ECON590 ADVANCED TOPICS IN FINANCIAL ECONOMICS

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Summer 2013 Term 1: MWF 2:00-4:05, Room 311

COURSE CONTENT

This a reading course that introduces the application of modern economics in the area of finance. Course content includes a reading list of both classic and contemporary research on microeconomic finance, macroeconomic finance, and international finance. The readings focus mainly on theories, although a chapter of empirical finance will be introduced at the end of this course as well. Student will learn to develop basic modeling skills, critically review major literature, as well as explore some of the frontier issues in financial research.

The course structure will be similar to that of Econ 605. The instructor present key papers from the reading list but also designate papers for students to present in class. Each student should expect to present 3-4 papers. This course will also invite guest speakers to give lectures on topics in their own expertise. Guest speakers will most likely be faculty members or upper year PhD students from the Finance Department of Fuqua Business School.

Prerequisite: Knowledge about microeconomics equivalent to the level of Econ 601 or Econ605. Working knowledge of calculus. No background on finance is required.

EVALUATION

Students will be evaluated by their in class presentations and an in-class final exam. Evaluation of student presentations is based on preparation, width and depth of the coverage, and the presenter's own critical comments. The in-class final exam will involve two or three analytical questions related to the course readings but emphasizes on students' comprehension of the fundamental modeling skills used in this class.

TOPCIS

The reading list below is intended to provide a general structure of this course at this point. The reading list will be modified with more or fewer papers included depending on the final number of enrollment.

1. Principle-Agent Problem, Mechanism Design, and Foundations in Game Theory

An introduction of the standard principle-agent problem, principles of mechanism design, and basic concepts of game theory. This chapter serves as a quick review of the most important microeconomic structure used intensively throughout the reading list.

2. Introduction to Financial Economics

The Design of Securities

Townsend, R., 1979, Optimal contracts and competitive markets with costly state verification, Journal of Economic Theory 21, 417-425.

Yang, Ming, 2012, Optimality of Securitized Debt with Endogenous and Flexible Information Acquisition, working paper, Princeton University

Firm Ownership and Control

Jensen, Michael C., and William H. Meckling. 1976, Theory of the firm: Managerial behavior, agency costs and ownership structure." Journal of financial economics 3, 305-360.

Grossman Sanford J. and Oliver D. Hart, 1986, The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration, Journal of Political Economy, 94, 691-719

3.Financial Intermediation

The Role of Financial Intermediary

Diamond, D., and P. Dybvig, 1983, Bank runs, deposit insurance, and liquidity, Journal of Political Economy 91, 401-19.

Financial Intermediary Capital

Holmstrom, B., and J. Tirole, 1997, Financial intermediation, loanable funds, and the real sector, Quarterly Journal of Economics 112, 663-91.

4. Market Liquidity

The Demand and Supply of Liquidity

Holmstrom, B., and J. Tirole, 1998, Private and public supply of liquidity, Journal of Political Economy 106, 1-40.

Liquidity and Search

Chang, Briana, 2012, Adverse Selection and Liquidity Distortion in Decentralized Markets, working paper, Northwestern University

Liquidity and Financial Intermediation

Bigio, Saki, 2012, Financial Risk Capacity, working paper, New York University

Liquidity and Asset Selection

Acharya, Viral and S. Viswanathan, 2011, Leverage, Moral Hazard, and Liquidity, Journal of Finance, 66, 99-138

Ebrahimy, Ehsan, 2012 Liquidity Choice, Productivity, and Efficiency, working paper, University of Chicago

5. Capital Structure

Optimal Capital Structure

Modigliani, Franco, and Merton H. Miller. 1958, The cost of capital, corporation finance and the theory of investment. American economic review 48, 261-297.

Capital Structure and Security Design

Leland, H., 1994, Corporate debt value, bond covenants, and optimal capital structure, Journal of Finance, 49, 1213-1252

Capital Structure and Investment

DeMarzo, Peter, Michael Fishman, Zhiguo He, and Neng Wang. "Dynamic agency and the q theory of investment." Journal of Finance, forthcoming (2012).

6. Finance and Macroeconomics

Finance and Business Cycles

Bernanke, B., and M. Gertler, 1989, Agency costs, net worth, and business fluctuations,

American Economic Review 79, 14-31.

Finance and Efficiency

Kehoe, T and D. Levine, 1993, Debt-Constrained Asset , Review of Economic Studies, 60, pp. 865-888

Lorenzoni, G., 2008, Inefficient credit booms, Review of Economic Studies 75, 809-833.

Finance and Capital Allocation

Song, Zheng; Kjetil Storesletten,and Fabrizio Zilibotti, 2011, Growing Like China, American Economic Review, 101, pp. 196-233

7. International Finance

Global Financial Imbalance

Mendoza, Enrique, Vincenzo Quadrini, and Victor Rios-Rull, 2009, Financial Integration, Financial Development and Global Imbalances, Journal of Political Economy, 117(3)

Financial Crisis

Zhiguo He and Arvind Krishnamurthy. 2012. Intermediary Asset Pricing. American Economic Review, forthcoming,

International Risk-Sharing

Maggiori, Matteo, 2012, Financial Intermediation, International Risk Sharing, and Reserve Currencies, working paper, University of California-Berkeley

8. Empirical Finance

Corporate Governance

Brav, Alon,Wei Jiang, Frank Partnoy, and Randall Thomas, 2008, Hedge fund activism, corporate governance, and firm performance, Journal of Finance 63, 1729–1775

Giroud, Xavier and Holger Mueller, 2011, Corporate Governance, Product Market Competition, and Equity Prices, Journal of Finance, 66, 563-600

Klein, April and Emanuel Zur, 2011, The Impact of Hedge Fund Activism on the Target Firm's Existing Bondholders, Review of Financial Studies, 24, 1735-1771

Board of Directors and CEO Compensation

Gabaix X. and A. Landier, 2008, Why has CEO pay increased so much? Quarterly

Journal of Economics 123, 49-100.

Bertrand, Marianne, and Sendhil Mullainathan. 2001, Are CEOs rewarded for luck? The ones without principals are. Quarterly Journal of Economics 116, 901-932.

Liquidity Management

Campello, Murillo, Erasmo Giambona, John R. Graham, and Campbell R. Harvey. "Liquidity Management and Corporate Investment During a Financial Crisis." Review of Financial Studies 24, no. 6 (2011): 1944-1979.

9. Asset Pricing (Guest speaker)

Papers that may be included in the final syllabus:

Aghion, P., and P. Bolton, 1992, An incomplete contracts approach to financial contracting, Review of Economic Studies 59, 473-494

Aggarwal, Rajesh K., and Andrew A. Samwick. "The Other Side of the Trade-Off: The Impact of Risk on Executive Compensation." Journal of Political Economy 107.1 (1999): 65-105.

Bansal, Ravi, and Amir Yaron. "Risks for the long run: A potential resolution of asset pricing puzzles." The Journal of Finance 59.4 (2005): 1481-1509.

Bolton, Patrick, Hui Chen, and Neng Wang. "A Unified Theory of Tobin's q, Corporate Investment, Financing, and Risk Management." The Journal of Finance 66.5 (2011): 1545-1578.

Bolton, Patrick, Hui Chen, and Neng Wang. Market timing, investment, and risk management. Journal of Financial Economics, forthcoming (2012)

Brunnermeier, Markus, and Yuliy Sannikov. 2010 "A macroeconomic model with a financial sector.", working paper, Princeton Univerisity

Buera, Francisco J., Joseph P. Kaboski, and Yongseok Shin. 2011. Finance and Development: A Tale of Two Sectors. American Economic Review 101, 1964--2002

Caballero, Richardo, Emmanuel Farhi, and Pierre-Olivier Gourinchas. 2008. An Equilibrium Model of "Global Imbalances" and Low Interest Rates. American Economic Review of Economic Studies 98, 358-393.

Clementi, G. L., and H. Hopenhayn, 2006, A theory of financing constraints and firm dynamics, Quarterly Journal of Economics 121, 229-265

DeMarzo, Peter, and Darrell Duffie. "A liquidity-based model of security design." Econometrica 67.1 (2003): 65-99.

Gorton, G., and G. Pennacchi, 1990, Financial intermediaries and liquidity creation, Journal of Finance 45, 49-71

He, Zhiguo. "A model of dynamic compensation and capital structure." Journal of Financial Economics 100.2 (2011): 351-366.

He, Zhiguo, and Wei Xiong. "Rollover risk and credit risk." The Journal of Finance 67.2 (2012): 391-430.

Hennessy, Christopher A., and Toni M. Whited. "How costly is external financing? Evidence from a structural estimation." The Journal of Finance 62.4 (2007): 1705-1745.

Rampini, A., and S. Viswanathan, 2010, Collateral, risk management, and the distribution of debt capacity, Journal of Finance 65, 2293-2322.

Shleifer, A., and R. Vishny, 1992, Liquidation values and debt capacity: a market equilibrium approach, Journal of Finance 47, 1343-66.