

## ECXXX Banking

### Module Outline and Reading List

#### Module Description:

This module is designed to introduce core economics reasoning about the fundamental businesses of commercial banking and investment banking. Those of the former can be classified roughly into two categories, financial intermediation and money creation, while those of the latter are mainly concerned with security issuance and merger and acquisition.

For each of them, as a viable business, the following questions naturally arise.

- What and how is the value added by this business?
- How is it provided in terms of contractual arrangements?
- What are the implications of these contractual arrangements for the banking industry and the whole economy?

It shall be underlined that the module will focus on economics reasoning and not be detailed in the practical side of the banking businesses, of which more material is provided in the EBS module BE610, *Introduction to Banking*. Students are encouraged to audit, if not register, this module, besides to read the *Economist* weekly and the *Financial Times* most days. Moreover, students will find google and wiki useful to check the meaning of unfamiliar terminologies.

#### Learning and Teaching Methods:

The module will consist of one two-hour lecture per week and a one-hour class every other week. Lecture notes and supporting materials can be accessed via the course material repository. Problem sets will be posted in the course material repository on a bi-weekly basis. Students are expected to complete them for class.

#### Assessment:

Required coursework will consist of a term paper. A two-hour final exam will be held during the Summer Examination period. Your grade in the module will be whichever is the Greater:

EITHER 50 per cent Coursework Mark, 50 per cent Exam Mark

OR 100 per cent Exam Mark

Details of assessment and submission deadlines are contained in the Postgraduate Economics Handbook, available from room 5B.206. Further information about the course is contained in the University's *course catalogue*, see; <http://www2.essex.ac.uk/courses/>.

**Main Textbooks:**

(FR) Freixas, X. and J. Rochet, *Microeconomics of Banking*, The MIT press, 2008, 2<sup>nd</sup> ed.

(M) Mishkin, Frederic S, *The economics of money, banking and financial markets*, Harlow : Pearson, 2013, 10<sup>th</sup> ed.

(R) Ritter, J. (2013), “Investment Banking and Securities Issuance”, chapter 5 in *Handbook of the Economics of Finance*, Edited by G.M. Constantinides, M. Harris and R. Stulz, Elsevier Science.

(GW) Gary Gorton and Andrew Winton (2013), “Financial intermediation”, Chapter 8, in *Handbook of the Economics of Finance*, Edited by G.M. Constantinides, M. Harris and R. Stulz, Elsevier Science.

**Module Content and Provisional Reading List:****Week 1: Introduction**

The businesses of banking and their historical developments

Reading list:

- FR, pages 1-7.
- M, chapters 8, 10, 12.
- R, subsections 1.2, 1.3.
- Selgin, G. and L. White (1987), “The Evolution of a Free Banking System,” *Economic Inquiry*, XXV, 439-57.

**Week 2: Theories of Money**

The main schools of theory about how fiat money helps real economic activities

Reading list:

- Nobuhiro Kiyotaki and Randall Wright, 1989, “On Money as a Medium of Exchange”, *Journal of Political Economy*, Vol. 97, No. 4 (Aug., 1989), pp. 927-954.
- Paul A. Samuelson, “An Exact Consumption-Loan Model of Interest with or without the Social Contrivance of Money,” *Journal of Political Economy*, Vol. 66, No. 6 (Dec., 1958), pp. 467-482.
- Nobuhiro Kiyotaki and John Moore, 2001, Clarendon lectures.  
<http://www.princeton.edu/~kiyotaki/>.
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**Weeks 3 - 5: Money Creation by Banks, Central Banking, and Bank Liquidity**

Reading List:

- Wang, T. (2013), “Money Creation by Banks and Central Banking,” unpublished.

- Diamond, D. and P. Dybvig (1983), “Bank Runs, Deposit Insurance, and Liquidity,” *Journal of Political Economy*, 91(3), 401–419.
- Jacklin, C. (1987), “Demand Deposits, Trading Restrictions and Risk Sharing”, in *Contractual Arrangement for Intertemporal Trade*, ed. E. Prescott and N. Wallace. University of Minnesota Press.
- Allen, F. and D. Gale (2000), “Financial Contagion”, *Journal of Political Economy*, 108, 1 – 33.

### **Weeks 6 and 7: Financial Intermediation – Ex post monitoring**

Reading list:

- GW.
- Diamond, D. (1984), "Financial Intermediation and Delegated Monitoring", *Review of Economic Studies*, 51 (3) 393-414. (A simpler version is: Diamond. D (1996), "Financial Intermediation and Delegated Monitoring: A Simple Case", *Economic Quarterly*, Federal Reserve Bank of Richmond, 82.)
- Wang, Tianxi (2010), “the Allocation of Liability, Delegated Monitoring, and Modes of Finance,” unpublished.

### **Week 8: Increasing Returns to Scale and Trend of Concentration in the Banking Sector**

Reading List:

- FR subsection 3.5.3
- Broecker, T. (1990), “Credit Worthiness Tests and Interbank Competition”, *Econometrica*, 58, 429-452.
- Wang, T. (2012), “Put Your Money where Your Mouth Is: An Model of Certification by Informed Financing”, unpublished.
- Wang, T. (2012), “Competition and Increasing Returns to Scale: A Model of Bank Size”.

### **Weeks 9 and 10**

Investment Banking

Reading List:

- R.
- Bodnaruk , A, Massa, M. and A. Simonov (2009), “Investment Banks as Insiders and the Market for Corporate Control,” *Review of Financial Studies*, 22 (12): 4989-5026.
- Ljungqvist, A., Marston, F. and WJ Wilhelm (2006), “Competing for Securities Underwriting Mandates: Banking Relationships and Analyst Recommendations,” *Journal of Finance*, 61 (1), 301–340.
- Augar, Philip, *The death of gentlemanly capitalism: the rise and fall of London's investment banks*, London Penguin 2001.