

Creating the Modern Financial System

**Course Syllabus
Professor David Moss**

CREATING THE MODERN FINANCIAL SYSTEM

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Creating the Modern Financial System offers a vital perspective on finance and the financial system by exploring the historical development of key financial instruments and institutions worldwide. The premise of the course is that students will gain a richer and more intuitive understanding of modern financial markets and organizations by examining where these institutions came from and how they evolved. The course is ideal for anyone who wants to deepen his or her understanding of real-world finance.

COURSE ORGANIZATION AND OBJECTIVES

The course content covers seminal financial developments in a diverse set of countries – but with a special focus on the United States – from the 18th century to the present. Reaching across the chronological arc of the course are three broad topics: (1) financial markets and instruments, (2) financial intermediaries, and (3) financial behavior. Although nearly every case touches on all three topics, each case also has a primary focus. Whereas some cases highlight the introduction of new financial markets (such as the Dojima futures market in early modern Japan) or the creation of new instruments (such as mortgage-backed securities), others trace the emergence and maturation of critical financial institutions (including banks and insurance companies). Still others focus on the behavior of financial actors and groups, particularly in the context of financial bubbles and crashes. Because the course highlights the origins of financial markets and instruments as well as the fallout from numerous financial crises, government also looms large as an actor in many of the cases.

Throughout the course, the goal is to provide students with the broadest possible grounding in real-world finance by exposing them to some of the greatest (and, at times, most devastating) moments in modern financial history. Although the past is unlikely to repeat itself exactly, business managers who have a strong background in financial history are likely to be better prepared for the full diversity of financial innovations, shocks, and crises that they'll face in the future.

COURSE ADMINISTRATION

Course grades will be based on class participation (50%) and a final paper (50%).

- CLASS #1: [The South Sea Company \(A\)](#) (708005)
- CLASS #2: [The Dojima Rice Market and the Origins of Futures Trading](#) (709044)
- CLASS #3: [Constructing a Nation: The United States and Their Constitution, 1763-1792](#)
(795063)
- CLASS #4: [Wall Street's First Panic \(A\)](#) (708002)
- CLASS #5: [Ruling the Modern Corporation: The Debate over Limited Liability in Massachusetts](#) (708016)
- CLASS #6: [The Campaign for Bank Insurance in Antebellum New York](#) (708037)
- CLASS #7: [Envisioning "Free Banking" in Antebellum New York \(A\)](#) (708038)
- CLASS #8: [The Armstrong Investigation](#) (708034)
- CLASS #9: [Financing American Housing Construction in the Aftermath of War](#)
(708032)
- CLASS #10: [Forecasting the Great Depression](#) (708046)
- CLASS #11: [German Banking Crisis](#) (710059)
- CLASS #12: [The Federal Reserve and the Banking Crisis of 1931](#) (709040)
- CLASS #13: [The Pecora Investigation](#) (711046)
- CLASS #14: [The Deutsche Bank \(A\)](#) (708044)
- CLASS #15: [Managing Failure: American Bankruptcy Law at a Crossroads](#)(705024)
- CLASS #16: [Fannie Mae: Public or Private?](#) (709025)
- CLASS #17: [Financing Higher Education in Australia](#) (711047)
- CLASS #18: [French Pension System: On the Verge of Retirement?](#) (799143)
- CLASS #19: [The International Monetary Fund in Crisis](#) (708035)
- CLASS #20: [Fed vs. ECB: Steering Monetary Policy Through Unprecedented Crises](#)
(711048)
- CLASS #21: [The Financial Crisis of 2007-2009, Part I \(Origins of the Crisis\)](#)(711104)

CLASS #22: [The Financial Crisis of 2007-2009, Part II](#)
(711104)

CLASS #1

TOPIC

The South Sea Company (A)

In early 1720, the South Sea Company and the Bank of England were competing for the right to issue new shares and to exchange those shares for government bonds that were then in the hands of the public. The British government had already executed two such debt conversions with the South Sea Company, in 1711 and 1719. The conversion under consideration in 1720, however, would be on a much larger scale. In time, the South Sea Company won the bidding war, and the House of Commons approved its debt conversion plan. Now it was up to the House of Lords to approve or reject the deal.

MATERIALS

[The South Sea Company \(A\)](#) (708005)

ASSIGNMENT

1. Up through 1719, had John Blunt and the South Sea Company served the British government well or poorly?
2. What was the South Sea Company's business model?
3. Should the House of Lords approve the South Sea Company's new conversion proposal in 1720?

CLASS #2

TOPIC

The Dojima Rice Market and the Origins of Futures Trading

In 1730, Japanese merchants petitioned shogun Tokugawa Yoshimune to officially authorize trade in rice futures at the Dojima Exchange, the world's first organized (but unsanctioned) futures market. For many years, the Japanese government had prohibited the trade of futures bills because it was widely regarded as a form of gambling that caused rice prices to rise. However, when the price of rice fell to record lows in the late 1720s, the samurai (whose income was tied to the value of rice) saw their economic position fall relative to the merchant class, whose growing economic power worried the nation's elites. The shogun responded by easing restrictions on futures trading, but without officially sanctioning a futures market at Dojima. The question now was whether he should heed the merchants' petition and take the next step.

MATERIALS

[The Dojima Rice Market and the Origins of Futures Trading](#) (709044)

ASSIGNMENT

1. Why did the Dojima market develop? What purpose(s) did it serve?
2. How did the market work? Please do your best to make sense of the various players, instruments, and transactions involved.
3. Should Yoshimune officially authorize a futures market at Dojima in 1730? Why or why not?

CLASS #3

TOPIC

Financial Turmoil, High Politics, and the U.S. Constitution

On February 11, 1790, James Madison walked onto the floor of the newly created House of Representatives and publicly rejected the financial handiwork of his old ally, Alexander Hamilton. At issue was Hamilton's "Report Relative to a Provision for the Support of Public Credit," which he submitted to Congress on January 14, 1790. The Report offered a sweeping financial program to deal with the many varieties of public debt accumulated during the American colonists' War of Independence against Britain. For a number of years in the late 1780s, Madison and Hamilton had worked closely together to craft and promote a new Constitution for the United States of America. Their efforts reached fruition when the Constitution was ratified in 1788 and when a new federal government was established the following year. But now, with Hamilton serving as Secretary of the Treasury under President George Washington and Madison representing his Virginia constituents in the House, these two political and intellectual giants emerged as fierce rivals as they struggled over how best to deal with the new nation's tenuous financial position.

MATERIALS

[Constructing a Nation: The United States and their Constitution, 1763-1792 \(795063\)](#)

ASSIGNMENT

The second discussion question below asks you to evaluate the Constitution as an economic strategy. Although the entire Constitution and the Bill of Rights are reprinted in the case (and are worth reading), some portions are more important than others for our purposes in the discussion. In preparing for class, you should focus especially on the following portions of the Constitution:

- . Article I, Sections 8-10 (pp. 18-19)
 - . Article II, Section 2 (pp. 20-21)
 - . Article III, Section 2 (p. 21)
 - . Articles IV-VI (pp. 22-23)
 - . Amendment V (p. 24)
1. What are the biggest challenges – economic and otherwise – facing the new nation in 1786-1787?
 2. In what ways was the Constitution designed to address these challenges? Try to evaluate the Constitution as an "economic strategy".
 3. Should the U. S. Congress adopt Hamilton's proposal to fund both the state and federal debts? (Should all state debts be assumed by the federal government? Should payment be made to the original or ultimate creditors?)
 4. Does the American experience in the late 18th century hold any lessons for Europe today?

CLASS #4

TOPIC

Wall Street's First Panic

In the early 1790s, a flood of newly issued public and private securities sparked an investment boom in the nascent United States. In New York, the bustling commercial district along Wall Street emerged as the center of the city's securities trade. One of the many Americans drawn into the frenetic and largely unregulated securities market was William Duer, who ultimately became a major player on the Street. As it turned out, however, Duer's financial dealings proved unsustainable, and his financial collapse helped to bring the securities boom to a halt. Shocked by the widespread devastation wrought by Wall Street's first panic, the New York legislature acted quickly to ban outdoor securities auctions and a popular class of financial instruments known as "time bargains,"

both of which were thought to have contributed to the boom and bust on Wall Street. Facing public outrage along with the new legal restrictions, New York's top brokers had to decide whether a new system for securities trading was needed and, if so, what it should look like.

MATERIALS

[Wall Street's First Panic \(A\)](#) (708002)

ASSIGNMENT

1. Who (or what) was most to blame for the financial panic of 1792?
2. Did lawmakers in Albany respond appropriately? Should they have done anything differently?
3. Did private actors (such as the leading brokers) have any responsibility to clean up the market? If so, what would you have recommended that they do?
4. Is there anything else that should have been done to help prevent another financial panic on Wall Street?

CLASS #5

TOPIC

Ruling the Modern Corporation: The Debate over Limited Liability in Massachusetts

In 1830, Governor Levi Lincoln, Jr. urged the Massachusetts state legislature to introduce a limited liability regime for manufacturing corporations similar to that adopted in neighboring states. At least since 1809, shareholders in the state's manufacturing corporations had faced unlimited liability, which held shareholders personally liable for corporate debts. While unlimited liability was meant to ensure financial prudence, Lincoln and others worried that this policy was doing more harm than good and driving capital from the state. With the governor pushing for action, it was up to the state legislature to decide how to proceed.

MATERIALS

[Ruling the Modern Corporation:](#)

[The Debate over Limited Liability in Massachusetts](#) (708016)

ASSIGNMENT

1. If you had been advising public officials in the early nineteenth century, what policies (if any) would you have recommended to help promote manufacturing -- either at the state level, the federal level, or both?
2. Should the Massachusetts legislature approve the limited liability law that Governor Lincoln is urging them to pass? Please identify the best arguments and evidence that could be marshaled both for and against your position.
3. Was any sort of liability law necessary? That is, could private parties have negotiated suitable liability arrangements on their own? Why or why not?

CLASS #6

TOPIC

The Campaign for Bank Insurance in Antebellum New York

The New York State legislature had come to a standstill in 1829 as lawmakers refused to charter any new banks or recharter any existing banks. Four of New York's forty banks had failed since 1825, and many legislators believed that a significant change in the banking regime was needed to shore up the state's financial system. Others, however, feared that a major change in the law was too risky, especially since over three-quarters of the state's banks held charters that were slated to expire over

the next four years. On the table was a completely untested proposal to create a mandatory public insurance fund that would back the banknotes and deposits of every state bank. As bank charters throughout New York State rapidly approached expiration, lawmakers faced a tough decision: should they pass the bill and gamble with the untried insurance fund, or should they seek a more traditional solution to the state's banking woes?

MATERIALS

[**The Campaign for Bank Insurance in Antebellum New York \(708037\)**](#)

ASSIGNMENT

1. What is the purpose of banks? Why is banking so prone to instability?
2. What were the main advantages and disadvantages of New York State's bank chartering system?
3. If you had been advising New York State's leading bankers in 1829, would you have recommended that they support or oppose Joshua Forman's mandatory bank insurance proposal?
4. If you had been advising New York State lawmakers in 1829, would you have recommended that they pass or defeat the bank insurance proposal?

CLASS #7

TOPIC

Envisioning "Free Banking" in Antebellum New York

Banks throughout New York State suspended specie payments (i.e., payments in gold and silver) in May 1837 following the collapse of several state banks and the onset of a nationwide financial panic. Amid the chaos, the upstart Whigs were able to depose the longstanding Republican majority in the state legislature. Responding to citizen anger, as well as perennial calls for more banking capital, the Whigs drafted a novel "free banking" bill, which would override the established bank chartering mechanism and allow any association with sufficient capital the opportunity to open a bank and issue bank notes (a widely accepted form of paper money at the time). The bill also required that every note issued by a New York bank be fully backed by bonds or mortgages. If enacted, the bill seemed likely to encourage the establishment of many new banks. There was no telling what the economic impact of the bill's special bank note provisions would be. Once the bill passed the legislature, Governor Marcy had to decide whether to sign this radical proposal into law.

MATERIALS

[**Envisioning "Free Banking" in Antebellum New York \(A\) \(708038\)**](#)

ASSIGNMENT

1. Was a new banking law needed in New York State in 1837?
2. What were the biggest strengths and weaknesses of the "free banking" proposal? If enacted, would free banking eliminate the problem of bank runs in the future? Why or why not?
3. If you were advising New York's leading bankers in 1837, would you have recommended that they support or oppose the free banking bill? Would you have recommended that they propose anything else as either a substitute or a complement?
4. If you were advising Governor Marcy in 1837, would you have recommended that he sign the free banking bill into law? Would you have recommended that he propose any other legislation, either as a substitute or a complement?

CLASS #8

TOPIC

The Armstrong Investigation

In the early 20th century, public outrage at certain life insurance practices led to an investigation in New York State that threatened to curtail growth in the industry. Charles Evans Hughes guided the four-month-long Armstrong Investigation, which made startling revelations and offered a number of controversial recommendations, several of which would forbid the most popular form of life insurance (tontine insurance), limit the growth of life insurers (which included several of the nation's largest financial institutions at the time), and prevent insurance firms from owning the stock of other companies. The New York State legislature approved all of the recommended measures and sent the bill to the Governor for his signature. The life insurance industry objected, however, claiming that some of the new rules would reduce consumer choice and unnecessarily lower returns on company investments.

MATERIALS

[The Armstrong Investigation](#) (708034)

ASSIGNMENT

1. What accounts for the dramatic growth of life insurance in the United States over the second half of the nineteenth century?
2. Why was life insurance regulated from such an early time? In your view, what types of regulation of life insurance are most appropriate? Least appropriate?
3. If you were advising Governor Higgins in 1906, would you have recommended that he sign the "big bill"? Why or why not? In your view, which of the Armstrong proposals were most needed? Least needed?

CLASS #9

TOPIC

Financing American Housing Construction in the Aftermath of War

At the end of WWI, the United States faced a significant housing shortage. Public officials feared the spread of disease – and even communism – in the nation's cramped urban centers where vacancy rates held near zero and families often "doubled up" in single housing units. Hoping to spark a burst of new construction, New York Senator William Calder called for the creation of eleven regional Federal Building Loan Banks that would serve as a new source of funds for mortgage lenders. The proposal was controversial, however. Opponents disliked the fact that the Federal Building Loan Banks would have the authority to issue tax-free, mortgage backed bonds, and many claimed that the private market would solve the housing shortage on its own. Proponents of the bill, meanwhile, believed that it was necessary to stave off a potentially disastrous and protracted housing shortage, and they cited the long-successful mortgage bond markets in France and Germany as evidence that their plan could succeed. Federal lawmakers had to assess the arguments on both sides and render a decision.

MATERIALS

[Financing American Housing Construction in the Aftermath of War](#) (708032)

ASSIGNMENT

1. Evaluate the strengths and weaknesses of the U.S. mortgage market as of 1919. What were the most important weaknesses, and what accounts for them?
2. What, if anything, should Americans in 1919 have learned from the earlier German and French innovations in the mortgage markets? Why hadn't European style mortgage bonds taken off in the United States?
3. Should Congress and the President enact Senator Calder's Federal Building Loan Bank bill?

CLASS #10

TOPIC

Forecasting the Great Depression

What is the proper role of professional economic forecasts in financial decision making? This case presents excerpts from three leading economic forecasters on the eve of, and just after, the stock market crash of October 1929. One set of excerpts is from Roger Babson, an entrepreneur from Wellesley, Massachusetts, who gained considerable fame for correctly predicting the market downturn on the basis of his own forecasting device, the “Babsonchart.” A second set of excerpts is from the staff of the Harvard Economic Society, an international group of illustrious economists and statisticians. To create its forecasts, the Harvard Economic Society developed a model that traced economic activity in three areas: speculation, business, and money. The Harvard group had great success when they introduced their model in the early 1920s, but failed to predict the stock crash in 1929. A third set of excerpts is from Irving Fisher, the premier monetary economist of his day and one of the most respected American economists of all time. Although the crash caught Fisher completely by surprise, he remained a major figure in the forecasting field in the 1930s. The case also includes a review of efforts following the crash, including those of the University of Chicago professor Garfield V. Cox, to estimate the accuracy of earlier forecasts.

MATERIALS

[Forecasting the Great Depression](#) (708046)

ASSIGNMENT

1. Which economic and financial forecasts, if any, would you have trusted in December 1929? In December 1931? Which forecasts would you have found most compelling? Least compelling? Why?
2. How, if at all, should financial analysts and investors make use of professional economic and financial forecasts?
3. Why did the Great Depression fool so many professional forecasters?

CLASS # 11

TOPIC

German Banking Crisis

In the summer of 1931, Germany was struggling with a deepening economic crisis. Production had fallen, unemployment was high, and bank deposits and gold were being withdrawn from the country at a rapid pace, threatening the value of the German mark. The country’s third largest bank, the Danatbank, was especially hard hit by the flagging economy and the flight of capital.

By July, the Danatbank was on the verge of collapse, and the bank’s charismatic and controversial senior partner, Jakob Goldschmidt, appealed personally to the government, the central bank, and his private banking rivals for a lifeline.

MATERIALS [Danatbank](#) (710059)

ASSIGNMENT

1. What, if anything, should the Reichsbank do to address the impending failure of the Danatbank in mid-July 1931?
2. What, if anything, should the De-Di Bank (the Deutsche Bank und Disconto-Gesellschaft) do to address the impending failure of the Danatbank?
3. Is there anything wrong with simply allowing the Danatbank to fail?
4. If you were advising the German Chancellor at this time, what advice would you

have offered regarding the Danatbank? What economic and political issues would have been of greatest concern?

CLASS #12

TOPIC

The Federal Reserve and the Banking Crisis of 1931

In early October 1931, in the midst of a global economic depression, the U.S. banking system was in crisis -- with bank suspensions running at near record levels. At the same time, the broader economy was sputtering, and U.S. gold reserves had come under severe pressure after Britain abandoned its gold standard in mid-September. As pressure continued to mount, the leaders of the Federal Reserve faced several critical decisions. Should they adjust interest rates? Was abandoning the gold standard an acceptable option? Should they lend more freely to the nation's commercial banks? Or would this only ensure the sorts of financial excess that had gotten the country into trouble in the first place? Was it time to give in to the mounting pressure, or to hold firm?

MATERIALS

[The Federal Reserve and the Banking Crisis of 1931 \(709040\)](#)

ASSIGNMENT

1. Why did Congress create the Federal Reserve in 1913, and what purposes was it intended to serve?
2. Who was most to blame for the U.S. banking crisis in 1930-31? Could this banking crisis have been prevented?
3. How would you characterize the Federal Reserve's response to the crisis up through September 1931? Was it reasonable/appropriate under the circumstances?
4. If you were advising Federal Reserve officials in early October 1931, what would you have recommended that they do?

CLASS # 13

TOPIC

The Pecora Investigation

In 1932, in the depths of the Great Depression, the Senate Banking Committee began a much-publicized investigation of the nation's financial sector. The hearings, which came to be known as the Pecora hearings after the Banking Committee's lead counsel Ferdinand Pecora, revealed how the country's most respected financial institutions knowingly misled investors as to the desirability of certain securities, engaged in irresponsible investment behavior, and offered privileges to insiders not afforded to ordinary investors. During the famous "Hundred Day" congressional session that began his presidency, Roosevelt signed two bills meant to prevent some of these abuses. The first law required companies to register new securities with the Federal Trade Commission (FTC) and to publish prospectuses with detailed information on their business ventures before they could offer new securities to the public. The second law established insurance for bank deposits and forced financial institutions to choose between investment and commercial banking.

Roosevelt also believed that the government should play a more active role in the financial system by regulating national securities exchanges. In February 1934, the president urged Congress to enact such legislation, prompting the introduction of a bill entitled the Securities Exchange Act. If enacted, this bill would force all securities exchanges to register with the Federal Trade Commission, would curtail the size of loans that could be advanced to securities investors, and would ban a number of practices (such as short-selling) that were thought to facilitate stock manipulation. Additionally, the legislation would require that all companies with exchange-listed securities publish detailed business reports as frequently as the FTC desired

and would subject any company or exchange deemed to be in violation of the act's provisions to increased legal liability.

Wall Street, represented in particular by New York Stock Exchange (NYSE) President Richard Whitney, took a strong position against the Securities Exchange Act. Whitney was ultimately summoned to testify during the congressional hearings on the Securities Exchange Act in late February 1934. Would he be able to convince lawmakers that the Securities Exchange Act would impose overly burdensome regulations on exchanges and stifle American securities markets, or would his arguments fail to win over those who believed that strict regulations were exactly what financial markets required following the Great Crash?

MATERIALS

[The Pecora Investigation](#) (711046)

ASSIGNMENT

1. Did the Pecora Hearings do more good than harm, or more harm than good?
2. If you had been a member of Congress in 1934, would you have favored or opposed the National Securities Exchange Act, introduced by Senator Fletcher?
3. Are Pecora-style hearings needed today? Why or why not?

CLASS #14

TOPIC

The Deutsche Bank

Founded in 1870 to help finance surging German exports and imports, the Deutsche Bank soon moved into domestic banking. In fact, its founders aimed to create both a commercial bank and an investment bank under one roof – that is, a “universal bank.” By the end of the nineteenth century, the Deutsche Bank was not only the largest bank in Germany, but also a strategic actor in the broader European market and, indeed, in the world economy. Over the first half of the twentieth century, however, the bank faced a series of national crises: defeat in WWI (1914-1918), revolution in 1919, hyperinflation in 1923, economic depression in the early 1930s, the rise of Hitler in 1933, another world war in 1939, and then total defeat in 1945. At the end of WWII, the Soviets closed the Berlin headquarters of the Deutsche Bank as part of their denazification effort. Meanwhile, the United States, Britain, and France, occupying the western portion of Germany, attempted to implement a policy of economic decentralization and broke what remained of the bank into small pieces. By 1950, facing a proposal from leading German bankers to allow the big banks to begin reconstituting themselves, the Allied powers and the new German legislature had to decide whether to accept this proposal or reject it.

MATERIALS

[The Deutsche Bank \(A\)](#) (708044)

ASSIGNMENT

1. What are the distinctive features of a universal bank? What are the biggest strengths and weaknesses of universal banking?
2. Imagine that you are a member of the managing board of the Deutsche Bank in early 1933 and that board Spokesman Georg Solmssen has shown you his letter to the supervisory board regarding the rise of the Nazis and his future role in the bank. He tells you that after sending the letter, he has received no response. What would you advise him to do? What, if anything, would you yourself do after reading the letter?
3. Why did the Americans want to break up the Deutsche Bank after World War II? Was this the right decision?
4. Should the Allied powers and the new German legislature accept the German bankers' proposal in 1950 to allow the big banks to begin reconstituting

themselves (i.e., in the case of the Deutsche Bank to move from 10 successor banks to 3)?

CLASS #15

TOPIC

Managing Failure: Bankruptcy in America

By the early 1970s, the U.S. bankruptcy system seemed increasingly out of control. Personal filings had shot up from 11,051 in 1945 to 178,202 in 1970, and critics complained that many consumer debtors were choosing bankruptcy as the “easiest way out.” On the corporate side, critics charged that successful restructurings were rare. Given all this, lawmakers in Washington had to decide whether the time had come to reform the nation's bankruptcy code and, if so, how best to do it.

MATERIALS

[Managing Failure: American Bankruptcy Law at a Crossroads \(705024\)](#)

ASSIGNMENT

1. Was the nation’s bankruptcy system truly in trouble in the early 1970s? What, in your view, were the biggest problems?
2. Why was a federal bankruptcy system needed at all? Would private markets have functioned differently (or less effectively) in the absence of a federal bankruptcy law? In answering these questions, be sure to consider both individual bankruptcy and corporate bankruptcy.
3. If you were advising President Nixon in 1973, what would you have recommended that he do with regard to the bankruptcy law? Would you have advised him to support the commission's proposals, offer an alternative set of reforms, or simply oppose any changes at all?

CLASS #16

TOPIC

Fannie Mae: Public or Private?

In 1987, President Ronald Reagan established the President’s Commission on Privatization to identify federal government functions that could be shifted to the private sector. One agency that the Commission considered was the Federal National Mortgage Association, or Fannie Mae.

Fannie Mae was a Depression-era creation that was charged with establishing a secondary market for home loans. By purchasing qualifying residential mortgages from individual home loan issuers, Fannie Mae provided these institutions with funds for the continued issuance of mortgages, thereby promoting the government’s goal of increased homeownership. Although lawmakers had already partially privatized Fannie Mae in 1954 and again in 1968, the agency in 1987 still retained close links to the federal government, including an emergency line of credit from the U.S. Treasury. After its deliberations, the President’s Commission recommended Fannie Mae be restructured into a fully private firm. Now it was up to Congress and the President to decide whether to accept and implement the Commission’s findings.

MATERIALS

[Fannie Mae: Public or Private? \(709025\)](#)

ASSIGNMENT

1. Why was Fannie Mae created? What purpose(s) did it serve?
2. Why was the federal government involved in the creation of Fannie Mae? Should the

- government have been involved? Should it have remained involved?
3. Should Congress and the President accept the Commission's recommendation to fully privatize Fannie Mae in 1987?

CLASS #17

TOPIC

Financing Higher Education in Australia

Even before Australian lawmakers abolished university tuition in 1973, students in Australia had long benefited from low tuition and large government subsidies. By the early 1980s, however, the nation's universities faced growing budget challenges and an apparent shortage of capacity as demand for higher education surged. Policymakers, cognizant of a growing budget deficit as well as a hard-hitting recession, hesitated to provide increased funding to higher education.

The debate over how best to finance Australian higher education finally came to a head in the late 1980s, following publication of the *Report of the Committee on Higher Education Funding* (commonly known as the Wran Report). Although the Wran Committee had considered several potential funding schemes, it ultimately proposed a radical system in which students would pay tuition financed through income-contingent loans provided by the government.

The Wran Report proved to be of particular interest to the Australian Prime Minister, Robert Hawke. The government's fiscal position seemed to demand that educational financing be overhauled, but there was no consensus on how best to do this. Could the Prime Minister convince his Australian Labor Party to abandon the free-education plank in its platform? And even if he could, how could he be sure that the Wran Committee's strategy was the right one and that its recommendations were workable? Would following an American model of full tuition for higher education and government-guaranteed student loans make more sense? These were just a few of the questions that the Prime Minister confronted as he contemplated new approaches for financing higher education in Australia.

MATERIALS

[Financing Higher Education in Australia \(711047\)](#)

ASSIGNMENT

1. Should Prime Minister Hawke adopt the Wran Committee's recommendations regarding the financing of higher education in Australia? What are the main pros and cons of the Wran Committee's recommendations?
2. What are the main alternatives to the Wran Committee's income-contingent lending approach? Of all of the possible reform options, which would you recommend to the Prime Minister if you were advising him?
3. Does the government need to be involved in the financing of higher education at all? Why or why not?

CLASS #18

TOPIC

The French Pension System

In 1995, France's large pay-as-you-go pension system was beginning to run into trouble. Ever-increasing longevity, the impending retirement of the baby boomers, and intense public pressure for a lower retirement age were all placing great strain on the existing system. The problem was only compounded by slackening economic growth, high unemployment, and the restrictions on deficit spending imposed by the European Maastricht accord. "The problem is so immense," a senior economist at the OECD observed, "that they'll have to completely change the system." Many critics believed that fundamental reform would have to involve profound changes in the nation's capital

markets as well as reduced reliance on the public sector. And yet the existing public pension system remained enormously popular in France. Pension policy thus represented a major challenge facing the nation's political and business leadership on the eve of the twenty-first century.

MATERIALS

[French Pension System: On the Verge of Retirement?](#) (799143)

ASSIGNMENT

1. Why did France adopt a pay-as-you-go public pension system earlier in the twentieth century? Was this a reasonable decision at the time? What have been the main implications (social, political, and economic) in the years since?
2. More generally, what are the pros and cons of a pay-as-you-go pension system?
3. What are the best options for addressing mounting pressures on the existing pension system in France? Be prepared to outline and defend your recommendations in class.

CLASS #19

TOPIC

The International Monetary Fund in Crisis

When Dominique Strauss-Kahn became the Managing Director of the International Monetary Fund (IMF) in late 2007, he faced a number of significant challenges. First, the organization was running out of money: over the previous decade developing countries had borrowed from the IMF less frequently, and when the IMF did not lend, it did not earn income. Instead, many developing countries had increased their foreign exchange reserves. The IMF also found itself unable to influence the macroeconomic policies of the United States and China in order to reduce global imbalances, and developing countries complained that they were underrepresented at the Fund. As the IMF's new Managing Director, Strauss-Kahn had to decide how best to address these challenges and in what direction to steer the fund. And the world needed to decide whether the IMF was still a necessary piece of the international financial architecture.

MATERIALS

[The International Monetary Fund in Crisis](#) (708035)

ASSIGNMENT

1. What was the IMF's original purpose in the international economy? Would you have supported the IMF's creation in the 1940s?
2. How has the IMF's mission changed since its inception? What accounts for these changes? Have they helped to adapt the organization to changes in the global economy?
3. If you were advising Dominique Strauss-Kahn, the new managing director of the IMF, how would you prioritize the various challenges facing the organization in early 2008 and how would you recommend dealing with them?

CLASS #20

TOPIC

Fed vs. ECB: Steering Monetary Policy Through Unprecedented Crises

In early April 2008, economic conditions in Europe appeared to be deteriorating on almost all fronts: sales figures were falling, business and consumer confidence were slumping, forecasts for European growth were being revised downward, and inflation was rising. In fact, figures for the month of March revealed that inflation had reached an annualized rate of 3.5%, Europe's highest level since 1992. On top of these broad economic problems, the European financial sector—indeed, the financial sector worldwide—was in turmoil. By April 2008, global financial institutions had written down the value of their mortgage-related investments

and other assets by at least \$230 billion, and businesses around the world were complaining that it was ever more difficult to secure credit.

In America, meanwhile, consumer confidence was falling, consumer spending had slowed to a near halt, and inflation had crept above 4%. In reaction to these dismal economic conditions, the Federal Reserve had steadily cut interest rates over a seven-month period, most recently lowering its key rate to 2.25% on March 18.

In sharp contrast to the Fed, the European Central Bank (ECB) had long held its key rate at 4%, where it stood when the ECB's Governing Council reconvened on April 10, 2008. Given both the market turmoil and the evident inflationary pressure, members of the ECB's Governing Council would have to weigh the available data extremely carefully as they decided whether to raise, lower, or maintain their benchmark interest rate. The significance of this decision could hardly be overstated, since it had the potential to send a strong signal about the nature of European monetary policy and the priorities of the ECB going forward.

MATERIALS

[Steering Monetary Policy Through Unprecedented Crises](#) (711048)

ASSIGNMENT

NOTE: In preparing this very long case, please feel free to skim parts that look familiar (such as pages 24, which review the origins of central banking in the U.S.) and parts characterizing the subprime market (such as pages 11-13), which we'll return to in subsequent classes. In reading the rest of the text, please focus in particular on the monetary strategies of the two central banks. As for the exhibits, they were designed not to require much in the way of number crunching. So you should be able to move through them relatively quickly.

1. What should be the main objectives of a major central bank like the Fed or the ECB? If these objectives ever come into conflict, how should central bankers prioritize among them?
2. What rule or target, if any, should central bankers use in setting monetary policy? What are the strengths and weaknesses of inflation targeting?
3. When the ECB's Governing Council meets on April 10, 2008, should it raise, lower, or maintain its benchmark interest rate? What are the main arguments for and against your position?

CLASS #21

TOPIC

The Financial Crisis of 2007-2009, Part I (Origins of the Crisis)

By the summer of 2009, many observers concluded that a catastrophic financial collapse – which seemed all but imminent the previous fall and winter – had been averted. Although the recession had still yet to be declared over and the economy's footing remained far from solid, many believed that the worst of the crisis was over. With the global financial system no longer spiraling into an abyss, government officials, business leaders, and American taxpayers could now take stock of where they had been and where they should be headed. In particular, many wondered how the disaster had happened in the first place: what exactly had caused the brutal financial crisis of 2007-2009?

MATERIALS

[Fighting a Dangerous Financial Fire: The Federal Response to the Crisis of 2007 - 2009](#) (711104)

ASSIGNMENT

Note: Although this is another unusually long case, we'll use it as the basis of both this class session (#19) and the next one (#20).

1. What were the main causes of the financial crisis of 2007-2009?

2. Was there a relationship between the crisis in the financial sector and the recession in the real economy? If so, what was the connection?
3. In late 2008 and early 2009, did the United States face a significant risk of falling into a second Great Depression? Why or why not?

CLASS #22

TOPIC

The Financial Crisis of 2007-2009, Part II (The Federal Response and its Consequences)

By the summer of 2009, many observers concluded that a catastrophic financial collapse – which seemed all but imminent the previous fall and winter – had been averted. Although the recession had still yet to be declared over and the economy's footing remained far from solid, many believed that the worst of the crisis was over. With the global financial system no longer spiraling into an abyss, government officials, business leaders, and American taxpayers could now take stock of where they had been and where they should be headed. Had the federal government responded properly to the crisis, and what role, if any, should it play going forward to prevent another one?

MATERIALS

[Fighting a Dangerous Financial Fire:](#)

[The Federal Response to the Crisis of 2007 - 2009 \(711104\)](#)

ASSIGNMENT

1. Did federal officials respond appropriately to the crisis? On net, would you judge the federal response to have been a success or a failure? What would you have done differently had you been in charge?
2. What sorts of regulatory reforms, if any, are needed now to prevent another major financial crisis from striking in the future? What are the biggest strengths and weaknesses of each of your recommendations?
3. More broadly, what do the crisis and the federal response tell us about the role of government in the United States in the early 21st century? Does this make you more optimistic or more pessimistic about the U.S. financial system going forward?