FINANCIAL CRISSES AND RECESSIONS OF THE 21st CENTURY
SPRING 2021

This course will explore the dramatic financial and macroeconomic developments that the United States has experienced over the last two decades. We will look at research on what factors precipitated the boom and bust in the housing market in the early 2000s and how the resulting mortgage crisis rippled through the global financial system and ultimately generated the most severe economic downturn since the Great Depression. We will analyze the policies put in place to stabilize the financial system, limit the economic fallout, and reduce the likelihood of future financial crises. The course will also examine the response of the financial system and the economy to the onset of the COVID-19 pandemic, with particular attention to how these developments and the appropriate policy responses compare with past episodes.

Instructor: Professor Karen Dynan
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https://scholar.harvard.edu/kdynan

Office hours: Selected times on Friday mornings and afternoons
To see the available appointments and sign up, go to this link

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Course schedule: Monday and Wednesday 1:30pm-2:45pm via Zoom (you can find the link on your Canvas calendar)

Course website: https://canvas.harvard.edu/courses/84781

PREREQUISITES. Intermediate macroeconomics (Ec 1011B or Ec 1010B) or by permission of the instructor. Students should have some familiarity with businesses cycles and the models that economists use to think about them (such as the IS-LM model). Students should also be comfortable reading non-technical research papers by economists.

LEARNING OBJECTIVES. The aim of this course is for you to understand and be able to engage in informed discussions about:

- The social, economic, and policy developments that laid the groundwork for the global financial crisis of 2007-2008.
- The developments in mortgage markets that precipitated the financial crisis—the home price
bubble, what part of the population drove the increases in mortgage debt, and the debate over why people default on mortgages.

- How the mortgage crisis turned into a full blown global financial crisis, including the roles of leverage, financial engineering, the shadow banking system, and financial regulation.
- How policymakers ultimately arrested the financial crisis and what factors complicated their decisions.
- The recessions that follow financial crises—what causes them, their human and macroeconomic costs, and why the ensuing recoveries tend to be long.
- The European debt crisis.
- How financial regulation was changed to reduce the likelihood of another financial crisis and the debate over whether these changes have been effective.
- The economic fallout from the COVID pandemic.
- The fiscal, monetary, and credit policies put in place to reduce the macroeconomic and human costs of the U.S. recessions of the 21st century and how such policies need to be shaped by the unique features of the times.

LECTURES. There will be two live lectures each week. I strongly encourage attendance. If the timing is problematic because of your time zone or another reason, you may watch the recorded lectures instead. If you are unable to attend lectures on a regular basis, please send me an email stating that you will be watching the recorded lectures instead.

I know that your home situation and/or internet access may make having your camera on problematic at times. That's okay. If you can have your camera on—even part of the time—that will be great since it will help cement personal connections. But you can be intellectually and socially engaged in class using the other digital tools provided and be “seen” by the teaching team and your classmates without a camera.

SECTIONS. Recommended. Time and place to be arranged.

READINGS. There will be a Canvas page for each lecture. You should consult these pages well in advance of each class as they will describe the required preparation. Depending on the session, preparation may involve readings, going through slides, watching videos, listening to podcasts, or other tasks. In addition to the required readings, I will list key academic pieces that I draw from for the class lectures. These pieces will be useful for students who want to do a deeper dive on the topics. Some of the required reading will be on news websites that require a paid subscription, but Harvard students should be able to access them all by following the instructions here.

ASSIGNMENTS. There will be five short (1-3 page) writing assignments for which students will be asked, for example, to describe a policy that would address a specific challenge or summarize and critique an empirical paper. You may confer with others as you prepare assignments, but your thoughts must be written up independently. You must complete all assignments to pass the course.

Assignment due dates:

Assignment 1: Wednesday February 17
Assignment 2: Wednesday March 3
Assignment 3: Monday April 5
Assignment 4: Monday April 14
Assignment 5: Wednesday April 28

PARTICIPATION. Participation can take many forms. You can raise your hand and ask questions
during class, you can post comments to the chat box, and you can post articles or start discussions on the Canvas discussion board.

EXAMS. The class will have a midterm exam and a final exam. For both exams, you will be able to refer to class notes, textbooks, and online resources as you prepare and write up your answers. In order to accommodate students in different time zones, the exams are scheduled as follows (both dates are tentative and will be firmed up by the beginning of the term):

- The midterm exam can be taken in any 75-minute continuous time block over the 48-hour period that begins at 1:30pm ET on Wednesday March 17 and ends at 1:30pm ET on Friday March 19.
- The final exam is scheduled such that it can be taken in any 3-hour continuous time block over the 48-hour period that begins at 9:00am ET on Friday May 7 and ends at 9:00am ET on Sunday May 9.

GRADES. Course grades will be determined from a weighted sum of the assignments (30%), the midterm (30%), and the final exam (40%). I encourage participation and will adjust grades upwards for those who contribute to constructive discussions.

COMMUNICATION. You should regularly check the Canvas class pages for information about required preparation for each class (and for slides, recordings, and other follow-ups after each class). We will also be sending out announcements via email with news about the class.

I will aim to arrive 5-10 minutes early for informal discussion (and will edit this discussion out of the recording). I will also regularly stay after class for questions about the material, current events, or other topics you would like to discuss.

I will hold regular office hours every week starting at the end of January. I have blocked out time on Friday mornings and Friday afternoons (ET). You can see the available appointments and schedule a time at this website. Email me if you would like to talk and the appointment times do not work for you.

Feel free to contact me by email with concerns and questions. When you do so, please include “EC 1746” as part of your subject line. I will make every effort to get back to you in a timely fashion, but if you do not hear back within 48 hours, please write again to make sure that I did not lose track of your email.

CODE OF CONDUCT. Please be on time for the lectures. All course activities—including class meetings, homework assignments, and exams—are subject to the Academic Integrity portion of the Harvard College Handbook for Students. Academic misconduct of any sort will not be tolerated.

TECHNICAL SUPPORT. The teaching fellows, David Brown and Liu Zhang, will be available during class sessions if you have specific questions or difficulties related to the use of Zoom during that class. For more general issues about Zoom or the Canvas page, contact Harvard University Information Technology at ithelp@harvard.edu or 617-495-7777.
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READINGS

The readings marked with ** are required. The other readings contain material that I will draw off for the class lectures and will be useful for students who want to do a deeper dive on these topics.

Class 1—Introduction and Overview

The goal of this class is for you to come out with a good sense of what you will get out of the course and some idea about how the material we will be covering in each individual class fits in with the "big picture."


Class 2— Antecedents 1: Economic and Financial Environment

The goal of this class is to familiarize you with key background factors that will come up repeatedly as we discuss how the financial crisis unfolded in coming classes.


Class 3—Antecedents 2: The Drive for Homeownership in the United States

The goal of this class is to offer background that will help you think about the role that the drive for homeownership in the United States played as you learn more about the financial crisis in coming classes.


**Class 4—The Basics of the Mortgage Boom and Bust**

The goal of this class is for you to understand the defining traits of the mortgage boom and bust as well as some key developments in mortgage finance that played a role.


**Class 5—Was the Mortgage Crisis "a Subprime Crisis"?”**

The goal of this class is for you to understand one of the most important debates around the mortgage boom and bust of the early 2000s.

** Conklin, James, W. Scott Frame, Kristopher Gerardi, and Haoyang Liu. *Did Subprime Borrowers Drive the Housing Boom?* Liberty Street Economics. February 26, 2020.


**Class 6—From the Mortgage Crisis to the Broader Financial Crisis 1**

The goal of this class is for you to understand some of key features of the shadow banking system; we will build on this material in the next class when we discuss why the pre-crisis shadow banking system was vulnerable to runs.
**To understand the parallels between the traditional banking system and the shadow banking system, you will need to understand two key sources of short-term funding in the shadow banking system—repurchase agreements ("repos") and asset-backed commercial paper ("ABCP"). If you have not heard these terms before, you will find it useful to do some background work before class. For repos, the very brief video on Investopedia is good, and this slightly longer Wall Street Journal video both describes repos generally and talks about why they became big news again in 2019. For ABCP, this Investopedia article explains what it is and how it compares to regular commercial paper.


Class 7—From the Mortgage Crisis to the Broader Financial Crisis 2

The goal of this class is for you to understand some key ways in which the financial system was exposed to losses and dysfunction in the period leading up to the financial crisis.

** We will be talking a lot about leverage in this lecture, so it would be useful for you to have a basic understanding of the leverage ratio coming into class. Please watch this short video from Marginal Revolution University.

If you want to go a little further on the risks and rewards of leverage, you can look into the closely related concept of margin trading (there is a ton of material out there on the topic—for example, this video and this Wall Street Journal article are short and useful). If you have been following the GameStop/Robinhood news, you know that margin trading figured prominently in that episode.


Class 8—Escalating Financial Market Stress and the Policy Response

The goal of this class is for you to understand the early stages of the financial crisis—why stresses began to mount, what policymakers did in response, and why things continued to escalate.

** The Day the Market Died. This American Life. October 3, 2008


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**Class 9—The 2008 Meltdown and the Policy Response**

*The goal of this class is for you to understand the specific events that drove the most intense phase of the financial crisis, the trade-offs that policymakers were weighing as they took various steps to rescue the financial system, and the consequences of these policy actions.*


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**Class 10—Policies to Help Insolvent Banks and Struggling Homeowners**

*The goal of this class is to finish off our discussion of the key ways in which the government mitigated the financial crisis; after doing so (either in this class or the next class) we will circle back to review the broad lessons we have learned.*

**TARP Programs Website.** US Treasury Department.


Class 11—Where Does the Blame Lie?

*The goal of this class is to pull together what we have learned about various potential contributing factors to help you form your own opinions about where the blame lies for the financial crisis.*

** FCIC report official conclusions. No need to read all 14 pages—just skim the bolded headlines.

** Dissent by Hennessey, Holz-Eakin, and Thomas, pages 414-417.

** Dissent by Wallison, pages 444-447.


Class 12—Crime and Punishment in the 2008 Financial Crisis (Guest Lecture by Tim Massad)

*The goal of this class is for you to gain a basic understanding of some of the legal accountability issues associated with the financial crisis.*


Class 13—The Euro’s Three Crises

*The goal of this class is for you to understand the Euro crisis and gain some insight into sovereign debt crises more generally.*


Class 15—Recessions and their Costs

The goal of this class is for you to understand the costs of recessions so that you can fully appreciate what was at stake in developing policies to fight the Great Recession.


Congressional Budget Office. Understanding and Responding to Persistently High Unemployment. February 16, 2012.


Class 16—Fiscal Policy Choices during the Great Recession

The goal of this class is for you to understand the fiscal policy choices made during the Great Recession and how they shaped our thinking about countercyclical fiscal policy going forward.


Class 17—Monetary Policy Choices during the Great Recession

The goal of this class is for you to understand monetary policy choices made during the Great Recession and how they shaped our thinking about countercyclical policy going forward.


Class 18—Credit Policy as a Recession-Fighting Tool

The goal of this class is to familiarize you with US government credit policy and how it affected the economy and individuals in the years following the financial crisis.


Dynan, Karen. What’s Wrong with Student Loans (and How to Fix It). October 2019.


**Class 19—Changes in Financial Regulation**

The goal of this class is for you to learn the major ways in which US financial regulation was changed after the financial crisis.


**Class 20—Changes in the Way Macroeconomists See the World**

The goal of this class is for you to learn about some of the newer ideas that macroeconomists have been discussing, with particular emphasis on their implications for policy.


Ng, Michael and David Wessel. *The Hutchins Center Explains: The Neutral Rate of Interest*. October 2018.


Yellen, Janet. *Former Fed Chair Janet Yellen on Why the Answer to the Inflation Puzzle Matters*. October 2019.

**Class 21—The Great Lockdown**

The goal of this class is to give you an introduction to the pandemic recession.


**Class 22—Financial and Monetary Policy during the Pandemic Recession**

*The goal of this class is for you to understand the financial and monetary policies deployed during the current economic crisis.*


**Class 23—Fiscal Policy during the Pandemic Recession**

*The goal of this class is to prepare you to engage in informed discussions about the fiscal policy response to the pandemic recession.*


**Class 24—What’s Next for the Pandemic Recession and Recovery**

*The goal of this class is to help you think about what’s ahead for the economy and to set us up for our coming discussion of unfinished policy business.*


**Class 25—Unfinished Policy Business**

*The goal of this class is wrap up our EC 1746 semester!*