ECON GU4710: Finance and the Real Economy

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Class meetings: T-Th 8:40-9:55 AM
Office hours: T 11:00-12:00 PM 1131 IAB

Overview This course uses economic theory and empirical evidence to study the links between financial markets and the real economy. We will consider questions such as: What is the welfare role of finance? How do financial markets affect consumers and firms? How do shocks to the financial system transmit to the real economy? How do financial markets impact inequality?

Prerequisites Economics 3211 (micro), 3213 (macro), and 3412 (econometrics) (or STAT 1201 or equivalent) are prerequisites for this course. In addition, working knowledge of a data analysis software (such as Microsoft Excel, Stata, R, or Python) is required.

Grading Your course grade will be based on approximately ten problem sets (25% of the grade), participation (10% of the grade), a Midterm Exam (25% of the grade) and a Final Exam (40% of the grade). If, for a valid reason, you miss the Midterm Exam, the Final Exam will count for 65% of the grade.

Problem Sets Late problem sets will not be accepted, however the lowest problem set score will be dropped. Please turn in hard copies of the problem sets whenever possible.

Some problem sets will require some coding. For these problem sets, students may work in teams (consisting of not more than 2 students), as long as the members of the team are indicated on the work that is handed in, and each member of the team hands in a separate report representing his/her answer to the questions posed in the assignment. Please turn in the code as well (which can be common).

Class Conduct Cell phone use is not allowed. Laptops are fine for taking notes, but please respect your classmates and instructor by limiting yourself to class-related activities.

Statement on Academic Dishonesty As members of an academic community, each of us has a responsibility to participate in scholarly discourse and research in a manner characterized by intellectual honesty and scholarly integrity, and plagiarism is a very serious violation. While I encourage you to discuss the course readings and assignments with your classmates, all work that you turn in, both for assignments and on exams, must be your own. Any suspected case of plagiarism will be reported to the university, and students who breach their intellectual responsibility in this regard should anticipate being asked to leave Columbia.

Statement on Disabilities Accommodations If you are a student with a disability and have a DS-certified 'Accommodation Letter' please come to my office hours to confirm your accommodation needs. If you believe that you might have a disability that requires accommodation, you should contact Disability Services at 212-854-2388 and disability@columbia.edu.

TextBooks and Additional Readings

- Required: Lecture slides distributed in class
- Recommended:

  Atif Mian and Amir Sufi *House of Debt: How They (and You) Caused the Great Recession, and How We Can Prevent It from Happening Again*

  Robert J. Shiller *Finance and the Good Society*

  Raghuram Rajan *Fault Lines: How Hidden Fractures Still Threaten the World's Economy*

  Joshua D. Angrist and Jorn-Steffen Pischke *Mastering 'Metrics:The Path from Cause to Effect*

Course Outline This is a tentative course outline. Readings will be assigned as the course progresses.

Week 1: Growing Size of the Financial Sector

Robin Greenwood and David Scharfstein. "The growth of finance". In: *The Journal of Economic Perspectives* 27.2 (2013), pp. 3–28

Thomas Philippon. "Has the US finance industry become less efficient? On the theory and measurement of financial intermediation". In: *The American Economic Review* 105.4 (2015), pp. 1408–1438

Thomas Piketty and Gabriel Zucman. "Capital is back: Wealth-income ratios in rich countries 1700–2010". In: *The Quarterly Journal of Economics* 129.3 (2014), pp. 1255–1310

Lending to Firms

Week 2: Financing Firms

*Chapter 5 Joshua D Angrist and Jörn-Steffen Pischke. *Mastering'metrics: The path from cause to effect.* Princeton University Press, 2014 (OR *Chapter 10 James H Stock and Mark W Watson. "Introduction to econometrics". In: (2007))

Jith Jayaratne and Philip E Strahan. “The finance-growth nexus: Evidence from bank branch deregulation”. In: *The Quarterly Journal of Economics* 111.3 (1996), pp. 639–670

Bartelsman Eric, Scarpetta Stefano, and Haltiwanger John. “Cross-country differences in productivity: The role of allocation and selection”. In: *American Economic Review* (2013)

Week 3: Entrepreneur Networth

Bengt Holmstrom and Jean Tirole. “Financial intermediation, loanable funds, and the real sector”. In: *the Quarterly Journal of economics* 112.3 (1997), pp. 663–691

Erik Hurst and Annamaria Lusardi. “Liquidity constraints, household wealth, and entrepreneurship”. In: *Journal of political Economy* 112.2 (2004), pp. 319–347

Alexander M Bell et al. *Who becomes an inventor in America? The importance of exposure to innovation.* Tech. rep. National Bureau of Economic Research, 2017

Thomas Chaney, David Sraer, and David Thesmar. “The collateral channel: How real estate shocks affect corporate investment”. In: *The American Economic Review* 102.6 (2012), pp. 2381–2409

Gabriel Chodorow-Reich. “The employment effects of credit market disruptions: Firm-level evidence from the 2008–9 financial crisis”. In: *The Quarterly Journal of Economics* 129.1 (2013), pp. 1–59

Lending to Households

Week 4: Financing Households

Milton Friedman. “The permanent income hypothesis”. In: *A theory of the consumption function.* Princeton University Press, 1957, pp. 20–37

Brian T Melzer. “The real costs of credit access: Evidence from the payday lending market”. In: *The Quarterly Journal of Economics* 126.1 (2011), pp. 517–555

Jean-Noël Barrot et al. “Import competition and household debt”. In: (2017)

David Laibson. “Golden eggs and hyperbolic discounting”. In: *The Quarterly Journal of Economics* 112.2 (1997), pp. 443–478

Week 5: Financing Households and Financial Crisis

Atif Mian, Kamalesh Rao, and Amir Sufi. “Household balance sheets, consumption, and the economic slump”. In: *The Quarterly Journal of Economics* 128.4 (2013), pp. 1687–1726

Alp Simsek. “Belief disagreements and collateral constraints”. In: *Econometrica* 81.1 (2013), pp. 1–53

Ing-Haw Cheng, Sahil Raina, and Wei Xiong. “Wall Street and the housing bubble”. In: *American Economic Review* 104.9 (2014), pp. 2797–2829

Markus K Brunnermeier, Alp Simsek, and Wei Xiong. “A welfare criterion for models with distorted beliefs”. In: *The Quarterly Journal of Economics* 129.4 (2014), pp. 1753–1797

Week 6: Securization

*Chapter 4 Joshua D Angrist and Jörn-Steffen Pischke. *Mastering'metrics: The path from cause to effect*. Princeton University Press, 2014

*Joshua Coval, Jakub Jurek, and Erik Stafford. “The economics of structured finance”. In: *The Journal of Economic Perspectives* 23.1 (2009), pp. 3–25

Joshua D Coval, Jakub W Jurek, and Erik Stafford. “Economic catastrophe bonds”. In: *The American Economic Review* 99.3 (2009), pp. 628–666

Benjamin J Keys et al. “Did securitization lead to lax screening? Evidence from subprime loans”. In: *The Quarterly journal of economics* 125.1 (2010), pp. 307–362

Claire Célérier and Boris Vallée. “Catering to investors through security design: Headline rate and complexity”. In: *The Quarterly Journal of Economics* (2017), qjx007

Vincent Glode, Richard C Green, and Richard Lowery. “Financial expertise as an arms race”. In: *The Journal of Finance* 67.5 (2012), pp. 1723–1759

Christophe Pérignon and Boris Vallée. “The political economy of financial innovation: evidence from local governments”. In: *The Review of Financial Studies* 30.6 (2017), pp. 1903–1934

Trading

Week 7: Arbitrage

Owen A Lamont and Richard H Thaler. “Can the market add and subtract? Mispricing in tech stock carve-outs”. In: *Journal of Political Economy* 111.2 (2003), pp. 227–268

Matthias Fleckenstein, Francis A Longstaff, and Hanno Lustig. “The TIPS-Treasury Bond Puzzle”. In: *the Journal of Finance* 69.5 (2014), pp. 2151–2197

Week 8: Are Prices Informative?

Albert S Kyle. “Continuous auctions and insider trading”. In: *Econometrica: Journal of the Econometric Society* (1985), pp. 1315–1335

Peter Koudijs. “Those who know most: Insider trading in eighteenth-century Amsterdam”. In: *Journal of Political Economy* 123.6 (2015), pp. 1356–1409

Robert J Shiller. “Do stock prices move too much to be justified by subsequent changes in dividends?” In: *American Economic Review* (1981)

John Y Campbell and Robert J Shiller. “The dividend-price ratio and expectations of future dividends and discount factors”. In: *The Review of Financial Studies* 1.3 (1988), pp. 195–228

Jennie Bai, Thomas Philippon, and Alexi Savov. “Have financial markets become more informative?” In: *Journal of Financial Economics* 122.3 (2016), pp. 625–654

Week 9: High-Frequency Trading

Eric Budish, Peter Cramton, and John Shim. “The high-frequency trading arms race: Frequent batch auctions as a market design response”. In: *The Quarterly Journal of Economics* 130.4 (2015), pp. 1547–1621

Charles M Jones. “What do we know about high-frequency trading?” In: (2013)

Emiliano Pagnotta and Thomas Philippon. *Competing on speed*. Tech. rep. National Bureau of Economic Research, 2011

Week 10: Asset Management

Kenneth R French. “Presidential address: The cost of active investing”. In: *The Journal of Finance* 63.4 (2008), pp. 1537–1573

Jonathan B Berk and Richard C Green. “Mutual fund flows and performance in rational markets”. In: *Journal of political economy* 112.6 (2004), pp. 1269–1295

José Azar, Martin C Schmalz, and Isabel Tecu. “Anti-competitive effects of common ownership”. In: *Journal of Finance* (2017)

Jakub W Jurek and Erik Stafford. “The cost of capital for alternative investments”. In: *The Journal of Finance* 70.5 (2015), pp. 2185–2226

Inequality

Week 11: Income Inequality

Thomas Philippon and Ariell Reshef. “Wages and human capital in the US finance industry: 1909–2006”. In: *The Quarterly Journal of Economics* 127.4 (2012), pp. 1551–1609

Claire Célérier and Boris Vallée. “Returns to talent and the finance wage premium”. In: (2017)

Xavier Gabaix and Augustin Landier. "Why has CEO pay increased so much?" In: *The Quarterly Journal of Economics* 123.1 (2008), pp. 49–100

Jonathan A Parker and Annette Vissing-Jorgensen. *The increase in income cyclicality of high-income households and its relation to the rise in top income shares.* Tech. rep. National Bureau of Economic Research, 2010

Jeffrey Clemens et al. *The Spillover Effects of Top Income Inequality.* Tech. rep. National Bureau of Economic Research, 2018

Jessie Handbury and David E Weinstein. "Goods prices and availability in cities". In: *The Review of Economic Studies* 82.1 (2014), pp. 258–296

Rebecca Diamond. "The determinants and welfare implications of us workers' diverging location choices by skill: 1980-2000". In: *American Economic Review* 106.3 (2016), pp. 479–524

Week 12: Wealth Inequality

Emmanuel Saez and Gabriel Zucman. "Wealth inequality in the United States since 1913: Evidence from capitalized income tax data". In: *The Quarterly Journal of Economics* 131.2 (2016), pp. 519–578

Xavier Gabaix. "Power laws in economics and finance". In: *Annu. Rev. Econ.* 1.1 (2009), pp. 255–294

Thomas Piketty. *Capital in the twenty-first century.* Harvard University Press, 2017

Matthieu Gomez. "What Drives the Recent Rise in Inequality?" Working Paper. 2016