

**THE UNIVERSITY OF HONG KONG  
FACULTY OF BUSINESS AND ECONOMICS**

**School of Economics and Finance  
ECON 3243 / ECON 0206  
Capital Theory  
Semester B, 2016-17**

**GENERAL INFORMATION**

**I. Instructor:** Dr. Claudian Kwok  
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Office: KK 1116  
Phone: 3917-1034  
Lecture: Monday 11:30 am – 12:20 pm KB113  
Thursday 10:30 am – 12:20 pm KB113  
Office Hours: TBA

**II. Pre-requisite**

This is an advanced Macroeconomics course intended for senior students with a Major in Economics.

The pre-requisites of the course are Intermediate Microeconomics (ECON 2101 / ECON 2210) AND Intermediate Macroeconomics (ECON 2102 / ECON 2220).

Mathematics (e.g., Calculus) and Statistics will be used extensively in the course.

**III. Course Website:** TBA

**IV. Textbook**

The main references of this course are journal articles (the list is presented on the second last page of this syllabus).

**COURSE DESCRIPTION**

This course studies the role of the financial sector in the macro-economy, in particular,  
(i) the relationship between the development of the financial sector and the long-term economic growth of an economy, and  
(ii) the dynamic interaction between the financial sector and short-term aggregate fluctuations.

Both theories and empirical evidence will be considered.

To study the (non-trivial) role of the financial sector, we will adopt a class of dynamic general equilibrium models in which asymmetric information exists in the financial sector. The following three articles will serve as the foundation of the course.

Levine, Ross. "Financial Development and Economic Growth: Views and Agenda," *Journal of Economic Literature*, June 1997, pp. 688-726.

Bernanke, Ben, and Mark Gertler. "Agency Costs, Net Worth, and Business Fluctuations," *American Economic Review*, March 1989, 79 (1), pp. 14- 31.

Williamson, Stephen. "Recent Developments in Modeling Financial Intermediation," Federal Reserve Bank of Minneapolis, *Quarterly Review*, Summer 1987, pp. 19-28.

### COURSE OBJECTIVES

- (1) To study the role of the financial sector in the macro-economy, in particular,
  - (a) the role of financial development in the long-term growth of an economy, and
  - (b) the dynamic interaction between the financial sector and short-run aggregate fluctuations.
  
- (2) To introduce students to a class of dynamic general equilibrium models in which frictions in the financial sector are modeled explicitly. By the end of the semester, students will be able to understand the essence of the models in Bernanke and Gertler (1989) and Williamson (1987).

### COURSE LEARNING OUTCOMES

Course Learning Outcomes	Faculty Overall Goals
CLO1 Students will develop an in-depth understanding on the role of the financial sector in the macro-economy	1, 2
CLO2 Students will understand a class of dynamic micro-foundation macro-economic models	1, 2

## COURSE TEACHING AND LEARNING ACTIVITIES

Course Teaching and Learning Activities	Expected contact hour	Study Load (% of study)
T&L1. Lectures	36	30%
T&L2. Self-Study	84	70%
Total	120	100%

Assessment Methods*	Weight*	Aligned Course Learning Outcomes
A1. Exercise	10%	1,2
A2. Term Test	30%	1,2
A3. Final Exam	60%	1,2
	100%	

\*To be confirmed at the beginning of the semester

### Term Test and Final Exam

- ✓ The final exam is cumulative.
- ✓ The term test and the final exam are closed book and closed notes. You will need to bring a calculator to the term test and the final exam.
- ✓ You will need to bring a Calculator to the term test and the final exam.

### Tutorials

There will not be any regular tutorial for the course. However, a special tutorial may be arranged if necessary.

### Class Attendance

Since there is no textbook for the course, class attendance will be important for students to learn the course materials.

## STANDARDS FOR ASSESSMENT

### Course Grade Descriptors

A+, A, A-	Strong evidence of superb ability to fulfill the intended learning outcomes of the course at all levels of learning: describe, apply, evaluate, and synthesize
B+, B, B-	Strong evidence of the ability to fulfill the intended learning outcomes of the course at all levels of learning: describe, apply, evaluate, and synthesize
C+, C, C-	Evidence of adequate ability to fulfill the intended learning outcomes of the course at low levels of learning such as describe and apply but not at high levels of learning such as to evaluate and synthesis
D+, D	Evidence of basic familiarity with the subject
F	Little evidence of basic familiarity with the subject

## Assessment Rubrics for Each Assessment

Performance Level	Assessment Rubrics for Exercise, Term Test and Final Exam
Outstanding A+, A, A-	Answers to all or almost all of the questions: (a) provide correct analysis of all the issues raised by the question, and (b) are presented in a clear and logical manner.
Proficient B+, B, B-	Answers to most of the questions: (a) provide correct analysis of the main issues raised by the question, and (b) are presented clearly.  And for the rest of the questions, most of the answers provide some reasonable analyses of the main issues raised by the questions.
Competent C+, C, C-	Answers to the majority of the questions provide correct analysis of the main issues raised by the question.  And for the rest of the questions, some of the answers provide reasonable analyses of some of the issues raised by the questions.
Adequate D	Answers to the majority of the questions provide reasonable analysis of the main issues raised by the questions.
Failure F	Few of the answers provide reasonable analysis of the main issue raised by the questions

## COURSE CONTENT

### **(1) Role of the Financial Sector in a neoclassical growth model with complete markets**

Solow's Growth Model and Real Business Cycle Model in an infinite time horizon two-period lived overlapping generations environment

### **(2) Frictions in the Financial Sector**

Optimal contracts and institutional arrangements in environments with:

- Moral Hazard
- Costly State Verification

### **(3) Relationship between the Financial Sector and the Macro-economy**

Financial Accelerator, capital accumulation and the role of financial intermediaries in an infinite time horizon two-period lived overlapping generations model with frictions in the financial sector

### **(4) Financial Crisis**

Credit Booms and Asset Bubbles: Causes and Consequences

### **(5) Empirical Evidence**

- Development of the Financial Sector and Long-Term Economic Growth
- Financial Sector and Short-term Aggregate Fluctuations

**REQUIRED/RECOMMENDED READINGS & ONLINE MATERIALS** (e.g. journals, textbooks, website addresses etc.)

*The following is a tentative list of the core readings for the course. The exact reading materials will be announced during the semester when we cover specific topics.*

Beck, Thorsten, and Ross Levine. "Stock Markets, banks, and growth: Panel Evidence," *Journal of Banking and Finance*, 2004, 28, pp. 423-442.

Bernanke, Ben, and Mark Gertler. "Agency Costs, Net Worth, and Business Fluctuations," *American Economic Review*, March 1989, 79 (1), pp. 14- 31.

Bernanke, Ben, and Cara Lown. "Credit Crunch," *Brookings Papers on Economic Activity*, 2:1991, pp. 205-247.

Cecchetti, Stephen. "The Future of Financial Intermediation and Regulation: An Overview," Federal Reserve Bank of New York, *Current Issues in Economics and Finance*, May 1999, 5(8) pp. 1-5.

Cetorelli, Nicola, Benjamin H. Mandel and Lindsay Mollineaux. "The Evolution of Banks and Financial Intermediation: Framing the Analysis," Federal Reserve Bank of New York, *Economic Policy Review*, July 2012, pp. 1-12.

Ennis, Huberto. "Some Recent Trends in Commercial Banking," Federal Reserve Bank of Richmond, *Economic Quarterly*, Volume 90/2, Spring 2004, pp. 41-61.

Levine, Ross. "Financial Development and Economic Growth: Views and Agenda," *Journal of Economic Literature*, June 1997, pp. 688-726.

Holmstrom, Bengt, and Jean Tirole. "Financial Intermediation, Loanable Funds, and the Real Sector," *The Quarterly Journal of Economics*, 1997, 112 (3), pp. 663-691.

International Monetary Fund. "When Bubbles Burst," Chapter II, *World Economic Outlook*, April 2003.

International Monetary Fund. "Financial Crisis: Characteristics and Indicators of Vulnerability," *World Economic Outlook*, May 1998, pp. 74-97.

Williamson, Stephen. "Recent Developments in Modeling Financial Intermediation," Federal Reserve Bank of Minneapolis, *Quarterly Review*, Summer 1987, pp. 19-28.

Rajan, Raghuram G. "Has Financial Development made the world riskier?" Federal Reserve Bank of Kansas Symposium, "*The Greenspan Era: Lessons for the Future*", 2005, pp. 313-369.

Selim, Elekdag and Yiqun Wu. "Rapid Credit Growth: Boon or Boom Bust?" IMF Working Paper. 11/241 (October 2011).

Williamson, Stephen, and Randall Wright. "New Monetarist Economics: Methods," Federal Reserve Bank of St. Louis, *Review*, July/August 2010, pp. 265-302.

**MEANS/PROCESSES FOR STUDENT FEEDBACK ON COURSE**

- conducting mid-term survey in additional to SETL around the end of the semester
- Online response via Moodle site
- Others: \_\_\_\_\_ (please specify)

**COURSE POLICY (e.g. plagiarism, academic honesty, attendance, etc.)**Term Test and Final Exam

- ✓ There will be no make-up for the term test.  
If you do not attend the test, you will automatically get zero mark for the test.  
  
However, if there is a legitimate medical reason that you miss the test, you will need to inform the teacher or the teaching assistant and provide medical certificate within 72 hours of the test. In such case, the weight of the term test will be allocated to the final exam.
- ✓ If you cheat in any of the term test or the final exam, you will get zero mark for the test or the final exam.
- ✓ For the University regulations regarding the final exam, please refer to the Examinations Unit of HKU.

Exercise

- ✓ Exercise submitted after the deadline will not be accepted. Students who do not submit their exercises on time will get “zero” mark.
- ✓ The University Regulations on academic dishonesty will be strictly enforced! Please check the University Statement on plagiarism on the web: <http://www.hku.hk/plagiarism/>

**ADDITIONAL COURSE INFORMATION (e.g. e-learning platforms & materials, penalty for late assignments, etc.)**