



The Financial System

MULT- UB.0027.01

Integrating Global Economics, Politics and Markets
In a Historical and Contemporary Context

Fall 2015

Prof Roy C. Smith

M-W 11:00 – 12.15

T/A:

Room: xxx

Course Description:

Recent global financial turbulence has demonstrated both how important the financial system is to the world economy and how complex it is.

Financial systems are centered on key institutions, instruments and markets. But they also involve governments, public policy and regulation. They span the globe from the US, the EU and Japan to Russia, China and the Emerging Markets. In critical ways, country-level financial architectures are integrating to form a more seamless, high-performance whole. This is good for efficiency, innovation and growth, yet it also amplifies problems during times of crisis.

This course provides students with a broad understanding of (i) How the global financial system works and what purposes it serves, (ii) What the major elements are and how they operate, and (iii) What risks and challenges the global financial system creates for individuals, business firms and policymakers.

In seeking to achieve these objectives, the course provides a perspective that helps students understand and make the most of their own professional opportunities. Along with a working knowledge of the global macroeconomy, foundations of finance and corporate finance, this course will be extremely helpful for students as a lens to focus on the key dimensions of the modern business environment.

Faculty:

Roy C. Smith is *Kenneth Langone Professor of Finance and Entrepreneurship* and a former partner of Goldman, Sachs & Co. and President of Goldman Sachs International. (rsmith@stern.nyu.edu)

Course Requirements:

The course requires three individually authored 1,000-word "Op-eds" submitted by each student during the semester. No group work is allowed. There can be no use of material from other sources without quotation marks, and with careful footnoting and attribution to avoid questions of plagiarism. The two best grades of the three submissions will be counted toward the final grade.

There are also closed-book mid-term and final examinations.

Class Participation:

I like to teach with lots of classroom discussion, and value initiatives taken by individual students to research things that are of interest to them and bring them up in class. At the instructors' discretion, a student's grade may be improved by as much as 10% due to class participation.

Attendance and Use of Laptops

Students are expected to attend every class and to arrive on time.

Laptops and other electronic devices may not be used in class.

Failure to follow these instructions can result in a negative class participation grade.

Blog:

I have recently launched a blog where Prof Ingo Walter and I give our views on current topics of interest relating to global banking and financial markets. In many cases the topics will be relevant to this course. So please check out "Banks and Markets: Seasoned perspectives on financial firms and markets" at bank-economics.blogspot.com

Grading:

At NYU Stern, we strive to create courses that challenge students intellectually and that meet the Stern standards of academic excellence. To ensure fairness and clarity of grading, the Stern faculty has agreed that for elective courses the individual instructor or department is responsible for determining reasonable

grading guidelines. The grading weights for this course (prior to consideration of class participation) are as follows:

- Op-eds (2) 20%
- Midterm exam 40%
- Final exam 40%

The Stern Finance Department has elected to use the following grading guidelines for this course and all other elective courses. Instructors must award grades of “A” or “A-” to approximately 35% of students in elective courses with enrollments of more than 25 students.

Textbook & Readings

There is no textbook for this course. The readings will be posted on NYU Classes under “Assignments.”

General Conduct and Behavior:

Students are expected to maintain and abide by the highest standards of professional conduct and behavior. Please familiarize yourself with Stern's Policy in Regard to In-Class Behavior & Expectations (<http://www.stern.nyu.edu/portal-partners/current-students/undergraduate/resources-policies/academic-policies/index.htm>) and the NYU Disruptive Behavior Policy (<http://www.nyu.edu/about/policies-guidelines-compliance/policies-and-guidelines/bullying--threatening--and-other-disruptive-behavior-guidelines.html>).

Academic Integrity Above All:

Integrity is critical to the learning process and to all that we do here at NYU Stern. As members of our community, all students agree to abide by the NYU Stern Student Code of Conduct, which includes a commitment to: (a) Exercise integrity in all aspects of one's academic work including, but not limited to, the preparation and completion of exams, papers and all other course requirements by not engaging in any method or means that provides an unfair advantage. (b) Clearly acknowledge the work and efforts of others when submitting written work as one's own. Ideas, data, direct quotations (which should be designated with quotation marks), paraphrasing, creative expression, or any other incorporation of the work of others should be fully referenced. (c) Refrain from behaving in ways that knowingly support, assist, or in any way attempt to enable another person to engage in any violation of the Code of Conduct. Our support also includes reporting any observed violations of this Code of Conduct or other School and University policies that are deemed to adversely affect the NYU Stern community.

The entire Stern Student Code of Conduct applies to all students enrolled in Stern courses and can be found here: www.stern.nyu.edu/uc/codeofconduct

To help ensure the integrity of our learning community, all assignments that you submit via the course's NYU Classes website will be routed through Turnitin, which will compare your submission to a database of prior submissions, current and archived Web pages, periodicals, journals, and publications. Your document will automatically become part of the Turnitin database.

Students with Disabilities

If you have a qualified disability and will require academic accommodation of any kind during this course, you must notify the instructors at the beginning of the course and provide a letter from the Moses Center for Students with Disabilities (CSD) at Tel. (212) 998-4980 or www.nyu.edu/csd verifying your registration and outlining the accommodations the Center staff recommends. If you will need to take an exam at the CSD, you must submit a completed Exam Accommodations Form (EAF) to them at least one week prior to the scheduled exam time to be guaranteed the alternative venue.

Course Outline

- | <u>Session/Date</u> | <u>Topic and Instructor</u> |
|---------------------|---|
| 1. 9/2 | Course Introduction <ul style="list-style-type: none">a. Elements of a functional economic and financial systemb. Key political philosophies of Economic Organization <p>Reading: R. Smith, "Who Was Adam Smith," from <i>Adam Smith and the Origins of American Enterprise</i>, and The History Guide, "Karl Marx – 1818-1883."</p> |
| 2. 9/9 | A Short History of the US Economic and Financial System (Guest, Prof. Richard Sylla) <ul style="list-style-type: none">a. Hamiltonian economic principles (1788)b. Ups and downs of central banking until Fed in 1913c. Globalization in 1914d. Economic Consequences of the Peace (Keynes 1919)e. US emerges as world economic superpower <p>Reading: R. Sylla, "Reversing Financial Reversals: Government and the Financial System since 1789" in <i>Government and the American Economy</i>;</p> |
| 3. 9/14 | Banks, Shadow Banks and other Financial Institutions <ul style="list-style-type: none">a. What is a bank and what does it do?b. How do banks earn money?c. Risk management in banking – market, credit, liquidityd. Asset & liability managemente. Bank failure – liquidity and solvency <p>Reading: IMF, "What is a Bank?," and "What is Shadow Banking?"</p> |
| 4. 9/16 | Fiscal and Monetary Policies <ul style="list-style-type: none">a. Fiscal: Budgets – Taxes & Spending; politicsb. Monetary Policies – Inflation, stability and full employmentc. Matching tools to goalsd. Banking as a policy transmission belte. Global dimensions of central banking <p>Reading: Alan Blinder, "How Central Should the Central Bank Be?" <i>Journal of Economic Literature</i></p> |
| 5. 9/21 | WWI Ends the Nineteenth Century and Changes the System <ul style="list-style-type: none">a. The Treaty of Versaillesb. Reparations |

- c. *The Economic Consequences of the Peace*
- d. The US and European economies of the 1920s

Reading: (Wikipedia) The Treaty of Versailles, and JM Keynes', *The Economic Consequences of the Peace*,

6. 9/23 **The Crash of 1929 and the Great Depression**

- e. The Banking Act of 1933 and the era of separated banking
- f. Application of Keynesian economics
- g. The beginning of US social welfare programs

Reading: "The Ordeal of Herbert Hoover," in David Kennedy's *Freedom from Fear (1929-1945)*

7. 9/28 **The Economics of WWII and the Cold War (1940-1950)**

- a. Financing WWII: taxation, rationing, direct controls
- b. Economic consequences of war in Europe and Japan
- c. Post war recovery efforts (Bretton Woods, Marshall Plan)
- d. The Cold War

Reading: "The War of Machines," in David Kennedy's *Freedom from Fear (1929-1945)*

8. 9/30 **How Markets Function – Laws, Regulations, Exchanges**

- a. Corporations, governments and regulation
- b. Fiduciary laws
- c. Banking and securities laws of the 1930s
- d. Stock Exchanges, over-the-counter markets
- e. Enforcement and litigation

Reading: "Legacies of the Corporation," in *Governing the Modern Corporation*, by RC Smith and Ingo Walter

9. 10/5 **Capital Markets**

- a. Deregulation, globalization and technology
- b. Capital market growth
- c. Corporations, new issues, mergers and acquisitions
- d. Market forces as change agents

Reading: "The New Financial Markets," in *Governing the Modern Corporation*, by RC Smith and Ingo Walter

FIRST OPED DUE

10. 10/7 **"Nixon Shock," the Unplanned Formation of the Euromarket**

- a. Balance of payment pressures, and funds flows

- b. Ending Bretton Woods
- c. The Euromarket evolves
- d. Swiss banks and “secret money”

Reading: “The Internationalization of American Finance - Global Banking Today,” from R C Smith, *The Global Bankers*, 1989

11. 10/14 **Japan Becomes an Economic Superpower (1970-1985)**

- a. Focus on rebuilding after World War II
- b. Zaibatsu, Keiretsu and “Japan Inc.”
- c. The Japanese banking and financial system

Reading: R. Smith: “The Rising of the Sun,” in *Comeback, The Restoration of American Banking Power*

12. 10/19 **The Oil Shock and “Petrodollars” (1973-1979)**

- a. Oil shocks in 1973 and 1978 and OPEC
- b. Distortion of global financial flows
- c. The great “third world” debt crisis and its impact of banks
- d. Sequential debt restructuring – focus on Latin America
- e. The “Brady Plan” as a successful market solution

Reading: RC Smith, “Hostage to the Bandidos,” from *Global Bankers*

13. 10/21 **Midterm Exam**

14. 10/26 **Currency Crises in Emerging Markets**

- a. Economics of development, risks of default
- b. Mexico 1982, 1988
- c. “The Washington Consensus”
- d. Asian Meltdown, 1997
- e. Argentina, 2001

Reading:

15. 10/28 **US S&L Crisis (1980-1990) (Guest: Prof. Larry White)**

- a. Ending US inflation on the 1970s (“Volcker Shock”) (1979)
- b. Causes and effects – S&L mismatching, banks try to push up share prices

Reading: Lawrence White, “A Cautionary Tale of Deregulation Gone Awry,”

16. 11/2 **The Forgotten Global Banking Crisis (1984-1994)**

- a. Failure of Continental Illinois

- b. The banking crisis grows
- c. Problems spread to Europe and Japan
- d. Deregulating Wall Street (the Fed backs off)

Reading: RC Smith, "Banking at the Brink" in *Comeback*

17. 11/4 **The EU, Maastricht the New Europe (1986-2010)**

- a. Politics and economics of the euro and the Eurozone
- b. The flawed structure of the euro-system
- c. Duties and powers of the ECB

Reading:

18 11/9 **German Unification and the Break-up of the Soviet Union**

- a. Surveying the wreckage of a failed economic system
- b. Privatization, the Treuhandanstalt and a return to the market
- c. Eastern Europe's transformation
- d. From state banks to private banks

Reading: *Jenapharm* (a case)

SECOND OPED DUE

19. 11/11 **The Great Tokyo Market Crash**

- a. The "bubble economy"
- b. The bubble bursts
- c. The aftermath – 25 years of low-to-no growth

Reading: RC Smith: "The Supernova Fades," from *Comeback*

20. 11/16 **Globalization and Market Integration**

- a. Market capitalization 3.6 times global GDP
- b. Markets are integrated, high correlation in difficult times
- c. FX flows, most for financial transactions
- d. Derivatives and hedging
- e. Importance of technology

Reading: McKinsey Global Institute, "Financial globalization: Retreat or reset?" 2013

21 11/18 **The Global Financial Crisis of 2007-2009**

- a. Preceded by tech bubble of 1999-2001
- b. MBS and excesses, lax regulation – market risk takes over
- c. Turbocharging bankers
- d. Consequences – in the financial and real sectors
- e. Fiscal and monetary policy changes
- f. Regulatory and enforcement changes

Reading:

22. 11/23 **Central Banks to the Rescue (Guest: Prof. Kim Schoenhoiltz)**

- a. Monetary intervention
- b. Quantitative easing, zero interest rates
- c. Spreading to Europe, Japan

Reading:

23. 11/30 **Greece and the Sovereign Debt Crisis in Europe**

- a. EZ Govt bond spreads after 1999
- b. Greece (and others) are rescued
- c. Flaws in the Euro system come home to roost
- d. Policy dilemmas for Germany and the others

Reading: RC Smith, “The Agony of the Euro,” *The Independent Review*, Summer 2013

24. 12/2 **The Reconstituted Global Banking System after the Crisis**

- a. Basel III
- b. G20, EU actions
- c. Dodd-Frank
- d. Prosecution and litigation
- e. The banking industry today

Reading: RC Smith, “Six Years After the Crisis,” *Journal of Financial Perspectives*, Summer 2014

25. 12/7 **Sanctions on Rule Breakers: Cuba, Iran, Russia, Syria, et. al.**

- a. What are sanctions, and how do they work?
- b. Effects of sanctions; success and failures

Reading: RC Smith and Ingo Walter, "Considering a Cuban Transition," Andrew Ross Sorkin, "High Hopes for Russia are Fading on Wall Street," *New York Times*, and *The Economist*, "Win Some, Lose Some," and "Putin, Sanctions and the Ukraine"

26. 12/9 **Red State Capitalism: Today's China**

- a. China's long road to economic growth
- b. Its existential dilemma
- c. Offshore RMB

Reading: Chapter 1, *Red Capital*, RC Smith, "A Sobering Anniversary," *Journal of Financial Perspectives*, July 2015

THIRD OPED DUE

27. 12/14 **Looking Forward, Betting on Basic Principles**

- a. Global; economic outlooks, trouble spots and unfinished business
- b. Democracy works better than authoritarianism
- c. Free markets work better than those with too much government intervention
- d. But, more is to be learned from all the future economic crises we will face

Reading: *The Economist*: "What's Gone Wrong with Democracy?" (March 1, 2014)

Final Exam: Dec xx, 10:00-11:50