

ECO 798

The Economics of Emerging Financial Markets

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COURSE DESCRIPTION:

Emerging financial markets (EFMs) are special in that they lack much of the necessary institutional infrastructure that enables their well-developed counterparts to function smoothly. This course will concentrate on problems inherent in the development of financial markets in transitional economies and in developing sound institutional structures. Some of the major topics we will focus on include: financial repression, financial development, liberalization, asymmetric information problems in financial markets, macroeconomic stabilization policies, the role of government ownership, guarantees and regulation, and institution building. This course will emphasize the economic theory behind financial market development, in general, and apply these theories to understanding and analyzing the particular problems associated with emerging market financial systems and in developing policies to enable them to operate efficiently and soundly.

TEXT: *Emerging Financial Markets*, Beim and Calomiris. The book is not great, but it is the only one that exists on EFMs. It provides good background information and statistics on EFMs.

EXAMS: There will be one exam (tentatively: 08MAY). The exam will be some combination of multiple choice, fill-in the blanks and essay. There will be occasional quizzes (about 6 quizzes total). These will be multiple choice, fill-in-the-blanks, and short answer.

SHORT TERM PAPER: Focusing on the financial problems of a particular EFM country. This paper should be about 15-20 typed pages, 1.5 spaced, 12-point type.

GRADES: The exam will comprise 35% of your grade. The term paper will be 40% of your grade, quizzes will be 20% and, attendance and participation will be worth 5% of your grade.

SCHEDULE: We will try to cover all 9 chapters of the text. To accompany the lecture topics, there will be a set of readings that I will assign to you each week. These articles will be on my website.

Outline of Course

- A. Introduction – What are Emerging Financial Markets and why are they Special?
Read: Chapter 1 (week 2)

B. Government Control and Financial Repression

Read: Chapter 2 (week 2 and 3)

1. The Role of Government in a Market Economy
2. Financial Repression By Governments (examples)
 - a. Inflation
 - b. Government Borrowing and Direction of Credit
 - c. Price Controls on Banks
 - d. Restrictions on Capital Flows
 - e. High Reserve requirements
 - f. Restrictions on Entry and Operation of Foreign Banks
3. Financial Liberalization and Financial and Economic Development

C. Institutional Foundations – Setting Incentives and Rules of the Game

Read: Chapters 3 & 4 (week 3)

D. Information and Financial Market Development

Read: Chapters 5 (week 4)

1. Asymmetric Information and Financial Market Development
 - a. Concept
 - b. Adverse Selection
 - c. Moral Hazard
2. Stock and Bond Markets
3. Mitigating Information Problems: The Dominant Role of Banks

E. The Trouble with Banks

Read: Chapter 7 (week 5)

1. Non-Performing Loans (NPL)
2. Regulation and Supervision of Banks
3. Deposit Insurance and asymmetric information problems
4. Market Discipline/Market Monitoring
5. Promoting Bank Efficiency
6. The Role of Foreign Banks in EFM Banking Systems

F. Exam (week 6)

G. Macroeconomic Stabilization Policies

Read: Chapter 6 (week 7)

1. Price Stability and Economic Development
2. Freeing Prices
3. Stabilization Policies and The Concept of a Nominal Anchor
 - a. Exchange Rate Policies
 - b. Monetary Aggregates
 - c. Interest Rates

H. Financial Crises

Read: Chapter 8

1. Crises are a Regular Feature of EFMs
2. Banking and Currency Crises
3. The Anatomy of a Crisis

I. What have we Learned? Where do we go from here?