Currency and Banking Crises in Emerging Markets (IBUS 6290), Spring 2015
Tuesdays 7:10 - 9:40pm, Duques 258
Instructor: Prof. D. Leipziger (DLeipzig@gwu.edu)
Office: Duques 450b  Office Phone: 202-994-8202
TA: tbd

Class Objectives: A financial crisis can be extraordinarily damaging to a country’s economic growth, public finances, and international credibility. Given the high costs of a crisis, one would imagine that policymakers would take the utmost care to avoid them. Unfortunately this is not always the case and some crises are clearly avoidable.

That said, a particular set of circumstances, domestically or globally, can trigger a currency or banking crisis, and in that event, policymakers need to utilize available tools and best practice to manage the crisis, shorten rather than lengthen its duration, and attempt to limit the spillover costs that can damage the pace of recovery.

This course will examine what causes a financial crisis and how various countries have responded to their specific crises. Cases will include Argentina, Mexico, Korea, and Greece, and Cyprus. Readings will accompany cases and selected guest lecturers may be invited for particular cases where they were involved in the management of the crisis.

Learning Objectives:

- To better understand the causes and impacts of financial crises on emerging market economies and the economic agents operating in these markets
- To drill down on the economic implication of crises and the alternative ways of dealing with specific shocks to the financial sector
- To examine specific country cases and ascertain how governments dealt with their crises and to assess the effectiveness of those measures in a public policy sense
- To gain basic lessons from financial crises and improved understanding of the measures being proposed to limit their frequency and associated contagion

Prerequisites:

Students taking the class should have had a solid macroeconomics course as part of their graduate course of study at GWU, so that the analytic links between financial issues and macroeconomic fundamentals can be further developed. If you feel your macroeconomics is rusty, you should review the basics of open economy macro, namely macroeconomic issues in a world with trade and free flows of capital in which policymakers face international influences in the conduct of policy.
Class Expectations:

Students should be conversant with the fundamentals of macroeconomics and the links between macro-economic management tools and the foreign exchange and money/bond markets. Towards this end, it would be wise to review your macro comprehension and consult either Mankiw and Ball or an equivalent macroeconomic text. Readings need to be completed before each class and the Instructor reserves the right to quiz students on selected reading assignments.

Class Assignments:

There will be two short written assignments:
   1) A three page Note on how a particular financial crisis could have been avoided or better managed in the case, or either South Korea or Argentina
   2) A three page Note on the topic of Old and New Lessons to Avoid Financial Crises.

The will be a final exam for the course.

Course Materials:

Required and Recommended readings will be available via the class Blackboard webpage. Links for the HBS cases will also be provided via Blackboard. Students are not required to purchase a textbook for this class, however students will be expected to purchase and read four assigned HBS case studies.
See the “Readings” Course Pack on Blackboard for the Harvard cases. (HCP)

Strong recommendation:

Read the Financial Times (FT) every day and bring in relevant articles to be discussed in class.

Grading:

Assignment # 1 (due Feb. 2nd) 20%
Assignment # 2 (due Feb 23rd) 20%
Final Exam (Mar 3rd) 50%
Classroom Preparedness and Participation 10%
CLASS SCHEDULE

Class 1: INTRODUCTION: Tuesday, January 13, 2015

Topics for Discussion:
• The analytic links between financial markets and the macro-economy
• The costs of financial crises in the short, medium and long term
• What factors are associated with financial crises? What have we learned since Kindleberger? The Glass-Steagall debate
• How did Canada manage to avoid the US financial crisis in 2009-2010?
• What contributes to prudent financial supervision: Chile vs. Spain
• The international financial architecture: LOLR and Who is in charge?

Recommended Readings for January 13th:

1) Mankiw, G. and L. Ball. Macroeconomics and the Financial System (Worth, 2010) Chapters 5, 18 and 19 or equivalent macro text covering exchange rates and capital flows, banking, and financial crises.

2) IMF, World Economic Outlook, Oct. 2015, Overview Chapter

Required Readings for Jan. 20th:

1) Caprio, G and D. Klingebiel, “Bank Insolvency: Bad Luck, Bad Policy, or Bad Banking?” Annual World Bank Conference 1996


4) Capital Controls in Chile in the 1990s, HBS Case # 9-705-031 (see HCP)

Class 2: Causes and Consequences of Financial Crises: January 20th, 2015

Guest Speaker: Dr. Augusto de la Torre

Topics for Discussion:
• What makes for differences in financial crises?
• What general lessons have we learned?
• What is current thinking on capital controls and do they work?
• How does one defend against financial crises and what’s to be avoided?
Required Readings for Jan. 27th:

1) **East Asian Financial Crisis**, HBS Case 9-074-045 *(see HCP)*


Class 3: Financial Crises in High-Growth Regions: January 27, 2015

Topics for Discussion:
- The structure and financing of the Korean economy
- The causes and consequences of the Korean financial crisis
- The links between corporate restructuring and the Korean crisis
- The management of contagion and the role of IFIs
- Lessons from the workouts in Thailand, Korea, and Indonesia
- The idiosyncratic policies of Malaysia
- The Chiang-Mai Initiative

Required Readings for Feb. 3rd:


2) **The 2000 Crisis in Argentina**, HBS Case # 9-704-004 *(see HCP)*


Assignment # 1

- Note on what Argentina should have done differently OR what Korea could have done differently before or during the crisis
- 3 pages - single spaced
- Due by 11:59 pm on Monday, February 2, 2015
Class 4: Argentina’s Currency Board and Its Eventual Demise: February 3, 2015

Topics for Discussion:
- The benefits and costs of a currency board
- What does a currency board imply for macro-policy?
- Why did the Convertibility Plan fail?
- The mechanics of the exit from the pegged exchange rate: winners and losers
- Observations from the ground and legacy issues
- The Costs and Benefits of Dollarization?

Required Readings for February 10, 2015:


3) Mexico: The Tequila Crisis, HBS Case # 9-702-093, (see HCP)

Class 5: Exchange and Banking Crisis in Mexico: February 10, 2015

Guest Speaker: TBD

Topics for Discussion:
- The Tequila Crisis and its Aftermath
- How does contagion work?
- What lessons are there for banks?
- What lessons are there for central banks?
- What lessons are there for policymakers?
- What are the similarities with exchange crises elsewhere?

Required Readings for February 17, 2015:


2) De Grauwe, Paul, “Crisis in the Euro-zone and How to Deal with It,” CEPS Policy Brief No. 204(February, 2010)

3) Latest IMF paper on Greece (to be distributed)
Topics for Discussion:
- What lessons from emerging markets did the Europeans not internalize?
- How to manage a debt restructuring?
- What options faced Greece and its partners in 2009?
- What are the options today and what affects the fate of the Euro?
- What's different about the Cyprus banking crisis?
- What do we learn from the optimal currency area literature?
- What do we know about the fixed exchange rate literature and its implications?

Required Readings for February 24, 2015:


3) International Monetary Fund, “The Effectiveness of Capital Controls and Prudential Policies in Managing Large Capital Inflows, IMF Discussion Note by Habermeier, Kokenyne and Baba, August, 2011

4) A redacted Financial Sector Assessment Program (FSAP) Report


6) Speech by Mark Carney, Governor of the Bank of Canada (to be distributed)

Assignment # 2
- Note on the topic of old and new lessons to avoid financial crises. Discuss what we have learned to do, or not do, based on past crises and how these admonitions may have changed in recent years due to a changing environment.
- 3 pages - single spaced
- Due by 11:59 pm on Monday, February 23rd, 2015
Class 7: Predicting and Preventing Crises: February 24, 2015

Topics for Discussion:
• What is the role of an FSAP (Financial Sector Assessment program)
• The changing roles of Central Banks, the IMF, World Bank, and the BIS
• Taking a look at Glenn Hubbard (video)
• Macro-Prudential Policy Tools and Frameworks: Progress Report to the G-20, Financial Stability Board (October, 2010)
• Unsolved issues of international coordination in crisis management

No required readings – study for the final

FINAL EXAM: MARCH 3, 2015