

Politics, Risk, and Banking Crises

Political Science 332

Mondays & Wednesdays, 10:00 a.m. – 11:30 a.m.

Lab Sciences 301

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Course Description

This course introduces students to the politics of banking and banking risk in particular. The first phase of the course will cover the basic tenets of financial risk and how private and public institutions manage it. The second phase of the course will cover the governance of specific types of bank risk, including credit risk, liquidity risk, foreign exchange risk, settlement risk, and systemic risk. The final section of the course will cover major banking crisis episodes including the crises in Latin America and Eastern Europe in the 1980s, the East Asian crisis of the 1990s, and the global financial crisis.

Following the course, students will be able to:

- Understand some of the basic tenets of banking and bank risk;
- Understand the politics of managing bank risk;
- Apply this understanding the major banking crisis episodes.

Text

Required: None. Readings marked with a **(R)** will be made available on 3 hour reserve at the Olin library, unless otherwise stated. Readings marked with an **(E)** are available electronically through the library.

Optional:

Charles Calomiris and Stephen Haber (2014). *Fragile by design: the political origins of banking crises and scarce credit*, Princeton University Press.(R)

Richard Grossman *Unsettled account: the evolution of banking in the industrialized world*, Princeton University Press.(E)

John Kay (2015). *Other people's money: the real business of finance*, PublicAffairs.(R. Kopolow Business Library)

David Moss (2004). *When all else fails: government as the ultimate risk manager*, Harvard University Press.(R. Law Library)

Evaluation (updated)

Item	Due Date	Weight
Assignment		10%
Class presentation		10%
Final exam		50%
Essay		50%

Students may choose any combination of evaluation methods above that sum to 100%. For example, a student may complete two assignments, one class presentation, write a midterm, and complete an essay. Or a student may write an essay and a final exam. The choice is yours. If you choose to write the final exam, it will be held during the exam period. The exam will be cumulative and include a combination of multiple choice, short answer, and essay questions.

Assignments will be posted on BLACKBOARD two weeks prior to the due date. Each will consist of three or four short-answer questions. Assignments are due on-line, through BLACKBOARD ONLY, unless alternative arrangements have been made in advance. Late submission of assignments will be penalized, to a maximum of 5 days. Late penalties will be assessed on a daily basis, including weekends, at a rate of 3% per day late (i.e., 7.5/10 to 7.2/10). Assignments submitted more than 5 days late will be given a grade of 0. Extensions will not be granted except on medical grounds, with appropriate documentation.

Schedule

Lecture 1 – Introduction (Jan 14)

- *No readings*

Lecture 2 – What is risk? (Jan 16)

Required:

- John Kay (2015). *Other people's money: the real business of finance*, PublicAffairs, Chapters 1 & 2.(R. Kopolow Business Library)

- David Moss (2004). *When all else fails: government as the ultimate risk manager*, Harvard University Press, Chapter 2.(R. Law Library)

Optional:

- David Moss (2004). *When all else fails: government as the ultimate risk manager*, Harvard University Press, Introduction.(R. Law Library)

Lecture 3 – What are banks? (Jan 23)

Required:

- Anat Admati and Martin Hellwig (2013). *The bankers' new clothes: what's wrong with banking and what to do about it*, Princeton University Press, Chapters 2, 3, 4, & 5.(E)

Optional:

- Charles Calomiris and Stephen Haber (2014). *Fragile by design: the political origins of banking crises and scarce credit*, Princeton University Press, Chapters 2 & 3.(R)
- Richard Grossman *Unsettled account: the evolution of banking in the industrialized world*, Princeton University Press, 2010. Chapters 1 & 2.(E)

Lecture 4 – Financial safety nets I (Jan 28)

Required:

- Peter Bernstein (1998). *Against the gods: the remarkable story of risk*, Wiley, Introduction and Chapter 4.(E)
- The Economist: “The slumps that shaped modern finance.” Available here: <https://www.economist.com/news/essays/21600451-finance-not-merely-prone-crises-it-shaped-them-five-historical-crises-show-how-aspects-today-s-fina>

Lecture 5 – Financial safety nets II (Jan 30)

Required:

- Rafael Repullo (2005). “Liquidity, risk taking, and the lender of last resort,” *International Journal of Central Banking* Vol. 1, No. 2, pp. 47-80.
- Charles Calomiris, Marc Flandreau, and Luc Laeven (2016). “Political foundations of the lender of last resort: a global historical narrative,” *Journal of Financial Intermediation*, Vol. 28, pp. 48-65.

Optional:

- Piergiorgio Alessandri and Andrew Haldane (2009). “Banking on the state,” Paper from Material Presented at the Federal Reserve Bank of Chicago/World Bank Event - International Financial Crisis: Have the Rules of Finance Changed?
- David Moss (2004). *When all else fails: government as the ultimate risk manager*, Harvard University Press, Chapter 4.(R. Law Library)

Lecture 6 – Liquidity risk I (Feb 4)

Required:

- Rafael Repullo (2005). “Liquidity, risk taking, and the lender of last resort,” *International Journal of Central Banking* Vol. 1, No. 2, pp. 47-80.

Lecture 7 – Liquidity risk II (Feb 6)

Required:

- Michael A. Gavin (forthcoming). “Independent central banks and banking crisis liquidity,” *The Review of International Organizations*.

Lecture 8 – Credit risk (Feb 11)

Required:

- Ethan Kapstein (1994). *Governing the global economy: international finance and the state*, Harvard University Press, Chapter 1.(R)
- Ethan Kapstein (1989). “Resolving the regulator’s dilemma: international coordination of banking regulations,” *International Organization*, Vol. 43, No. 2, pp. 323-347.

Optional:

- Ethan Kapstein (1992). “Between power and purpose: central bankers and the politics of regulatory convergence,” *International Organization*, Vol. 46, No. 1, pp. 265-287.
- Maureen O’Hara and Wayne Shaw (1990). “Deposit insurance and wealth effects: the value of being ‘too big to fail’,” *The Journal of Finance* Vol. 45, No. 5, pp. 1587–1600.

Lecture 9 – The politics of international risk sharing (Feb 13)

Required:

- Michael A. Gavin (2018). “Financial safety nets and the pursuit of national autonomy in the emerging world,” Working Paper.

Lecture 10 – Foreign exchange risk (Feb 18)

Required:

- Gregory Chin (2010). “Remaking the architecture: the emerging powers, self-insuring and regional insulation,” *International Affairs*, Vol. 86, No. 3, pp. 693-715.
- Michael Dooley, David Folkerts-Landau, and Peter Garber (2004). “The revived Bretton Woods system: the effects of periphery intervention and reserve management on interest rates and exchange rates in center countries,” National Bureau of Economic Research Working Paper 10332.

Optional:

- Martin Feldstein (1999). “Self-protection for emerging market economies,” National Bureau of Economic Research, Working Paper 6907.

Lecture 11 – Settlement risk (Feb 20)

Required:

- Gary Gorton (1985). “Clearinghouses and the origin of central banking in the United States,” *The Journal of Economic History*, Vol. 45, No. 2, pp. 277-283.
- Bank for International Settlements (2003). “The role of central bank money in payment systems,” Committee on Payment and Settlement Systems. Read sections 1, 2, & 3.
- Gabriele Galati (2002). “Settlement risk in foreign exchange markets and CLS Bank,” *BIS Quarterly Review*, December.

Lectures 12 & 13 – Banking crises (Feb 25 & 27)

Required:

- Gary Gorton (2012). *Misunderstanding financial crises: why we don't see them coming*, Oxford University Press, Chapters 1, 2, & 3.(R. Kopolow Business Library)

- Charles Calomiris (2009). “Banking crises and the rules of the game,” National Bureau of Economic Research Working Paper No 15403.

Lecture 14 – Essay workshop (Mar 4)

Lectures 15 & 16 – The Great Depression (Mar 6 & 18)

Required:

- Charles Kindleberger (1986). *The world in depression: 1929-1939*, University of California Press, Chapter 14.(R)
- Barry Eichengreen (1992) *Golden fetters: the gold standard and the Great Depression*, Oxford University Press, Introduction.(R)
- Gary Gorton, Toomas Laarits, and Tyler Muir (2019). “1930: First modern crisis,” NBER Working Paper 25452.

Optional:

- Beth Simmons, (1997). *Who adjusts? Domestic sources of foreign economic policy during the interwar years*, Princeton University Press.(R)

Lecture 17 – Banking under Bretton Woods (Mar 20)

Required:

- Michael Bordo (2017). “An historical perspective on the quest for financial stability and the monetary policy regime,” Hoover Institution Economics Working Paper 17108.

Lectures 18 & 19 – The Latin American debt crisis (Mar 25 & 27)

Required:

- Jeffrey Frieden (1991). *Debt, development, and democracy: modern political economy and Latin America, 1965-1985*, Princeton University Press, Chapters 1, 2, & 3.(R)
- Thomas Oatley (2016). *International political economy*, Routledge, Chapter 14.(R)

Lectures 20 & 21 – Crises of the 1990s: East Asia and others (Apr 1 & 3)

Required:

- Thomas Oatley (2016). *International political economy*, Routledge, Chapter 15.(R)
- Barry Eichengreen (1997). “The Baring crisis in a Mexican mirror,” *International Political Science Review*, Vol. 20, No. 2, pp. 249-270.

Optional:

- Stephen Haggard (2000). *The political economy of the Asian financial crisis*, Peterson Institute for International Economics.(E)

Lecture 22 – The Eurozone and risk sharing (Apr 8)

Required:

- Waltraud Schelkle (2017). “The political economy of monetary solidarity: understanding the Euro experience,” Oxford, UK: Oxford University Press. Chapters 1, 2 & 3. (R)

Lectures 23 & 24 – The Global Financial Crisis (Apr 10 & 15)

Required:

- Martin Wolf (2014). *The shifts and the shocks: what we’ve learned – and have still to learn – from the financial crisis*, Allen Lane, Chapters 1, 2, & 3.(R. Kopolow Business Library)
- Eric Helleiner (2011). “Understanding the 2007-2008 global financial crisis: Lessons for scholars of international political economy,” *Annual Review of Political Science*, Vol. 14, pp. 67-87.

Lecture 25 – Post Global Financial Crisis (Apr 17)

Required:

- Adam Tooze (2018). *Crashed: how a decade of financial crises changed the world*, Viking, Introduction.(R)
- Michael Pettis (2013). *The great rebalancing: trade, conflict, and the perilous road ahead for the world economy*, Princeton University Press, Chapters 1, 8, & 9.(R)

Optional:

- Barry Eichengreen (2018). *The populist temptation: economic grievance and political reaction in the modern era*, Oxford University Press.(E)
- Mervyn King (2016). *The end of alchemy: money, banking, and the future of the global economy*, W. W. Norton & Company.(R)

Lecture 26 – Essay panel presentations (Apr 22)

Lecture 27 – Final Exam (Apr 24)