Lecturer: Prof. Jacek Rostowski
Course: 4 credits

**Aims of the course**

The aim of the course is to develop the students' understanding of the microeconomics of money and banking, of the role of the monetary and banking systems in a market economy, and of the macroeconomic impact of the behaviour of banking firms. Students should also develop a knowledge of the structure of banking systems, their place in the wider environment of the financial system and of the economy as a whole, as well as the implications both for microeconomic regulatory policy and national and global macroeconomic policy of bank behaviour. Lectures will concentrate on the structure of financial and banking systems and on the microeconomic theory of banking, as well as the impact of the banking sector on macroeconomic fluctuations and policy. A final section will address the issue of banking reform in the transition from Communism. Seminars will address a wide range of historical, empirical and policy topics, and will require broad reading, critical analysis of the recommended material and its succinct presentation in class.

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**Assessment:**

The course will consist of lectures and seminars. Students will be required to present a seminar paper on a specific topic relating to the course, to submit this paper after revision, as a term paper and to pass a written 3 hour essay-type exam at the end of the course.

The purpose of this form of assessment is to help develop students’ presentational and writing skills, as well as their ability to summarize arguments, cogently and convincingly.

**Grading**

Term paper 45%
Term examination 55%

Course Outline:

PART ONE: INTRODUCTION - THE STRUCTURE OF FINANCIAL SYSTEMS

PART TWO: REASONS FOR THE EXISTENCE OF BANKS.

PART THREE: BANK RUNS AND BANK REGULATION.

PART FOUR: OTHER REASONS FOR BANK REGULATION.

PART FIVE: THE EVOLUTION OF BANKING REGULATION SINCE THE 1930s.

PART SIX: INTEREST RATES, MONEY AND CENTRAL BANKS IN MACROECONOMIC POLICY.

PART SEVEN: DEBT DEFLATION, BANKING AND THE MONETARY TRANSMISSION MECHANISM.

PART EIGHT: BANKING REFORM IN TRANSITION.

ECONOMICS OF MONEY AND BANKING

PART ONE: INTRODUCTION - THE STRUCTURE OF FINANCIAL SYSTEMS

1. Wealth, real assets, financial assets and capital markets.

2. Financial development and growth.


5. Credit as a short term facilitator of investment.

5. The interaction of bank credit and equity finance.

PART TWO: REASONS FOR THE EXISTENCE OF BANKS.
1. Traditional explanations for the existence of banks.
2. Adverse selection, the ex-post verification problem and moral hazard.
5. Firm bankruptcy costs and the existence of banks.

PART THREE: BANK RUNS AND BANK REGULATION.
1. Unconvincing arguments for bank regulation.
2. Causes of bank runs: individual bank runs and runs on the system.
3. Information based and irrational runs.
4. What the authorities can do about bank runs.
5. What banks can do to prevent bank runs.

PART FOUR: OTHER REASONS FOR BANK REGULATION.
1. Justifications of bank regulation.
2. Neo-classical and Neo-Austrian views of banking competition.

PART FIVE: THE EVOLUTION OF BANKING REGULATION SINCE THE 1930s.
1. Main mechanisms of regulation during the "Keynesian" period.
2. The erosion of controls since the 1960s and inflation.
3. Changes in supply conditions: telecoms and computers.
4. The decline of the banking industry.
5. Implications of the decline of the banking industry for regulation.
6. The "new regulatory framework".
7. International harmonisation in the "New Framework".
PART SIX: INTEREST RATES, MONEY AND CENTRAL BANKS IN MACROECONOMIC POLICY.

1. Monetarist and Keynesian transmission mechanisms.
2. Should central banks control interest rates or the monetary base?
3. International capital mobility on the term structure of interest rates.
4. Credit rationing and the "credit channel" for monetary policy.
5. Other channels for the monetary transmission mechanism.

PART SEVEN: DEBT DEFLATION, BANKING AND THE MONETARY TRANSMISSION MECHANISM.

1. Net worth, equity rationing and business cycles.
2. The Greenwald-Stiglitz model and credit rationing.
3. Debt deflation and the Greenwald-Stiglitz model.
4. Unemployment in the Greenwald-Stiglitz model.
5. Anatomy of a debt deflation.
6. Debt deflation via the aggregate demand channel.
7. Including asset prices in the price level for monetary policy purposes.
8. Asset prices in the inter-war period in the US.

PART EIGHT: MONEY AND BANKING IN TRANSITION

1. The Monobank system, Active and Passive Money, the MFO.
2. The "Main Sequence" of banking reforms in Central Europe and the FSU Model.
3. Radical Proposals for banking Sector Reform.
4. The Payments System, Settlement Risk and Inter-enterprise Arrears.
5. Banking Crises in PCEs and their Remedies.
6. Progress with the wrong model?
1. **Assess the "real bills doctrine" and the "principle of reflux" which figured prominently in the three cornered debates between the currency school, the banking school and the free banking school in mid-nineteenth century England.**


2. **Discuss the controversy between bullionists and the currency school on the one hand and supporters of the banking school on the other.**


3. **Why are middle developed countries particularly subject to banking crises?**

4. Does a "hard-peg" exchange rate system make a country more susceptible to banking crises?


5. Discuss the arguments for and against the independence of central banks.


6. Should central banks supervise the banking system, and if so should they supervise non-bank financial institutions as well?


7. How do regulation and ownership affect banking sector performance and stability?


8. Assess Argentina’s attempt at creating a credible and partly market-based system of bank regulation. Does it hold lessons for other emerging market and transition economies?


9. Does the stringency of bank supervision affect the macroeconomy?


10. Can the ECB’s monetary policy function properly given the differences in legal and financial structure among the states participating in EMU?


11. Does a "pensions overhang“ threaten the macroeconomic stability of the developed countries?

International Monetary Fund World Economic Outlook, Focus on Fiscal Policy, pp50-60.*

E. Phillip Davis "The Development of Pension Funds: an approaching Financial
12. How convincing is the evidence that financial sector development leads to faster economic growth?


13. Account for the existence of credit rationing. Is this phenomenon likely to be important in practice?


14. How important is the lending channel for macroeconomic policy?


15. Assess the empirical evidence on the imperfection of capital markets.


16. Is "relationship banking" superior to other kinds of banking?


17. Should financial institutions specialise or diversify so as to maximise their efficiency and profits?


18. Discuss the effectiveness of the following financial institutions in Transition Economies:

All presenters and students:


a) Universal Banks.


b) Commercial Banks.


c) Privatization Funds:


19. To what extent are the problems of the financial sector in China special?