

THE AMERICAN UNIVERSITY
DEPARTMENT OF ECONOMICS

Spring Semester 2010
19.634.01

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TA:

Office Hours:
Mon 2:00-5:00 pm
8:00-9:00 pm
Wed 1:00-2:00 pm
5:00-6:00 pm

Ofc hrs:

**DEVELOPMENT FINANCE AND BANKING
COURSE SYLLABUS**

I. WHAT THIS COURSE IS ALL ABOUT

This course mainly deals with the role of finance in economic development, with emphasis on developing countries (LDCs). It aims to provide the student with a better understanding of:

- the role of financial intermediation in the process of economic development;
- financial systems in the developing countries and in particular, the role of formal banking and informal financial institutions;
- the role of governments and multilateral institutions (IMF-World Bank) and the effects of financial policies
- globalization trends in financial markets and their impact on developing countries;
- financial crises and systemic risks; and
- microfinance and innovative finance for the poor

Financial systems - through their ability to mobilize savings, create money and allocate funds - are institutional clearinghouses that have a profound impact on the domestic economy as well as the world economy. One way or the other, they enhance, inhibit or complicate the pursuit of economic development.

Financial systems are not static. They undergo crises and periods of recovery; they also can expand - not only by means of financial deepening and widening but also through the process of globalization. Financial institutions can also be created or changed; new financial instruments can

be developed and old ones made obsolete; and financial policies can be altered. But in order to understand the process of financial development, we need to understand the interaction between the financial sector and the real sector (goods and services production). In developing countries, financial systems are characterized by the coexistence and parallel operation of a formal financial sector (dominated by commercial banks) and an informal financial sector - a situation commonly denoted as "financial dualism". We compare and contrast the features and operations of informal lenders, credit cooperatives and banks.

Against this backdrop, the issues of multilateral institutions' influence and the debates regarding government intervention in financial markets are examined as well. Financial market deregulation and liberalization have been the dominant views until recently and have been crucial subjects of controversy in the last few decades. We examine both the theoretical foundations and the historical perspective of 800 years of financial crises as well as more recent experiences of both developing and developed countries, particularly the 2008 US financial meltdown and the international dimensions.

Finally, any course on development finance must address microfinance and other innovative financial institutions. Indeed, there is a growing consensus that financial development cannot be achieved by focusing attention on formal financial institutions and markets alone. A wide range of innovative institutions such as microcredit schemes, cooperatives, ROSCAs have been providing financial services, especially loan provision, to small enterprises, poor households and women. We will examine their roles and their performance as well.

II. COURSE REQUIREMENTS

A. PREREQUISITES

Students will be expected to have taken the prerequisites for this course or its equivalent namely: 19.500 Price Theory and 19.501 Income Theory. There will be some technical materials that may require students to review their economic concepts and tools beforehand.

B. ASSIGNED READINGS.

There are three textbooks for this course, which are available in the campus bookstore namely:

1. (SPRATT), Stephen Spratt, Development Finance, Routledge, Oxford, UK 2009.
2. (REINHART and ROGOFF) This Time is Different: Eight Centuries of Financial Folly, Princeton University Press, Princeton, NJ 2009.
3. (AGHION) Beatriz de Aghion and Jonathan Morduch, The Economics of Microfinance, MIT Press, Cambridge, Massachusetts, 2006.

The remainder of the required readings will be made available either through e-journal online (AU library website), BLACKBOARD and/or hard copy. We will be using intensively the blackboard for this course. Announcements and reminders as well as data sources and discussion questions will

be circulated through this website. BE SURE TO CHECK THE BLACKBOARD on a weekly basis.

C. ACADEMIC INTEGRITY

I take plagiarism, cheating and academic dishonesty very seriously, and I am required to report cases to the Dean of the College of Arts and Sciences, whose policy is to fail students for the course. Please read the university's Academic Integrity Code closely, and be sure to ask me if you have any questions. The code is available online at <http://www.american.edu/academics/integrity/index.htm>.

In doing your reaction essays, projects and writing papers, you must properly cite all sources (1) directly quoted, (2) paraphrased, or (3) consulted in any fashion. Sources include all printed material as well as the Internet. Proper citation means using a standard citation format: MLA, APA, or Chicago.

It is also considered plagiarism if you merely rework source material, placing an author's thoughts in other words without contributing your own ideas. For that reason, you must include some kind of source note whenever drawing on someone else's interpretation. A source note can be a sentence or more in your paper, or it can be a footnote. A source note should clarify the extent to which your interpretation is indebted to your source, explaining both (1) what you use and (2) where you depart or differ from the source.

It is also considered plagiarism to submit drafts, response papers, and other informal assignments without properly citing sources and acknowledging intellectual debts. Failure for the course is the typical sanction in such cases.

D. CLASSROOM RULES AND OFFICE HOURS

This class will meet every monday from 5:30-8:00 pm. Each class will include a student news report, lecture and discussion. You are expected to attend class and participate in class discussion. Note that there will be "randome call on reaction essay reading"

You are also expected to read the assigned readings AHEAD before coming to class. Students are held responsible for everything covered in class and in the assigned readings.

Blackboard will be used to communicate with you about assignments and changes in the class schedule. You should therefore check it on a regular (weekly) basis.

I appreciate it if you observe strictly my office hours (see above). If this is not convenient, you may set up an appointment ahead of time during other times (please send advanced notice for this). My teaching assistant and I are available to help you in going through some of the more difficult/technical part of this course.

C. COURSE REQUIREMENTS

1. RESEARCH PAPER (50%)

You will be required to develop a research paper that includes submitting the following:

- a) Thesis Statement and outline submission (5%)
- b) Final Research paper. (35%)
- c) Research Paper/Discussant Presentation (10%)

The research paper should be an in-depth exploration of any topic covered in this course. The thesis statement, outline and references is roughly 2 pages. Literature review paper should be max 8 pages and final research paper should be maximum 15 pages (excluding cover page and tables). Bear in mind that this has to be a development finance issue or problem. Please find below a detailed description of the above paper components and requirements.

a. Thesis Statement and Outline

Develop a clear statement identifying the issue or problem you want to examine. Formulate an OUTLINE of the main sections of your paper, along with a list of references. Your thesis statement, outline and references should be 2-4 pages in length.

If you plan to write an empirical paper, be sure to check FIRST on the availability of and access to the data. Then familiarize yourself with the sample design, the variables and other characteristics of the data so you can have a feasible and doable thesis statement.

DUE DATE: February 15. No extensions given.

b. Literature Review

A literature review examines the contributions and limitation, methodology and key findings of the relevant studies that address the issue being examined. It should not be a summary nor an annotated bibliography of these studies. Rather, a good literature review critically compares and contrasts the approaches and findings of those studies. Be sure to evaluate the underlying assumptions and the method used for investigating the problem or issue.

In searching for references, the bibliography sections of the textbooks and assigned readings on the topic are good starting points. The use of the AU library database as well as internet provides additional materials on the subject but you need to be selective and must cite fully these sources.

DUE DATE: March 22. [No extensions given.]

c. Final Research Paper

The final research paper should incorporate the following:

- i) **Introduction and Significance of the Study** - This includes the thesis statement and a brief discussion of the significance of such a study such as the analytical, empirical or policy merits of the issue being discussed.

- ii) **Review of literature (revised)**. This section should address the comments given to your literature review.
- iii) **Theoretical Framework or Empirical Analysis**. This main section of your paper must provide your own (conceptual or empirical) analysis of the issue. It must present your own perspective and analysis of the issue. You need to compare and contrast your results with those in existing studies and provide a brief explanation.

I strongly encourage students especially Phd students to conduct an empirical analysis and make use of primary or secondary data. Be sure to describe briefly the methodology (and data if relevant) you intend to use.

Exploratory extensions or modifications of existing theoretical models are another option. Be sure to mention whose model you plan to modify and provide the basis for the extension.
- iv) **Bibliography**. This section should list all references you cite or have used in preparing the paper including those from the internet (citing the website).

The paper must be typed, double-spaced and should have a maximum length of 15 page (including tables, figures). It must be submitted in hard copy (not via email.)

RESEARCH PAPER DUE: date of final exam.

d. Research Paper presentation and discussion(10%)

Each student will be asked to make a 10 minute presentation of their own research paper (a work-in progress of the final paper) in class. In addition, each student will serve as a discussant to another paper and write a one-page comment (3 minute presentation).

I will assign the discussants for each paper by April 12.

RESEARCH PAPER PRESENTATION: April 26.

2. CLASS ATTENDANCE AND CLASS PARTICIPATION (25%)

Students are expected to actively participate in class. Throughout the semester, students will be asked to discuss readings and engage in debates, discussions, and a group project on financial crises. Details on the latter will be given later. These will be graded on a periodic basis.

Additionally, each student will be assigned to a particular week to pick a 2008 (substantive) news article on a developing or transition economy (in Financial Times, Washington Post, New York Times, the Economist, Wall Street Journal, Economic and Political Weekly, or Far Eastern

Economic Review) relevant to the course topic. The article should be posted in the discussion board of the Blackboard by monday (10 am). The student then leads a ten-minute discussion during the wed class.

3. WEEKLY REACTION ESSAY/ FINAL EXAM (30 %)

Students can choose either to do the Reaction essays as described below or take the final exam at the end of the semester.

a. REACTION ESSAY OPTION:

This option requires the student to write 10 reaction essays on the assigned readings starting in week 2. Each reaction essay must reflect the student's familiarity and understanding the assigned readings that week and are posted in the discussion forum of the blackboard. The student is expected to participate actively and to share his/her insights, interpretation and analysis of the readings in class.

Student can write additional reaction essays for bonus points.

Some tips on writing a reaction essay:

- It should state the critical points (2-3 key ideas) that are raised in the readings and it should describe how the readings address these ideas.
- It should provide a critical evaluation of the arguments, assumptions and findings, especially for articles with different perspectives.
- It should also provide your own reflection on the issue or topic. For example, you can explore the implications of a particular finding or result, the replicability or application of a study approach, etc.

Submission of hard copy is required on the day of the scheduled discussion. It should be 2-3 pages (3 pages maximum). Late essays are given an automatic grade of C (or equivalent) and will not be accepted after three days late.

b) FINAL EXAM option.

Final exam will be given on the scheduled exam date.

D. COURSE GRADE AND DEADLINES:

The course grade will be based on the following:

Research paper and Presentation	45%
Class Attendance and Participation	25%
Weekly Reaction Essays/Final Exam Option	30%
TOTAL	100%

As a reminder, please note the following due dates:

Feb 22: THESIS STATEMENT AND PAPER OUTLINE

March 22: LITERATURE REVIEW SUBMISSION

April 26: RESEARCH PAPER PRESENTATIONS

Final Exam date: FINAL PAPER SUBMISSION

Students are required to receive a passing grade (70 or above) in all course requirements to receive a passing grade for the course. Grades are calculated as follows:

A (90-100)

B (80-89%)

C (70-79%)

D (60-69%).

F (59% and below).

Please note that each letter category includes both pluses and minuses. Late submissions and extensions will not be accepted/given unless accompanied by a written letter (stating medical or important emergency reason) and accompanying note from doctor.

COURSE SCHEDULE AND ASSIGNED READINGS

[NOTE: There may be changes in the course schedule during the semester. You will be informed in advanced. The list of assigned readings will be posted in the blackboard.]

Week 1 - January 11 Introduction and Course Overview

SPRATT, Chap 1

Week 2 - January 25 Finance, Poverty, Development and Growth

SPRATT, Chap 2

John G. Gurley; E. S. Shaw (1955) "Financial Aspects of Economic Development", *The American Economic Review*, Vol. 45, No. 4. (Sep), pp. 515-538. [BLACKBOARD]

Stable URL: [http://links.jstor.org/sici?sici=0002-](http://links.jstor.org/sici?sici=0002-8282%28195509%2945%3A4%3C515%3AFAOED%3E2.0.CO%3B2-8)

[8282%28195509%2945%3A4%3C515%3AFAOED%3E2.0.CO%3B2-8](http://links.jstor.org/sici?sici=0002-8282%28195509%2945%3A4%3C515%3AFAOED%3E2.0.CO%3B2-8)

FOCUS: Poverty in Developing Countries:

Banerjee, A and E. Duflo (2006), "The Economic Lives of the Poor", MIT Dept of Economics Working Paper. [BLACKBOARD]

Weeks 3 and 4 – February 1, 8: Financial Institutions and Markets in Developing Countries Financial Dualism: Formal and Informal Financial Sectors

SPRATT, Chaps 4-5

Germidis, Dimitri, Dennis Kessler and Rachel Meghir, (1991) *Financial Systems and Development: What Role for the Formal and Informal Sectors?*, Paris, OECD, Selected chapters [HANDOUT]

Ghate, P. B. "Interaction Between the Formal and Informal Financial Sectors: The Asian Experience", *World Development*, Vol. 20, No. 6, 1992. [BLACKBOARD]

Case Study Material 1: STOCK MARKETS IN DEVELOPING COUNTRIES

Arestis, P., Demetriades, P.O. and Luintel, K.B. (2001), "Financial Development and Economic Growth: The Role of Stock Markets", *Journal of Money, Credit and Banking*, 33(1), pp. 16-41 [BLACKBOARD]

Ross Levine and S. Zervos (1996) "Stock Markets, Corporate Finance, and Economic Growth: An Overview" *World Bank Econ Review*, Volume 10: 223-239 [BLACKBOARD]

Ajit Singh (1997), "Financial Liberalisation, Stock Markets and Economic Development", *Economic Journal*, pp. 771-782, Stable URL: <http://links.jstor.org/sici?sici=0013-0133%28199705%29107%3A442%3C771%3AFLSAED%3E2.0.CO%3B2-B>

Week 5 - Feb 15 Globalization of Financial Markets

SPRATT Chaps 6 (pp. 191-203), 7 (pp.204-254)

Case Study 2: IMF and WORLD BANK

Anne O. Krueger (1998), "Whither the World Bank and the IMF?" *Journal of Economic Literature*, Vol. 36, No. 4 (Dec., 1998), pp. 1983-2020. [AVAILABLE IN JSTOR or BLACKBOARD]

Joseph Stiglitz (2001). "The Role of International Financial Institutions in the Current Global Economy." In *The Rebel Within*, edited by Ha-Joon Chang. London: Anthem. [BLACKBOARD]

Prasad, Eswar, Kenneth Rogoff, Shang-Jin Wei and M. Ayhan Kose (2003), "Effects of Financial Globalization on Developing Countries: Some Empirical Evidence," Washington, DC: International Monetary Fund.

Case Study 3: ROLE AND IMPACT OF FDI

SPRATT Chapter 9.

Milberg, W. (1999) "Foreign Direct Investment and Development: Balancing the Costs and Benefits", in International Monetary and Financial Issues for the 1990s, Vol. XI. Geneva: UNCTAD. <http://r0.unctad.org/p166/modules2001/mod2/Milberg.pdf>

Braunstein, Elissa. (2004) ""Foreign Direct Investment, Development and Gender Equity: A Review of Research and Policy," Prepared for the UNRISD report Gender Equality: Striving for Justice in an Unequal World. (<http://www.umass.edu/peri/pdfs>)

Week 6_ February 22 Theoretical Foundation of Financial Liberalization

SPRATT CHAPTER 3 pp. 58-65

R. McKinnon (1973), *Money and Capital in Economic Development*, Brookings Institution, Washington DC, Chs.1, 2, 5 and 6 [HANDOUT]

Gibson, Heather D. and Euclid Tsakalotos (1994), "The Scope and Limits of Financial Liberalisation in Developing Countries: A Critical Survey," *Journal of Development Studies*, 30(3), 578-628.

Weeks 7-9 March 1, 9 and 22 Historical Perspective on Financial Crises

REINHART AND ROGOFF, Chapters 1-3, 10-12

SPRATT, Chap 7.

Video: Sections of "The ascent of money: A financial history of the world" 2009

CASE STUDY 4: Anatomy of a Financial Crisis (Group Project)

SPRING BREAK March 10-14, 2008

Week 10: March 29 The US Financial Meltdown

REINHART AND ROGOFF, Chapters 13-15.

Video: "Inside the Meltdown". Frontline. 2009.

Week 11 – April 5 Financial Development and Poverty

Jalilian, Hossein and Colin Kirkpatrick (2002), "Financial Development and Poverty Reduction in Developing Countries," *International Journal of Finance and Economics*, 7, 97-108. [BLACKBOARD]

Holden, Paul and Vassili Prokopenko (2001), "Financial Development and Poverty Alleviation: Issues and Policy Implications for Developing and Transition Countries", *IMF Working Paper*, WP/01/160, Washington, DC: International Monetary Fund [BLACKBOARD]

Arestis, P. and Caner, A. (2005), "Financial Liberalization and Poverty: Channels of Influence", *International Papers in Political Economy*, New Series, Vol. 1, No. 1 [BLACKBOARD]

Week 12 - April 12 Informal Finance

AGHION Chaps 3 and 4.

Karla Hoff and Joseph Stiglitz, "Imperfect Information and Rural Credit Markets: Puzzles and Policy Perspectives", *World Bank Economic Review*, Vol 4, No. 3 September 1990.[BLACKBOARD]

Besley, Timothy et al. (1993) "The Economics of Rotating Savings and Credit Associations", *American Economic Review*, Vol. 83, Issue 4, September 1993. [BLACKBOARD]

Case Study 5: AFRICA

Miracle, M.P., Miracle, D.S. and Cohen, L. (1980), "Informal Savings Mobilization in Africa", *Economic Development and Cultural Change*, 28, 701-724. [BLACKBOARD]

Week 13 - April 9 Savings, Insurance and Gender

De Aghion and Morduch, Chaps 6 and 7

Case Study 6: BANGLADESH, PERU, KENYA

Jonathan Morduch, "Does Microfinance Really Help the Poor? New Evidence on lending Program in Bangladesh" Paper Presented at the NEUDC Conference, Yale University, October 1998.[BLACKBOARD]

Copestake, J. et al (2005) "Monitoring the Diversity of the Poverty Outreach and Impact of Microfinance: A comparison of Methods Using Data from Peru, *Development Policy Review*, Vol. 23, No. 6, pp. 703-723. [BLACKBOARD]

Johnson, S. (2004) "Gender Norms in Financial Markets", *World Development*, Vol. 32, No. 8, pp. 1355-1374 [BLACKBOARD]

A. M. and Gupta, R. S. (1996) Who Takes the Credit? Gender, Power, and Control Over Loan Use in Rural Credit Programs in Bangladesh, *World Development* 24 (1), pp. 45-63.

Week 14 – April 26: Paper Presentations

TIPS FOR WRITING A GOOD REACTION ESSAY

Objective

You are asked for each essay to choose two or three assigned readings addressing a specific topic* and to write a critical assessment as well as your own reflection on the subject.

The goal is to provide an opportunity for you to analytically examine the assigned readings and even to explore beyond what these readings provide by looking at additional references related to the readings and/or topic. The essay also serves as a tool for actively participating in class discussions.

***NOTE:** The chapters in Fry's book and a few of the assigned articles are more challenging to write reaction essays on, because these are written either as a textbook or as a survey of the literature. Choose the readings that allow you to do an analytical exploration or critical assessment.

Reaction Essay General Format:

I provide below a general format for a good reaction essay:

1. Introduction (section 1). Use the first paragraph to introduce the topic to your reader. A brief summary of the purpose of the two readings (i.e. why they were done) might be included here.
2. Section 2. Discuss and analyze the first reading by answering the following questions:
 - a. What is the main thesis or hypothesis and how does this relate to the topic of inquiry for that week? There may be one or several thesis or hypothesis. Your task is to understand the readings well enough to state the thesis of the paper/essay hypotheses that were tested and how each address the subject matter.
 - b. What particular reasoning or set of arguments is given or what type of method was used to analyse the data? Be as specific as possible (e.g. time series analysis, econometric analysis, etc; what are the variables being studied, Where appropriate, identify them as independent variables, dependent variables, or subject variables.
 - c. What were the main findings or conclusions that the authors come to? State them and tell us how you think they were either supported or not by the methods and results.
3. Section 3. Discuss and analyze the second reading using the same guide questions given for section 2.
4. Section 4. This section should "tie the readings " together. Note the ways that the readings relate to each other and/or complement each other. Note differences. Do you

- agree with them? Provide your own views and reaction to these readings. Explain, in a “nutshell”, what can be concluded from these studies as a whole. Be concise.
5. Conclusion. Make this paragraph a synthesis of the points that you think are important. Be sure to include any additional insight or reflection that you may have.
 6. References: include the full references of any additional article or source you have used.

NOTE: You can modify the above format to suit your own writing style and creativity but it should still contain the information as stated above.

Your essay will be reviewed and evaluated on the clarity of your writing, clear articulation of the main arguments in the readings and your own critical assessment, and finally, the organization of the ideas (both the authors’ and yours) into a coherent whole

Additional tips:

Read the articles/readings carefully and be sure that you understand them. Then you will be able to talk about the articles and express ideas in your own words. Copying and paraphrasing is not permitted. Writing a rough draft should help you clarify your ideas and fit as much important information/thoughts as possible into two-three pages. You may discuss the readings with others, but your writing must be your own.

Be sure that your paper is free of spelling errors and consists of complete and grammatical sentences. Clarity of content will be considered along with content in grading.

Due dates: day of discussion of assigned readings (in class)

Each reaction essay should be 2-3(maximum), well-organized and succinct pages in length, double-spaced. Late papers will lose half a letter grade for each day after the due date, and will not be accepted after Friday of that week.

I expect you to share your views and assessment in class discussions.

TIPS FOR WRITING A GOOD LITERATURE REVIEW PAPER:

The good review of the literature should not be a mere listing of summaries that are typically found in the intro and conclusion parts of the article(s), books, etc. or in the abstracts. A good literature review:

- tells a coherent story of how the various authors/materials address the issue at hand (i.e. the underlying perspective or approach, their assumptions and their main findings or conclusions, etc.);
- describes briefly the type of information (primary, secondary, survey data, government statistics, interviews, case studies, experiments, etc.) or data used by the various authors; and the methodology they choose to employ in their work; and
- critically compares and contrasts the different approaches or studies, etc. For example, you can compare the way the different authors define or approach the problem, use varied assumptions, and apply particular methods to prove their point or test their hypothesis.

Proper citation of the sources in your paper is a MUST. I expect students to acknowledge ideas and sentence(s)/paragraphs taken from another person's work. There is severe penalty for plagiarism. Please use the guidelines for references that is given. Use either footnotes or endnotes whenever appropriate.

TIPS FOR WRITING A GOOD RESEARCH PAPER

A good research paper typically include the following sections:

- Introduction - a succinct introduction that states the thesis statement, its study focus and the significance of your study. It also provides a brief description of the sections of your paper as well as any data/secondary sources you plan to use.
- Context or Background of the Study (if relevant) – should be relatively short and provides the historical, macroeconomic or institutional context of your study.
- Review of the Literature – provides a summary of the different perspectives, approaches or views/position on the topic or issue. It is usually helpful to compare and contrast the representative authors or research that illustrate the different perspectives or views.
- Analysis or Conceptual Framework – describes your analytical/conceptual framework, research methodology, or empirical analysis (including the statistical results and their interpretation if any) in a clear and coherent manner.
Analytical models and empirical analysis may be preliminary exploration of the thesis; what counts is your originality, rigor and coherence in presenting your analysis.
- Summary and Conclusions – a brief summary of the main results or points of your paper and the policy implications. You may also include any direction in future research that you would like to suggest.
- Bibliography – list of references cited in your paper. Please make sure that the citation follows the Chicago Manual of References or the format used in academic (scholarly) journal.
- Tables and Appendices (optional) – tables should include references or sources of information/data.

Do keep in mind that the research paper grade includes (i) the student's ability to integrate BOTH CLASS reading and OUTSIDE reading materials into his/her analysis of the topic, (ii) the thoughtfulness, clarity and logic of the student's analysis, and (iii) creativity/resourcefulness. As usual, good writing and organization also influence the grade as well. Make sure that proper citation of references are made (Citation of references in the text and/or footnotes and in the bibliography will be part of grading). Avoid any form of plagiarism or undocumented use of another person's work.