

**MANAGEMENT 298D-18: «THE CRISIS»
COURSE SYLLABUS**

COURSE OBJECTIVES AND FORMAT

This course will provide an in-depth synthetic and critical analysis of the global economic crisis of 2008-2009. The goals of the class are to provide: a) an understanding of the causes of the crisis, b) an overview of the onset of the crisis, including its similarities and differences with past crises, and c) a critical appraisal of the policy response to the crisis, including financial bailouts, monetary policy, fiscal policy and emerging regulatory reforms. The class will take both a US and a global perspective, and will conclude with an outline of the aftermath and general lessons to be drawn. The class will be relevant to the field of management by stressing the private sector's role in the crisis and the effects of the crisis for the conduct of business.

The course will go well beyond a factual treatment of the global economic crisis and will provide general frameworks that can be used to understand macroeconomic crises more generally. Each session will be organized around one or two frameworks of economic analysis, and will apply them to an understanding of the current crisis. The frameworks will draw from the fields of microeconomics, macroeconomics, finance, real estate and international economics, integrating and extending the knowledge obtained from other Anderson courses. Managerial Economics (Management 405) is a prerequisite for the course. The Global Economy (Management 406), while not strictly a prerequisite, is highly recommended, either taken prior or concurrently with Management 297B. Basic macroeconomic concepts will be used repeatedly during the class and basic knowledge of macroeconomics will be assumed.

The format of the course will be a classroom discussion and debate. As such, it is imperative that you come well-prepared, having done *all* of the readings - the course will entail a substantial amount of readings to prepare for class. The instructor has a point of view, but challenging that point of view will be encouraged, and even required. Lively class participation will be essential to the success of the course. The model for the class is that of a workshop where constructive debate is essential, rather than a one-directional lecture. Visitors from the worlds of finance and policy will contribute on occasion.

TEXT

The main readings are contained in the course binder or will be emailed. I reserve the right to assign additional required readings as the course develops since the crisis is still unfolding and new writings and new developments will surely occur during the quarter.

A suggested background textbook for the class is N. Gregory Mankiw, *Macroeconomics*, 6th ed., Worth, 2007. This textbook provides helpful background reading for the general concepts discussed in class, for those who have not taken Management 406 or for those who would need a refresher. Additionally, selected chapters from this book will be required readings for some sessions of the class.

CLASS REQUIREMENTS

Final grades in this class determined by performance in the following requirements:

Midterm project outline: 10%

Final projects paper and presentation: 30%

Session note: 15%

Class participation: 45%

These requirements are detailed below. Under no circumstances will special assignments substitute for inadequate performance, nor will extra-credit projects be assigned.

FINAL PROJECT

The main requirement of the class is a group-level research project on one of the topics covered in class and listed in the outline below. You are to form groups of either 5 or 6 students. Each group will be randomly assigned to a general area among the major topics of the class. Within that broad area, groups will have substantial freedom to pick a more specific topic. The topic chosen needs to be narrow enough that it lends itself to in depth primary and secondary research, but broad enough to be of interest to the whole class.

To ensure that the choice of topics is appropriate each group is to submit a midterm project outline, due by email on Wednesday February 2nd. The outline should include a general description of the project's topic and a list of the primary and secondary resources that the group is planning to use. I will meet with each group to discuss their outline and choice of topics in the first two weeks of February.

There are two deliverables for the final project:

1) An in class presentation (Powerpoint) that will occur in the last two weeks of class (sessions 9-10 in the outline below). The presentations will occur in the order in which the topics were covered in the course.

2) A final paper, due on Wednesday March 16th by email to me. The written paper is due one week after the end of the presentations to give all groups an opportunity to adjust the content based on discussions during the presentation. The page limit is 30 pages, with *reasonable* formatting.

SESSION NOTE

Each student will be tasked with writing one session note during the course of the quarter. This session note will be a summary of: a) the readings assigned for one class session, and b) the content of that class session. The note is not to exceed three pages. Each student will be assigned one class session randomly, and the note will be due one week after the session it is meant to cover.

CONTACT INFORMATION

My office is located in Anderson C-510 in Entrepreneur's Hall. Office phone: (310) 825-4507. Cell: (650) 245-3271. The easiest way to reach me is usually by email: wacziarg@ucla.edu. I will respond to your emails promptly, and will be accessible to answer questions throughout the winter quarter. You may set up appointments to meet with me at any time via email.

ATTENDANCE POLICY

Attendance is required at all sessions. For any absence I ask that you email me prior to the missed class to inform me of your absence as a courtesy. You are entitled to one absence during the quarter. Absences beyond the first will affect your final grade. It is not possible to pass the course with three or more absences.

USE OF UNAUTHORIZED MATERIALS

You can use any campus resource to integrate the class reading list and carry on your final project research. Any published work that is used in your written paper must contain the appropriate citation. Violations will be brought to the MBA Student Ethics Committee.

USE OF THE COMPUTER

All course materials, including electronic copies of all my slides will reside on the course home page:

<http://internal.anderson.ucla.edu/course/2010-2011/wi298d18/cgi-bin/main.fcgi>

You can download and review course materials at your leisure. Slides were created in PowerPoint and will be made available in PDF format as the quarter progresses.

Note: Since all of you will have portable computers, I expect that many of you will choose to take notes directly on your laptop. Please be considerate of your fellow classmates and limit your use of the computer in class to this purpose. Surfing the Internet and catching up on your correspondence is distracting to those around you and is not acceptable.

INSTRUCTOR EVALUATION

After the third week, your views about the course will be formally solicited. There will also be a final course evaluation. You are free to stop by and discuss the course with me and offer suggestions for improvements at any time. I will be very accessible and receptive to feedback. In addition, an opportunity for providing me with anonymous feedback exists by using the following web link:

<http://internal.anderson.ucla.edu/faculty/romain.wacziarg/feedback/feedback.html>

MISCELLANEOUS

Please display name cards at each class. When a guest speaker is invited to speak in class, you must keep a professional attire.

COURSE OUTLINE

Class #	Date	Week #	Title
I. The Causes			
1	Wed. Jan. 5	Week 1	Course Introduction: The Big Picture
2	Wed. Jan. 5	Week 1	The Explosion of Debt
3	Wed. Jan. 12	Week 2	The Housing Bubble: The Housing Market
4	Wed. Jan. 12	Week 2	The Housing Bubble: The Subprime Crisis
5	Wed. Jan. 19	Week 3	Financial Innovation: Asset Backed Securities and All
6	Wed. Jan. 19	Week 3	The Anatomy of a Financial Crisis
II. The Onset			
7	Wed. Jan. 26	Week 4	The Financial Crisis: Fall 2008
8	Wed. Jan. 26	Week 4	The Credit Crunch
9	Wed. Feb. 2	Week 5	International Transmission and Global Imbalances
10	Wed. Feb. 2	Week 5	The Fiscal Crisis in Europe
III. The Response			
11	Wed. Feb. 9	Week 6	Financial Bailouts: TARP and other Acronyms
12	Wed. Feb. 9	Week 6	The Fed and Monetary Policy
13	Wed. Feb. 16	Week 7	Fiscal Policy and Fiscal Politics
14	Wed. Feb. 16	Week 7	The Debate on Regulatory Reform
15	Wed. Feb. 23	Week 8	The Aftermath: Unwinding the Policy Response
16	Wed. Feb. 23	Week 8	The Future of the Economy and the Future of Economics
IV. Student Presentations			
17	Wed. Mar. 2	Week 9	
18	Wed. Mar. 2	Week 9	
19	Wed. Mar. 9	Week 10	
20	Wed. Mar. 9	Week 10	

SESSION DESCRIPTIONS AND READINGS
(subject to change)

PART I. THE CAUSES

Session 1 part 1 – Wednesday January 5: Course Introduction: The Big Picture.

The financial meltdown of fall 2008 finds its source in the subprime crisis, beginning in 2006, and before that in the vast accumulation of household and government debt in the United States. This introductory session, after a brief summary of the syllabus and other logistical issues, will present the basic themes of the class, providing an overview of the causes, onset and responses to the crisis in general terms. The idea is to set up the “big picture” before delving in greater detail into each of these components.

Required readings: Course syllabus; Chinn and Frieden: “Reflections on the Causes and Consequences of the Debt Crisis of 2008”; Udell: “Wall Street, Main Street, and a credit crunch”

Session 1 part 2 – Wednesday January 5: The Explosion of Debt.

This session introduces a series of criteria to evaluate the sustainability of a country’s debt level. We will discuss what constitutes a sustainable debt burden, and how households should be expected to respond to increases in government debt. Much of the session is devoted to examining detailed data on the debt burden within the United States, in a historical perspective. The deep determinants of the crisis are to be found in excessive debt levels. The session will cover the causes of the explosion of debt.

Required readings: Mankiw, Chapter 15; Roubini: “Debt Sustainability: How to Assess Whether a Country is Insolvent”.

Session 2 part 1 – Wednesday January 12: The Housing Bubble: The Housing Market.

The immediate trigger of the crisis was a downturn in the housing market, starting with the subprime mortgage crisis in 2006. This session reviews the economics of the housing market, and discusses housing market trends in a historical perspective, focusing on the years leading to the current crisis – until now.

Required readings: Leamer, chapter 20, additional readings TBA.

Session 2 part 2 – Wednesday January 12: The Housing Bubble: The Subprime Crisis.

The downturn in the housing market was triggered by the subprime crisis. New mortgage instruments progressively appeared in the period leading to 2006, with increasing lax credit criteria, and these were in part responsible for the real estate bubble analyzed in Session 3. In this session we will discuss how the real estate meltdown can be understood as a manifestation of a vicious cycle linking subprime mortgage foreclosures and housing prices.

Required readings: HBS Case: “Subprime Meltdown: American Housing and Global Financial Turmoil”, by Julio Rotemberg; Audio: NPR’s This American Life: “The Giant Pool of Money” (05/09/2008: http://www.thisamericanlife.org/Radio_Episode.aspx?episode=355 and 09/25/2009: http://www.thisamericanlife.org/Radio_Episode.aspx?sched=1318); Ashcraft and Schuermann: “Understanding the Securitization of Subprime Mortgage Credit”.

Session 3 part 1 – Wednesday January 19: Financial Innovation: Asset Backed Securities and All.

The subprime bubble was made possible in part by financial innovation, chiefly securitization, which created chains of moral hazard whereby mortgage originators could afford to care little whether creditors were able to repay their loans, and whereby the true bearers of credit default risk were hard to trace. This session reviews different kinds of asset-backed securities, focusing on mortgage-backed securities.

Required readings: Dwight Asset Management Company: “Fixed Income Primer: Asset-backed securities”; HBS case: The Economics of Structured Finance”, by Coval, Jurek and Stafford; Mark Spitznagel: “The Man Who Predicted the Depression”.

Class Visitor: TBA

Session 3 part 2 – Wednesday January 19: The Anatomy of a Financial Crisis.

This session will examine the typical pattern followed by recessions and by financial crises, to pave the way for an analysis and understanding of the current crisis. For recessions, we will rely on Leamer’s characterization. For financial crises, we will rely on a unique database of financial crises put together by Reinhart and Rogoff, and use their work as a starting point for a discussion of the typical stages followed by an economy as it undergoes a financial crisis – from onset to recovery.

Required readings: Leamer, pages 103-171. Reinhart and Rogoff, “This Time is Different: Eight Centuries of Financial Folly”, chapters 10 and 14.

PART II. THE ONSET

Session 4 part 1 – Wednesday January 26: The Financial Crisis: Fall 2008.

This session will analyze the events of September 2008, including the takeover of Bear Stearns, the collapse of Lehman Brothers, through to the government takeover of AIG, placing this specific financial crisis in the context of those studied in the previous session.

Required readings: Sorkin: “Too Big to Fail” (chapter 15), Wessel: “In Fed We Trust” (Introduction and Chapter 1).

Class visitor: TBA

Session 4 part 2 – Wednesday January 26: The Credit Crunch.

Following the collapse of Lehman Brothers and the events of the fall of 2008, fears of a credit crunch spread through the US economy and the world. A severe crunch was only averted due to concerted action by the US Treasury and the Fed. This session describes the credit crunch that occurred in the fall of 2008. We will study the theory of leverage cycles, linking credit conditions to the real economy.

Required readings: Brunnermeier: “Deciphering the Liquidity and Credit Crunch 2007–2008”; Geanakoplos: “Solving the Present Crisis and Managing the Leverage Cycle”.

Session 5 part 1 – Wednesday February 2: Channels of International Transmission and Global Imbalances

In this sessions, we will focus on the international dimensions of the crisis. While its trigger was to be found in the US real estate market, the onset of the financial crisis in the United States was followed by its worldwide transmission. We examine the manifestations of the global financial and economic crisis outside of the United States and discuss the potential and actual channels of international transmission, both to advanced and developing economies. One of the manifestations of the American thirst for debt in the decades leading to the crisis was the development of major global financial imbalances, the main manifestation of which was the large and growing US current account deficit, and the concurrent Chinese surplus. This session examines the importance of global imbalances and discusses the threat they pose to the world economy.

Required readings: Blanchard and Milesi-Ferretti, “Global Imbalances: Past, Present and Future”; Dooley and Hutchison: “Transmission of the U.S. Subprime Crisis to Emerging Markets: Evidence on the Decoupling-Recoupling Hypothesis”

Background reading: Barro, Chapter 17.

Session 5 part 2 – Wednesday February 2: The Fiscal Crisis in Europe

This session will discuss the specificities of the crisis in Europe, with special attention to the ongoing fiscal crisis.

Required readings: TBA

PART III. THE RESPONSE

Session 6 part 1 – Wednesday February 9: Financial Bailouts: TARP and other Acronyms

The Troubled Assets Relief Program (TARP) was the first major response to the crisis in the fall of 2008. It consisted of a bank bailout program totaling more than \$700 billion, approved in haste by the US Congress. In this session, we will debate the justifications for such a program, and for the other bailout programs that soon followed (including the Fed's various asset purchasing programs). Bailouts were meant to reduce the incidence of systemic risk, but the major cost is the perpetuation of moral hazard in the financial sector.

Required readings: Swagel: “The Financial Crisis: An Inside View”; Veronesi and Zingales: “Paulson’s Gift”.

Class visitor: TBA

Session 6 part 2 – Wednesday February 9: The Fed and Monetary Policy

Another policy response to the crisis was the major expansion of the Federal Reserve’s balance sheet in the days and weeks following the collapse of Lehman Brothers. The idea was to inject liquidity into the economy in order to avert a complete collapse of credit and the banking system. We will examine the general principles of monetary policy and the specificities of monetary policy in the context of very low nominal interest rates and financial turmoil.

Required readings: Gordon, Chapter 5, pp. 117-147; Bernanke: The Federal Reserve's Balance Sheet: An Update. Alfaro and Kim: “U.S. Subprime Mortgage Crisis: Policy Reactions (B)” (HBS case 9-709-045).

Session 7 part 1 – Wednesday February 16: Fiscal Policy and Fiscal Politics

Fiscal policy was the third main pillar of the policy response to the financial crisis. The Bush Administration's stimulus package of 2008, together with the Obama Administrations American Recovery and Reinvestment Act of 2009 injected hundreds of billions of dollars in federal spending and tax cuts in an attempt to jump start aggregate demand. In this session, we will not only describe these policies, we will also debate the economic merits of fiscal policy. We will discuss the state of knowledge on the multiplier effect of fiscal policy, and debate whether the fiscal deficits implied by the accumulated deficits create more problems than they are solving.

Required readings: Barro and Redlick, “Macroeconomic Effects from Government Purchases and Taxes”; Romer, and Romer, “The Macroeconomic Effects of Tax Changes: Estimates Based on a New Measure of Fiscal Shocks”; Romer and Bernstein: “The Job Impact of the American Recovery and Reinvestment Plan” (focus on the graph on page 4); Hamilton: “Yes the future deficits are worrisome” (http://www.econbrowser.com/archives/2009/11/yes_the_future.html - make sure to browse the links to Krugman’s contrary view also).

Session 7 part 2 – Wednesday February 16: The Debate on Regulatory Reform

Many commentators have blamed lax regulation of banks, unregulated financial innovations and faulty executive compensation schemes for the financial crisis. This has led to calls for reforms of the financial system, not only in the US but more broadly worldwide. In this session we will critically examine claims that regulatory failure was responsible for the crisis, and examine avenues for possible regulatory reform.

Required readings: Calomiris: “Bank Regulatory Reform in the Wake of the Financial Crisis”; Rajan: “The Credit Crisis and Cycle-Proof Regulation”; Narayanan and Brem: “Executive Pay and the Credit Crisis of 2008 (B)” (HBS case # 9-110-005); Edmans and Gabaix: “Incentive Accounts: A Solution to Executive Compensation”.

Session 8 part 1 – Wednesday February 23: The Aftermath: Unwinding the Policy Response

As noted above, the crisis entailed massive injections of financial resources into the financial and industrial sector (bailouts), a huge expansion of the money supply (monetary policy) and large increases in budget deficits (fiscal policy). These were exceptional measures for exceptional times, but as the economy recovers, it is essential to unwind these policies. Doing it too soon might endanger the recovery. Doing it too late risks inflation and perhaps a debt crisis. This session will discuss the conundrum faced by policy makers as they strive to unwind the policy response to the global economic crisis.

Required readings: Carlo Cottarelli and Jose Viñals: “A Strategy for Renormalizing Fiscal and Monetary Policies in Advanced Economies”; IMF: “Market interventions during the financial

crisis: how effective and how to disengage?” (Chapter 3 in the Global Financial Stability Report).

Session 8 part 2 – Wednesday February 23: The Future of the Economy and the Future of Economics

How should we expect the crisis to affect the future path of capitalist systems? Is the solution curbing the power of the financial industry? How will rising populism affect the course of advanced economies? How should the crisis alter the way we think about the operation of market economies? Admittedly, these are vast questions. In this capstone session, we will address the global and long-run implications of the crisis.

Required readings: Zingales: “Capitalism After the Crisis”; Johnson: “The Quiet Coup” (Atlantic Monthly, May 2009); Krugman: “How Did Economists Get It So Wrong?”; Cochrane: “How did Paul Krugman get it so Wrong?”.

PART IV. STUDENT PRESENTATIONS

Session 9 – Wednesday March 2
Session 10 – Wednesday March 9

These 2 sessions will be devoted to in-class presentations of the group-level projects, and in-depth class discussions of the topics they will cover.