

Economics 487a: Speculative Bubbles and Financial Panics

Course Outline and Reading List

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BOOKS AVAILABLE FOR PURCHASE AT THE YALE BOOKSTORE

You will be expected to read all of Charles P. Kindleberger's *Manias, Panics and Crashes* (CK). The 1994 edition, published by Wiley, is noticeably more up to date than earlier editions and in paperback, new, costs no more than older editions. The Yale Bookstore ordered an older edition at first, but should by now have replaced it with the 1994 edition. They should accept an exchange if you bought the older edition by mistake, as this was entirely their error.

The Econometrics of Financial Markets by Campbell, Lo and Mackinlay (CLM) is an excellent survey of empirical financial models and results. However, only 10-15% of the book will be assigned. Most of the book treats econometric methods in more detail than necessary for this course. We will be using introductory material from various chapters, which sets out models and theoretical results at a level and with a pattern of emphasis that matches what we need in the course. You might purchase the book if you expect to do further study in finance after this course, or if you have taken enough econometrics so that the unassigned parts of the book might help you in writing a course paper.

Speculative Bubbles, Speculative Attacks, and Policy Switching by Flood and Garber (FG) collects papers by these two authors on the subject matter of this course. We will use at least 10%, and possibly as much as 30% of this book. However, all of the chapters of the book have appeared elsewhere, usually as journal articles, and the book itself (along with Campbell, Lo and Mackinlay) is on reserve, so it will be quite possible to do the assigned readings without buying the book. The book has some papers that extend theories beyond what we will do in class and a number that analyze particular countries and periods. These could be useful in finding paper topics.

1. INTRODUCTION

1.1. Anatomy of Bubbles and Crises.

CK, Chapters 1-3

1.2. Simple Asset Price Models: Why Prices Don't Change Smoothly.

CLM, sections 1.4-1.5, p.9-25

CLM, section 9.1.1, p.341-44

2. WHAT IS A BUBBLE?

2.1. Tulipmania.

FG, Chapters 3 and 2, in that order. Chapter 3 originally from *Journal of Political Economy*, June 1989. Chapter 2 from *Journal of Economic Perspectives*, spring 1990.

CK, Chapter 7

2.2. Fundamentals and Rational Bubbles.

CLM, section 7.1, p.253-267

"The Determinants of the Variability of Stock Market Prices", by Sanford J. Grossman and Robert J. Shiller, *American Economic Review* 71, May 1981

3. LENDING, LEVERAGE, INSURANCE, AND BETTING

3.1. Does Credit Play a Role in Every Bubble and Crisis?

CK, Chapters 4,6 and 8

3.2. The Economic Functions of Lending.

3.2.1. *Intertemporal trade, no uncertainty.*

3.2.2. *Risk-sharing: CAPM.*

CLM, sections 5.1-5.2, p.181-187

3.2.3. *Risk-sharing: Stochastic discount factor, completeness of markets.*

CLM, section 8.1, p.293-5

3.2.4. *Asset trading when there are differences of opinion.*

Notes to be handed out

4. IRRATIONALITY AND CRIMINALITY

4.1. Criminality.

CK, Chapter 5

4.2. Irrationality.

"The Behavior of Home Buyers in Boom and Post-Boom Markets," by Case and Shiller *New England Economic Review*, November/December 1989

Smith, Suchanek and Williams, "Bubbles, Crashes and Endogenous Expectations in Experimental Spot Asset Markets", *Econometrica* 56, September 1988

(some additional reading may be assigned)

5. BANKRUPTCY

5.1. Moral Hazard: Explaining the Standard Loan Contract.

TBA

5.2. Banking and Bank Runs.

sections TBA of *Financial History of the United States* by Davis Dewey
possibly additional reading on a theoretical model

6. POLICY SWITCHING; ARE MONETARY AND FISCAL POLICY DISTINCT?

6.1. The Theory.

FG, Chapter 9; originally from *Journal of International Economics* 17,1984.
TBA, applying the fiscal theory of the price level

6.2. Examples?

Buiter, Willem, Giancarlo Corsetti and Paolo Pesenti, *Financial Markets and European Monetary Cooperation*, Chapters 2 and 3, p. 19-66. (SSL call # HG3942 B85X 1998).

Goldstein, Morris, David Folkerts-Landau, Peter Garber, Liliana Rojas-Suarez, and Michael Spencer, *International Capital Markets: Part I, Exchange Rate Management and International Capital Flows*. (SSL call # HG3891 I566).

7. LENDER OF LAST RESORT AND OTHER POLICIES TO FORESTALL OR END CRISES

CK, Chapters 10-12

Friedman and Schwartz, *A Monetary History of the United States*, Chapter 7, p. 299-419 (this was also published as a separate book, *The Great Contraction*)