises.
- Crises and Long Run Growth (Ranciere, Tornell, Westerman, 2008).

### Weeks 3 and 4. Banking Crises

- **Key Issue: how far are crisis driven by new fundamentals and/or by panic behavior?**
- Panics and Bank Runs: The Diamond-Dybvig Model.
- The Role of Fundamental in Financial Crises
- Public vs. Private Information

### Quiz 1.

### Week 5. Currency Crises

- **Key Issue: why and how countries peg exchange rate regime fails?**
- Inconsistency between Fiscal and Monetary Policy.
- Credibility of currency pegs.
- Foreign currency debt and the balance sheet effect of large depreciation
- 

### Week 6 and 7. Sovereign Debt Crises

- **Key Issue: why do country repay their debt and why (sometimes) they don't?**
- The nature of sovereign risk
- Strategic Default
- Debt Overhang
- Debt restructuring

### Week 8. Crisis Prevention, Crisis Resolution

- **Key Issue: How can we best prevent crises and how should we react to their incidence?**
- Preventing Crises: Micro and Macro-Prudential Regulation.
  - Deposit Insurance
  - Capital Requirement

- The Role of Monetary Policy
- Resolving Crises:
  - Bailouts and Restructuring (Tirole, 2012)
  - Liquidity Traps
- Time Inconsistency: Concept and Issues. (Keister, 2009)
- Reinventing Financial Regulation.

## Quiz 2.

### Weeks 9 and 10. From the US Crisis to the Euro Crisis.

- **Key Issue: Do Monetary Unions make crises more severe and recoveries more difficult to achieve?**
- A brief Recap:
  - From the US Financial Crisis to the European Banking Crisis.
  - From Banking Crisis to Sovereign Debt Crisis (and back).
  - Crisis Exit: Exchange Rate vs. Fiscal Devaluation
  - Effective Design of Macro Policies in Currency Unions
  - Inequality and Crises
  - Political Economy of Crises, Stabilization and Reforms

### Weeks 11 to 14: Additional Topics

- Manias and Bubbles.
- The Great Depression
- Argentina: a History of Crises.
- The Dodd-Frank Reform
- Inequality and Crises.
- Economic and Political Crises

### Week 15. In class Presentation of Final Projects

#### Statement for Students with Disabilities

Any student requesting academic accommodations based on a disability is required to register with Disability Services and Programs (DSP) each semester. A letter of verification for approved accommodations can be obtained from DSP. Please be sure the letter is delivered to me (or to TA) as early in the semester as possible. DSP is located in STU 301 and is open 8:30 a.m.–5:00 p.m., Monday through Friday. Website and contact information for DSP: [http://sait.usc.edu/academicsupport/centerprograms/dsp/home\\_index.html](http://sait.usc.edu/academicsupport/centerprograms/dsp/home_index.html), (213) 740-0776 (Phone), (213) 740-6948 (TDD only), (213) 740-8216 (FAX) [ability@usc.edu](mailto:ability@usc.edu).

#### Statement on Academic Integrity

USC seeks to maintain an optimal learning environment. General principles of academic honesty include the concept of respect for the intellectual property of others, the expectation that individual work will be submitted unless otherwise allowed by an instructor, and the obligations both to protect one's own academic work from misuse by others as well as to avoid using another's work as one's own. All students

are expected to understand and abide by these principles. *SCampus*, the Student Guidebook, ([www.usc.edu/scampus](http://www.usc.edu/scampus) or <http://scampus.usc.edu>) contains the University Student Conduct Code (see University Governance, Section 11.00), while the recommended sanctions are located in Appendix A.

### **Emergency Preparedness/Course Continuity in a Crisis**

In case of a declared emergency if travel to campus is not feasible, USC executive leadership will announce an electronic way for instructors to teach students in their residence halls or homes using a combination of Blackboard, teleconferencing, and other technologies.