

COURSE OUTLINE

Econ 4389: Greed, Personal Interaction, and Economic Collapse

Prof. S. Craig
Office: 202A, M

Hours: M 3-4:30; Th 4-5:00 pm
or by appointment

Fall, 2009
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Required Texts: MicroMotives and MacroBehavior, Thomas Schelling, 1978.
 A Failure of Capitalism, Richard A. Posner, Harvard University Press, 2009.

This is a microeconomics class on the causes of the current economic downturn (the Posner book calls it a depression). The press at the time seemed to claim it was irrational behavior by firms, and this class is my search to see if there is a rational reason (of sorts!) To understand what happened, we will need to cover a wide variety of material from different classes. First, we will do the housing market (urban economics). Then, we will do credit markets (money and banking). Then, we will do externalities (public economics/ also called public finance; also, part of this is behavioral economics). Then we will put the ideas together and see if they make a rational explanation. Based on the explanation, we will examine the government actions to see if they address any of the root causes. In conclusion, we will examine the regulation proposed by Posner, and see if we think it might be welfare enhancing.

As you can see from this brief list, we will use much of the material you have learned in your other courses to build economic models to explain how the economy got into this mess. We will do a lot of modeling, using the graphical tools to which you have already been exposed. If you have had Intermediate Microeconomics 3332, you will be well prepared for this class. If in doubt, see me.

The course requirements are:

Class attendance is mandatory

One midterm essay exam (with graphical analysis), and one final exam (graphs!)

You will be expected to do the readings ahead of class (and they are interesting, anyway).

If I find that many people are unprepared for any portion of the class, I may assign additional readings.

We will write at least one paper, and up to three, that are sort of like extended homeworks.

The midterm will count 25%, the final 50%, and the rest will be a combination of homework and class participation (I anticipate the homework will be 20%).

Course Outline

1. Introduction,
 - Read the Conclusion in Posner, (P), Chap 12
 - Read the Introduction of Schelling (S), Chap 1

2. The housing market, P, pp1-28;
 - Why do people buy? With credit?
 - Why is this market subsidized?
 - How can a housing bubble form? Why?
 - *Is it the Fed's fault?
 - *Are house buyers (borrowers) rational? Lenders?

3. Credit Markets, S Chap 3, P Chap 2,3
 - The structure of bank lending
 - How can a subprime loan be rated prime?
 - *Should banks be allowed to offer subprime loans?
 - Is banking regulation good for the economy? Why?
 - *required reserves vs. "near banks."
 - *role of credit default swaps
 - Should banks take risks? What is the market for risk?
 - *Effect of deposit insurance
 - What is the role of banks in money creation? Is money a "public good?"
 - *Should "near banks be regulated?
 - Is pay for bank CEOs a problem?

4. Public goods and public intervention, P, pp194-220
 - Moral hazard vs. externalities
 - Are institutions "too big to fail?"

5. Policy Conclusion, P Chap 7, Chap 10
 - This would be a good place for additional readings on the bailout of AIG, and auto cos.

FINAL EXAM: Tuesday, Dec 15, 2-5pm

**** N.B. There will be no make-ups for the final exam. Make-ups for mid-terms are available with advance, prior, written permission from the professor.