

STANFORD UNIVERSITY

**ECON 143/MS&E 147/POLITICAL SCIENCE 127/
PUBLIC POLICY 143/INTERNATIONAL POLICY 227
FINANCE AND SOCIETY
WINTER 2019**

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COURSE DESCRIPTION

This interdisciplinary course explores the economic, political, and cultural forces that shape the financial system and, through this system, have major effects on the economy and on society. You will gain an understanding of how the interactions between individuals, corporations, governments, and the media can help the financial system and the economy work better or in turn allow those with better information and control to harm others unnecessarily. Topics include the basic principles of investment and funding, corporations and their governance, financial markets and institutions, and political and ethical issues. We will discuss recent and ongoing news events and analyses immediately relevant to the material. The approach will be rigorous and analytical but not overly mathematical. A few visitors will further enrich the discussion.

TEXTBOOK AND SUPPLEMENTARY READINGS

The required textbooks for the course are

The Bankers' New Clothes: What's Wrong with Banking and What to Do about It, Admati, Anat and Martin Hellwig, Princeton University Press, 2013 (paperback edition, 2014).

How to Speak Money: What the Money People Say – and What it Really Means, John Lanchester, Norton, 2014.

Additional materials will be online sources or put on reserve in the library. We will also discuss regularly current events related to course material, and students should try to follow the news on issues around the financial system, financial regulation, etc.

ATTENDANCE AND CLASS ENGAGEMENT

Students should attend class and read assigned materials prior to class. Class participation grades will reflect attendance and quality of contribution to the discussion in the top 15 class sessions (out of 17). *Participation is particularly important for those sessions when we have visitors.* The visitors can provide insights and opportunities to engage that are invaluable and which cannot be easily replicated.

To improve engagement and class participation, we will use Poll Everywhere technology. Please register at <https://www.polleverywhere.com/> using your correct student name as in Stanford directory, download the Poll Everywhere App (for use in class) and respond to surveys and polls when prompted.

REVIEW SESSION

Course Assistant will lead review sessions on Fridays during the same time as class to allow for more discussion and review and to go over problem sets and assignments. Attending the sessions is strongly recommended. Please sign up for the Piazza course in the first week of the quarter [here](#).

GRADING

There will be 5-7 problem sets or short assignments; students can work on those in small groups and turn in the problem sets via Gradescope. Gradescope access code is 9GE835. In addition, there will be a midterm exam and a final exam. These will be held as follows:

- **Midterm exam: in class on Wednesday, Feb. 6, 2019.**
- **Final exam: Wednesday, March 20, 2018, 3:30-6:30 pm.**

Please note these times and consult teaching staff as soon as possible regarding any conflicts or accommodations you may need by the end of Week 2 of the quarter.

The course grade will be determined by:

- | | |
|----------------------------|-----|
| ○ Class participation | 20% |
| ○ Problem sets/Assignments | 20% |
| ○ Midterm exam | 20% |
| ○ Final exam | 40% |

Schedule

BNC refers to *Bankers New Clothes*, HSM refers to *How to Speak Money*

Session 1

Monday, 1-7-19

Introduction: Why and How Much Finance?

Topics:

Course overview; what is finance about? Who are the participants?
How does everyone interact with the system?

Read:

HSM: pp. 3-30

“My Speech to Finance Graduates,” Robert Shiller, *Project Syndicate*, May 22, 2012 <https://som.yale.edu/news/news/robert-shiller-addresses-finance-graduates>

“Jeb Hensarling and the Allure of Economism,” James Kwak, *Baseline Scenario*, December 20, 2016
<https://baselinescenario.com/2016/12/20/jeb-hensarling-and-the-allure-of-economism/>

“A Boom in Credit Cards: Great News for Banks, Less So Consumers,” Jessica Silver-Greenberg and Stacy Cowley, *New York Times*, October 19, 2017
<https://www.nytimes.com/2017/10/19/business/credit-cards-debt-banks.html>

Session 2

Wednesday, 1-9-19

Time and Money

Topics:

Why does money have “time value?” interest rates; future and present value, financial decisions.

Read:

HSM: Interest rates, Inflation, Deflation, Bond, Compound interest, Hyperinflation, Real and nominal, 72.

“Note on the Time Value of Money” (posted on Canvas).

Session 3

Monday, 1-14-19

Risk, Insurance, and Diversification

Topics:

Random variables and expected value, insurance and “hedging;” reducing risk by diversification; prices and returns; risk premium.

Read:

HSM: Hedge (pp 21-22), Insurance, Securities, risk, yield, hedge.

“What Republicans, Democrats Aren't Telling You About Repealing the Individual Mandate,” Robert Pearl, *Forbes*, December 5, 2017

<https://www.forbes.com/sites/robertpearl/2017/12/05/individual-mandate/#141d955964e0>

“Student Borrowers Assume Too Much Risk,” Atif Mian and Amir Sufi, *Washington Post*, May 29, 2014

http://www.washingtonpost.com/opinions/student-borrowers-assume-too-much-risk/2014/05/29/e2ebfdb0-df81-11e3-8dcc-d6b7fede081a_story.html

Session 4

Monday, 1-16-19

Topics:

Borrowing and Risk

Mortgages; corporations; balance sheets and limited liability; leverage and risk, raising equity, the dilution fallacy, payouts.

Read:

BNC: Chapter 2

HSM: Balance sheet, Mortgage, No-recourse loan, Limited liability, Equities, Rights issue

“A House is Not a Credit Card,” Bethany McLean, *New York Times*, November 13, 2014

<http://www.nytimes.com/2014/11/14/opinion/a-house-is-not-a-credit-card.html>

Monday, 1-21-19

MLK holiday

Session 5

Wednesday, 1-23-19

Topics:

The Dark Side of Borrowing

Default and the bankruptcy process; liquidity problems, student debt; insolvency, distress, conflicts of interest, debt overhang, risk-shifting.

Read:

BNC: Chapter 3.

HSM: Bankruptcy, Default, Chapter 11, Haircut, Insolvent, Holes in the balance sheet; Restructuring, Student loans;

“Is Debt Overhang Causing Firms to Underinvest?” Filippo Occhino, Federal Reserve Bank of Cleveland, July 10, 2010

<https://www.clevelandfed.org/en/newsroom-and-events/publications/economic-commentary/economic-commentary-archives/2010-economic-commentaries/ec-201007-is-debt-overhang-causing-firms-to-underinvest.aspx>

“Who Could Get Hurt by PG&E’s Fire-Driven Bankruptcy: QuickTake,” David Baker, Bloomberg News, January 14, 2019
<https://www.bloomberg.com/news/articles/2019-01-14/who-could-get-hurt-by-pg-e-s-fire-driven-bankruptcy-quicktake>

Session 6

Monday, 1-28-19

Banking Basics

Topics:

Commercial banks and central banks; deposits and payment system; loans; risks in banking; bank runs; deposit insurance;

Read:

BNC: Chapter 4, Chapter 10, pp. 148-158

HSM: Bank of England, Banking Union, Cajas, Central banks, ECB, Extend and pretend, Federal Reserve, Fiat money, Lender of last resort, Quantitative easing (QE), Reserve currency, SMEs, ZIRP, Zombie bank

“Europe’s banking union lacks the key element of deposit insurance,” Isabel Schnabel, *Financial Times*, August 28, 2018
<https://www.ft.com/content/4a3d048a-a9fb-11e8-8253-48106866cd8a>

Watch:

That Movie about Money
https://www.youtube.com/watch?v=pfXIA_zTfxY

Session 7

Wednesday, 1-30-19

Systemic Risk and the Financial Crisis

Topics:

Securitization, investment banks; derivatives and other innovations; the interconnectedness of the system; financial crises and systemic risk.

Read:

BNC: Chapter 5.

HSM: Black Scholes, Credit Default Swap (CDS), Derivatives, Investment Banks, Interest Rate Swaps, Repo, Options, OTC, Prop trading, Securitization, Shadow Banking, Synthetic, Traders, analysts & quants.

“Are You Ready for the Financial Crisis of 2019?” Alex Williams, *New York Times*, December 10, 2018
<https://www.nytimes.com/2018/12/10/style/2019-financial-crisis.html>

Session 8

Monday, 2-4-19

Markets, Information, and Governance

(Visitor: Fahmi Quadir)

Topics:

The purpose and control of corporations; hedge funds; long and short positions in financial markets, fraud.

Read:

HSM: Stocks and shares, Shareholder value, Greater Fool theory, Hot money, Long and short, Mr. Market

“Presentation to House Subcommittee for hearing on “The Long and Short of Hedge Funds: Effects of Strategies for Managing Market Risk,” David Rocker, May 22, 2003 (posted on Canvas), from p.2 bottom “I would like...” till p.4 fn 3, end of quote.

“Short Seller Who Foresaw Valeant Crash Now Bets on Tesla Falling,” Tatiana Darie, Bloomberg News, October 9, 2018
<https://www.bloomberg.com/news/articles/2018-10-09/short-seller-who-foresaw-valeant-crash-now-bets-on-tesla-falling>

Session 9

Wednesday, 2-6-19

Midterm (material through Session 7)

Session 10

Monday, 2-11-19

Introduction to the Politics of Banking

(Visitor: Graham Steele)

Topics:

Was the 2007-2009 crisis preventable? Can laws and regulations help prevent future crises and, if so, how?

Read:

BNC: Chapters 6

HSM: Externalities; Deregulation, City of London, Glass Steagall, Reform, Regulatory, Volcker rule, Bullshit vs nonsense, Nationalization, Moral Hazard, Rent.

“Banks’ Lobbyists Help in Drafting Financial Bills,” Eric Lipton and Ben Protess, *New York Times*, May 23, 2013
<https://dealbook.nytimes.com/2013/05/23/banks-lobbyists-help-in-drafting-financial-bills/>

Session 11

Wednesday, 2-13-19

The Economics of Equity Funding in Markets

Topics:

Debt and equity funding in financial markets, book and market values, managerial incentives.

Read:

BNC, Chapter 7 and 8

HSM: Private Company; Governance, London Whale Bond market, Debt for equity, Market capitalization, Deleveraging

Monday, 2-18-19

President Day holiday

Session 12

Wednesday, 2-20-19

The Role and Regulation of Auditors (Visitor: Samantha Ross)

Topics

Accounting standards and auditors; regulation of auditors; enforcement.

Read:

Regulators Draw from Audit Firms, Kathleen Day, Washington Post, June 7, 2002,
https://www.washingtonpost.com/archive/business/2002/06/07/regulators-draw-from-audit-firms/33bc4988-7a3f-4ed3-93dd-2f08989d6b0b/?utm_term=.0fdb287956b7

“The Dozy Watchdogs,” Dan Rosenheck, *The Economist*, December 13, 2014.

<http://www.economist.com/news/briefing/21635978-some-13-years-after-enron-auditors-still-cant-stop-managers-cooking-books-time-some>

“The Big Flaw: Auditing in Crisis,” Jonathan Ford and Madison Marriage, *Financial Times*, July 31, 2018.

<https://www.ft.com/content/29ccd60a-85c8-11e8-a29d-73e3d454535d>

Session 13

Monday, 2-25-19

Subsidies in Banking and Corporate Governance (Visitor: Sarah Bloom Raskin)

Topics:

Debt subsidies, too-big-to-fail, corporate purpose and governance.

Read:

BNC Chapter 9

“The Great Bank Escape,” Anat Admati, *Project Syndicate*, December 31, 2012

https://admati.people.stanford.edu/sites/g/files/sbiybj1846/f/the_great_bank_escape_by_anat_admati_-_project_syndicate.pdf

“Vanguard's John Bogle Created More Social Good than any Contemporary in Finance,” JC de Swaan, *Quarz*, January 18, 2019

<https://qz.com/1527689/vanguards-john-bogle-created-more-social-good-than-any-contemporary-in-finance/>

Session 14

Wednesday, 2-27-19

The Role of the Media

Topics:

The role of media in informing and educating the public, why and how media can become distorted; comparing finance and tech.

Read

“Telegraph's Peter Osborne resigns, saying HSBC coverage a 'fraud on readers',” John Plunkett and Ben Quinn, *Guardian*, February 18, 2015 <http://www.theguardian.com/media/2015/feb/17/peter-osborne-telegraph-hsbc-coverage-fraud-readers>

“Germany’s regulator bans short-selling in Wirecard,” *The Economist*, February 21, 2019
<https://www.economist.com/finance-and-economics/2019/02/23/germanys-regulator-bans-short-selling-in-wirecard>

“Why we need to regulate the tech platforms,” Rana Foroohar, *Financial Times*, November 5, 2017,
<https://www.ft.com/content/84f402ac-bfc0-11e7-b8a3-38a6e068f464>

Session 15

Monday, 3-4-19

Capital Regulations and Global Politics

Topics:

Capital regulations (levels, calibration, equity substitutes, measurements), level playing field and national champions

Read:

BNC, Chapter 12 (Chapter 11 optional)

HSM: Deregulation, Leverage, Basel III, Core capital, Risk weighting. G7, G8, G20, ESM, IMF, “Tragedy of the commons,” Troika, sovereign, technocrat.

“BoE official warns against return to ‘light-touch’ regulation,” Caroline Binham, *Financial Times*, February 26, 2017
<https://www.ft.com/content/0e36b7fe-fac2-11e6-9516-2d969e0d3b65>

Letter to Senate Banking Committee, Anat R. Admati, John H. Cochrane, Paul Pfleiderer and Amit Seru, September 25, 2018
<https://admati.people.stanford.edu/sites/g/files/sbiybj1846/f/admati-cochrane-pfleiderer-seru-letter-9-25-2018.pdf>

Session 16

Wednesday, 3-6-19

Institutional Investors and Financial Markets (Guest: Jay Kang)

Topics:

Institutional investor types including asset managers, endowments, sovereign wealth funds. How individuals can invest.

Read:

HSM: Asset Allocation, Arbitrage, EFFs, Fundamentals, Graham, Ben (1894-1976),

“Auther’s Note: Ivy League,” John Authers, *Financial Times*, November 16, 2017 (until “Macy’s Bursting Balloon”)

<https://www.ft.com/content/77784830-cb24-11e7-ab18-7a9fb7d6163e>

“Stop Universities from Hoarding Money,” Victor Fleischer, *New York Times*, August 19, 2015

<https://www.nytimes.com/2015/08/19/opinion/stop-universities-from-hoarding-money.html>

(Optional) “Melting pot,” Tom Buerkle, *Reuter Breaking Views*, February 20, 2019

<https://www.breakingviews.com/features/university-endowments-are-study-in-u-s-inequality/>

Session 17

Monday, 3-11-19

Financial Market and Technology

Read:

HSM: High-Frequency Trading, Hot money, Manias, panics, and crashes. Bitcoin and digital assets

“Bitcoin was not a Bubble, until it was,” Spencer Jacob, *Wall Street Journal*, December 14, 2018

<https://www.wsj.com/articles/bitcoin-wasnt-a-bubble-until-it-was-11544783400>

“U.S. SEC Stops 'Munching' Munchee's ICO After Registration Concerns Raised,” Roger Aitken, *Forbes*, December 12, 2017

<https://www.forbes.com/sites/rogeraitken/2017/12/12/u-s-sec-stops-munching-munchees-ico-after-registration-concerns-raised/#5c37d84f3144>

“Sen. Brian Schatz introduces a new bill to tax stock trades and curb high-frequency trading,” Emily Stewart, *Vox*, March 5, 2019

<https://www.vox.com/policy-and-politics/2019/2/28/18235067/brian-schatz-financial-transaction-tax-stock-market>

Session 18

Wednesday, 3-13-19

Conclusion: Making Finance Work for Society

Topics:

Summary of the key ideas and what they might mean to your interactions with the financial system in your future personal and professional life; fiduciary rule.

Read:

BNC prefaces, Chapter 13 (Chapter 1 optional)

“The 21 Questions You’re Going to Need to Ask About Investment Fees,” Ron Lieber, *New York Times*, February 10, 2017
<https://www.nytimes.com/2017/02/10/your-money/the-21-questions-youre-going-to-need-to-ask-about-investment-fees.html>

“Financial Crises, Corporate Scandals and Blind Spots: Who is Responsible?” Anat Admati, London School of Economics Blog, January 25, 2018
<https://blogs.lse.ac.uk/businessreview/2018/01/25/financial-crises-corporate-scandals-and-blind-spots-who-is-responsible/>

(Optional) “Wells Fargo Says Its Culture Has Changed. Some Employees Disagree,” Emily Flitter and Stacy Cowley, *New York Times*, March 9, 2019
<https://www.nytimes.com/2019/03/09/business/wells-fargo-sales-culture.html>