

GRAD-C8-106: Economic Crises

Dr. Steffen Ahrens

1. General information

Class time	Mon, 14-16h
Course Format	The Economics II lecture will be taught online, in real time, via the platform Clickmeeting. Small participatory labs will accompany the lecture and will be taught onsite at the Hertie School, or online via the platform Clickmeeting or Teams, depending upon your location. Online office hours will be available.
Instructor	Dr. Steffen Ahrens
Instructor's e-mail	TBD
Assistant	Email: adjunctsupport@hertie-school.org
Instructor's Office Hours	The online office hours are Mondays, 10-12h. Please send an email to the instructor to make an appointment.

Link to Module Handbook [MIA](#) and [MPP](#)Link to [Study, Examination and Admission Rules](#)Instructor Information:

Steffen Ahrens is a visiting professor (Lehrstuhlvertretung) in macroeconomics at the Friedrich-Schiller-University Jena. He has specialized in behavioral and experimental macroeconomics and finance. His research focuses on topics in monetary macroeconomics analyzed through the lens of behavioral and experimental economics and on the role of cognitive biases for financial markets. Prior to his appointment at Jena, he held a six-year Post-doc position at the Technische Universität Berlin and a one-term visiting professorship (Lehrstuhlvertretung) in macroeconomics at the University of Konstanz. He studied economics at Kiel University and the University of Illinois at Urbana-Champaign. He received his doctorate in economics from Kiel University. During his doctoral studies he held positions as teaching and research assistant to Prof. Dennis Snower, PhD and as Research Economist at the Kiel Institute for the World Economy.

2. Course Contents and Learning ObjectivesCourse contents:

The course introduces the theory of economic crises. The theory is discussed against the backdrop of the recent financial crises of 2007/2008 and other historical accounts of previous financial-, banking-, and currency crises. Many of these crises can be viewed as coordination games where markets suddenly swing from a socially efficient equilibrium to a socially inefficient equilibrium. An emphasis on the analysis of coordination will overarch this course and lead us to the current frontier of the research on economic crises.

Main learning objectives:

Students learn why economics crises occur, how they evolve, and by which means they can be prevented or, as the case may be, resolved. They become familiar with modern methods of solving coordination games and learn to apply these methods in the context of economic crises models.

Target group:

This course is targeted towards students with a methodological interest in economics and finance (i.e. using theoretical models to understand real world economic phenomena) and a practical interest in policy advice, for instance, regarding crises resolution policies and crises prevention through regulation.

Teaching style:

The instructor will present the contents in a typical lecture style. Students are encouraged to participate actively throughout the presentation by asking question and stimulate discussions.

Prerequisites:

An introductory level knowledge of microeconomics is recommended.

Diversity Statement:

I celebrate diversity in my everyday life through my friends, my colleagues and co-authors, my profession, and the team that teaches this class. I have always taken a multinational and multicultural perspective. I believe that diversity fosters the inventiveness of thought, generates mutual understanding and respect, and is an enrichment to personal experience.

I have passionately fostered cultural exchange through my long standing position as coordinator of the student exchange program between Kiel University in Germany and the University of Illinois at Urbana-Champaign. Through this program I was able to send German students to experience their study abroad in the United States and had the honor to host American students of multiple ethnic backgrounds at Kiel University. During my own studies abroad at the University of Illinois, I was also a member of the international student organization *International Illini* of the University of Illinois.

3. Grading and Assignments

Composition of Final Grade:

Assignment 1: Take home exercise	Deadline: March 14 th , 11:59pm	Submit via Moodle	40%
Assignment 2: Take home exercise	Deadline: May 9 th , 11:59pm	Submit via Moodle	40%
Assignment 3: Short Essay	Deadline: May 21 st , 11:59pm	Submit via Moodle	20%

Assignment Details

Assignment 1

Students solve a problem set with problems related to the materials covered in the lectures and the lab. The assignment will be completed in a one-week take home exercise.

Assignment 2

Students solve a problem set with problems related to the materials covered in the lectures and the lab. The assignment will be completed in a one-week take home exercise.

Assignment 3

Students write a short essay (~1500 words) describing a financial crises of their choice (with the exception of the financial crises of 2007/2009). The essay should make clear what type of crises is considered (according to the categorization introduced in class, i.e. asset price crises, banking crises, currency crises or a combination of them) and describe which political and economic circumstances led to the financial crises of their choice, how it unfolded through time, and which governmental actions were taken to encounter it.

Late submission of assignments: For each day the assignment is turned in late, the grade will be reduced by 10% (e.g. submission two days after the deadline would result in 20% grade deduction).

Attendance: Students are expected to be present and prepared for every class session. Active participation during lectures and seminar discussions is essential. If unavoidable circumstances arise which prevent attendance or preparation, the instructor should be advised by email with as much advance notice as possible. Please note that students cannot miss more than two out of 12 course sessions. For further information please consult the [Examination Rules](#) §10.

Academic Integrity: The Hertie School is committed to the standards of good academic and ethical conduct. Any violation of these standards shall be subject to disciplinary action. Plagiarism, deceitful actions as well as free-riding in group work are not tolerated. See [Examination Rules](#) §16.

Compensation for Disadvantages: If a student furnishes evidence that he or she is not able to take an examination as required in whole or in part due to disability or permanent illness, the Examination Committee may upon written request approve learning accommodation(s). In this respect, the submission of adequate certificates may be required. See [Examination Rules](#) §14.

Extenuating circumstances: An extension can be granted due to extenuating circumstances (i.e., for reasons like illness, personal loss or hardship, or caring duties). In such cases, please contact the course instructors and the Examination Office *in advance* of the deadline.

4. General Readings

Allen, Franklin and Douglas Gale (2007). Understanding Financial Crises. Oxford: Oxford University Press.

Aschinger, Gerhard (2001). Währungs- und Finanzkrisen: Entstehung, Analyse und Beurteilung aktueller Krisen, Vahlen Verlag, München.

Kindleberger, Charles P. and Robert Z. Aliber (2011). Manias, Panics, and Crashes: A History of Financial Crises. New York: Palgrave Macmillan.

5. Session Overview

Session	Session Date	Session Title
1	08.02.2021	Historical overview of financial crises
2	15.02.2021	The role of speculation for financial crises

3	22.02.2021	Efficiency of financial markets and (rational) asset price bubbles
4	01.03.2021	Historical overview of the subprime crisis of 2007-2009
5	15.03.2021	Securitization
Mid-term Exam Week: 22 – 26.03.2021 – no class		
6	29.03.2021	Banking crises
7	12.04.2021	Moral hazard in banking and banking regulation
8	19.04.2021	Introduction to open-economy monetary economics
9	26.04.2021	1st generation currency crises
10	03.05.2021	2nd generation currency crises
11	10.05.2021	Global Games and speculative attacks
12	???.2021	3rd generation currency crises
Final Exam Week: 17 – 21.05.2021 – no class		

6. Course Sessions and Readings

All required readings will be accessible on the Moodle course site before semester start. In the case that there is a change in readings, students will be notified by email.

Required readings are to be read and analysed thoroughly. Optional readings are intended to broaden your knowledge in the respective area and it is highly recommended to at least skim them.

Session 1: Historical overview of financial crises

Learning Objective	Students get an overview of important historic financial crises, they learn how to categorize these events into asset price-, banking-, and currency crises, and they study the anatomy of a typical financial crises.
Required Readings	Bordo et al. (2001), Is the Crisis Problem Growing More Severe? Economic Policy 16(32), p. 53-82. Minsky, H. (1977). The Financial Instability Hypothesis: An Interpretation of Keynes and an Alternative to "Standard" Theory. Nebraska Journal of Economics and Business, 16(1), 5-16.
Optional Readings	Allen, Franklin and Douglas Gale (2007). Understanding Financial Crises. Oxford: Oxford University Press. Chapter 1. Kindleberger, Charles P. and Robert Z. Aliber (2011). Manias, Panics, and Crashes: A History of Financial Crises. New York: Palgrave Macmillan. Chapter 2.

Session 2: The role of speculation for financial crises

Learning Objective	From a methodological point of view, students learn how to analyze the role of speculation, using a standard microeconomic demand and supply analysis of the goods market. The goals are to understand the difference between speculation and arbitrage and to recognize not only the risks, but also the benefits of speculation.
Required Readings	Johnson, H.G. (1976), Destabilizing Speculation: A General Equilibrium Approach, <i>Journal of Political Economy</i> , 84, pp. 101-108.
Optional Readings	Aschinger, Gerhard (2001). Währungs- und Finanzkrisen: Entstehung, Analyse und Beurteilung aktueller Krisen, Vahlen Verlag, München. Chapter 1.

Session 3: Efficiency of financial markets and (rational) asset price bubbles

Learning Objective	Students discuss the validity of Fama's efficient-market hypothesis and learn how to study rational asset price bubbles in a standard overlapping generations model.
Required Readings	Shiller, R.J. (1981), Do Stock Prices Move Too Much to be Justified by Subsequent Changes in Dividends?, <i>American Economic Review</i> , 71, pp. 421-436.
Optional Readings	Brunnermeier, M.K. and Oehmke, M. (2012), Bubbles, Financial Crises, and Systemic Risk, NBER Working Paper Series No. 18398, National Bureau of Economic Research.

Session 4: Historical overview of the subprime crisis of 2007-2009

Learning Objective	Students get an overview over the sequence of events regarding the financial crises of 2007/2009. In doing so, they get an introductory understanding of the main causes and the basic mechanisms of the financial crises.
Required Readings	Blanchard, O. (2009), The Crisis: Basic Mechanisms, and Appropriate Policies, IMF, WP 09/80.
Optional Readings	Hellwig, Martin (2008), The Causes of the Financial Crisis, CESifo Forum 9 (4), p. 12-21.

Session 5: Securitization

Learning Objective	Students learn why and how banks engage in securitization. Using simple numerical examples, students understand how securitization blurs the overall risk of these financial vehicles.
Required Readings	Gorton, G. and Metrick, A. (2012), Securitized banking and the run on repo, <i>Journal of Financial Economics</i> , 104(3), pp. 425-451.

Optional Readings	Tirole, Jean. The Theory of Corporate Finance. Princeton: Princeton University Press, 2006. Chapter 12.4.
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Session 6: Banking crises

Learning Objective	Applying the well-known Diamond-Dibvyg model, students learn why bank runs occur and how they can be prevented by governmental policy.
Required Readings	Diamond, D.W. and Dybvig, P.H. (1983), Bank Runs, Deposit Insurance, and Liquidity, Journal of Political Economy 91(3), pp. 401-419.
Optional Readings	Allen, Franklin and Douglas Gale (2007). Understanding Financial Crises. Oxford: Oxford University Press. Chapters 2.3 and 3.

Mid-term Exam Week: 22 – 26.03.2021 – no class

Session 7: Moral hazard in banking and banking regulation

Learning Objective	Students learn the moral hazard incentives involved in the governmental resolution mechanisms to prevent bank runs and how to address the moral hazard incentives with banking regulation. These theoretical insights are discussed against the background of the current banking regulation of the Basel Committee on Banking Supervision.
Required Readings	Hanson, S.G., Kashyap, A.K. and Stein, J.C. (2011). A Macroprudential Approach to Financial Regulation. Journal of Economic Perspectives, 25(1), pp. 3-28.
Optional Readings	

Session 8: Introduction to open-economy monetary economics

Learning Objective	Students learn the basic concepts of open-economy monetary economics, including nominal and real exchange rates, interest parities, purchasing power parity, and balance-of-payments adjustments.
Required Readings	Any introductory textbook on international economics or finance will do.
Optional Readings	

Session 9: 1st generation currency crises

Learning Objective	Students get an overview of historic accounts of so-called first generation currency crises of the 1970s and 1980s. They learn which political and economic circumstances characterize this generation of currency crises and study the well-known Krugman model to explain why speculative attacks necessarily occur under these circumstances and how the model can be extended to achieve greater empirical fit.
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Required Readings	Krugman, P. (1979). A Model of Balance-of-Payments Crises. <i>Journal of Money, Credit and Banking</i> , 11(3), 311-325. doi:10.2307/1991793 Robert P. Flood, Peter M. Garber (1984), Collapsing exchange-rate regimes: Some linear examples, <i>Journal of International Economics</i> , Volume 17, Issues 1–2, 1984, Pages 1-13.
Optional Readings	Botman, D.P.J. and Jager, H. (2002), Coordination of speculation, <i>Journal of International Economics</i> 58(1), pp. 159-175. Sexana, S.C. (2004), The Changing Nature of Currency Crises. <i>Journal of Economic Surveys</i> 18(3), p. 321-350.

Session 10: 2nd generation currency crises

Learning Objective	Students get an overview of historic accounts of so-called second generation currency crises of the 1990s. They learn which political and economic circumstances characterize this generation of currency crises and study the well-known Obstfeld model to explain why speculative attacks occur. From a methodological point of view, students understand that speculative attacks of the second generation can be described as a coordination problem with multiple rational equilibria.
Required Readings	Maurice Obstfeld (1996), Models of currency crises with self-fulfilling features, <i>European Economic Review</i> 40(3–5), pp. 1037-1047.
Optional Readings	Sexana, S.C. (2004), The Changing Nature of Currency Crises. <i>Journal of Economic Surveys</i> 18(3), p. 321-350.

Session 11: Global Games and speculative attacks

Learning Objective	Students get an introduction into the theory of global games. Applying a strongly simplified version of this theory, students learn how to theoretically select a unique equilibrium out of multiple equilibria.
Required Readings	Corsetti, G., Dasgupta, A., Morris, S., and Shin, H. (2004). Does One Soros Make a Difference? A Theory of Currency Crises with Large and Small Traders. <i>The Review of Economic Studies</i> , 71(1), 87-113.
Optional Readings	Morris, S. and Shin, H.S. (1998). Unique Equilibrium in a Model of Self-Fulfilling Currency Attacks. <i>American Economic Review</i> 88, pp. 578-597.

Session 12: 3rd generation currency crises

Learning Objective	Students get an overview of historic accounts of so-called third generation currency crises of the 2000s. The third generation currency crises connect currency crises with banking crises or asset price crises. Studying some theoretical frameworks, students learn how these different crises types are interdependent and may fuel each other.
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Required Readings	Krugman, P. (1999), Balance Sheets, the Transfer Problem, and Financial Crises, <i>International Tax and Public Finance</i> 6, pp. 459–472.
Optional Readings	Sexana, S.C. (2004), The Changing Nature of Currency Crises. <i>Journal of Economic Surveys</i> 18(3), p. 321-350.

Final Exam Week: 17 – 21.05.2021 – no class