V53.0396, Honors Seminar: Politics and Finance

Fall Semester 2006-2007,
Tu, Th 9:30-10:45, SILV 804 (Silver Center)

Instructor: Prof. Howard Rosenthal

Office: 726 Broadway, Room 743
Office Phone, 212-998-7512
Office Hours, Wednesday 10:00 – 12:00. Use e-mail to make appointment outside of these hours or to reserve a time slot in office hours.
E-mail: hr31@nyu.edu

Overview:
This seminar examines how legislation and regulation influences the structure of financial markets and how players in these markets intervene in the political process to create or modify legislative and regulatory outcomes. Particular emphasis will be placed on the United States. International comparisons will also be present. The class will assume that students have had exposure to microeconomics and finance but not to political theory. A brief introduction to political theory will be provided. The approach will be similar to that used in microeconomics, except that transactions will be made through voting institutions rather than through economic exchange.

The seminar will use an interdisciplinary approach with readings from political science, economics, law, and history. Most of the reading will be non-technical but there will be bursts of formal models and econometrics.

One book is to be purchased. A large majority of the other readings are posted on Blackboard. All other required readings will be assembled in a seminar packet. Some non-required items will be on reserve.

The class will make use of Voteview, a database of all congressional roll call votes from 1789 to 2000, and software for looking at the votes. There will be a tutorial on Voteview. The program should be available on cluster computers. If you have a Windows computer of your own, you can download Voteview as freeware from voteview.ucsd.edu (no www). Go to the data download page and scroll until you find Voteview. Then, just follow the instructions. Voteview takes somewhat under 100MB of disk space if you want the entire history of the House and Senate. You can delete Congresses you don’t want to save disk space. You can also download Voteview from voteworld.berkeley.edu.

Seminar Prerequisite:
At least one course in economics.

Seminar Requirements:
There will be weekly assignments, typically taking the form of 2-3 page reports. The assignment with the lowest grade is dropped from the final grade computation. If you miss an assignment because of illness, etc., that assignment can be the one you drop. Assignments will be due in class (or posted electronically
before class. No late assignments will be read. **There will be a “midterm” in class exam on Tuesday, November 21.**

For several of the class assignments, students will be asked to study congressional roll call votes using VOTEVIEW, a database that includes all roll calls between 1789 and 2000. VOTEVIEW was programmed by Boris Shor ’96. If you have a Windows (no Macs) machine, you can run VOTEVIEW on your own PC. The program can be downloaded and installed from the data download page at Voteview.ucsd.edu or through voteworld.berkeley.edu. Voteview was programmed by Boris Shor, now an assistant professor at the Harris School at the University of Chicago.

Class project. Before the 1929 stock market crash, ordinary Americans invested in equities on an unprecedented scale. The most widely held firms were public utilities, most notably American Telephone and Telegraph, which had more shareholders than any other firm. The utilities were thought of as “safe” stocks for “widows and orphans”. As a class, we will take a look at what happened to electric utilities since the deregulation of the electric power industry. I will ask each student to pick a utility and trace its history since about 1970. It would be natural, where possible, to pick a utility in your home state. You should trace out the evolution of the number of shareholders in the utility and its stock price, M & A activity, hedge fund investment, and other financial information. You should ask how politics has been relevant to changes in the firm. For recent years, there are ample electronic resources through the FEC, state PUCs, state governments, Lexis-Nexus, etc. The further back you go in time, you will have to be entrepreneurial in finding materials that are not available on the Internet. A minimum 15 page paper will be due in the last class, Tuesday, December 12, if presented in hard copy. Electronic documents in MS-Word or in pdf can be submitted through e-mail as late as Sunday, December 17. All assignments can also be submitted as e-mail attachments.

Approximate weights in final grade: midterm 25%, project 35%, assignments 15%, presentations 15%.

**Sept. 5-7: Politics Really Matters: The Case of Conrail**

Required Readings.


Recommended:


Class exercise: The lectures will be devoted to explicating the theory of pivotal politics and using the theory to understand why Conrail was privatized through a public offering rather than being sold to Norfolk and Southern as proposed by Elizabeth Dole, Secretary of Transportation in the Reagan administration. More recently, Conrail was absorbed by Norfolk and Southern and the Chessie System. **Option 1.** Use the web or the library to learn what you can about the sale of Conrail. Write a brief 2-3 page note emphasizing any insights provided by the theory of pivotal politics (see Brady and Volden) as to why Congress did not insist in the 90s, as against the 80s, that Conrail be preserved.

**Option 2:** More recently, United’s attempt to absorb USAirways was blocked by the government. Did Conrail disappear and USAirways survive for political reasons? Or can you make a case, in terms of economic efficiency, that both outcomes were reasonable?

Reading Assignment: You can get an official view of what these agencies do and how they handle a current “hot” issue by using the following URLs:

- Regulatory Agencies
  The Investor’s Advocate: How the SEC Protects Investors and Maintains Market Integrity
  http://www.sec.gov/about/whatwedo.shtml
  The CFTC at a Glance.
  http://www.cftc.gov/cftc/cftcabout.htm
  The Structure of the Federal Reserve System
- Selective Disclosure
  Final Rule: Selective Disclosure and Insider Trading
  http://www.sec.gov/rules/final/33-7881.htm
  Regulation FD: The SEC’s New Selective Disclosure Rule Takes Effect
  http://www.haledorr.com/practices/prac_pubsdetail.asp?ID=804610242000&groupId=2&TypeID=9
  SEC Selective Disclosure Conference Call
  [You will need RealPlayer or similar to listen to this. It is a one hour recording, so you may want to sample. The conference call provides some insight into the interplay between the regulator and the regulated.]
  http://www.vennewswire.com/BRTABLE/022500/
- Also read the assembled set of NYTimes stories assembled in the document “Selective Disclosure” on the seminar web page.

Sept. 14-19: The Rule of Law and Financial Markets around the World

Readings:

*Shleifer, Andrei and Robert W. Vishny. 1997. The Journal of Finance 52 (2) June. 737-


Recommended:

Sept. 21: Activists and Finance: California Redwoods

Reading:


Sept. 26-28: Regulatory Change and Regulatory Gridlock

Reading


Oct. 3-5: Regulatory Failure and the Mortgage Market

Readings:


Recommended:


Assignment: Is the federal guarantee of private pension plans likely to generate a massive repeat of the S&L crisis. Use the web and library to learn what you can about this issue. Evaluate possible policy changes such as mandating that all pension plans be defined contribution rather than defined benefit, eliminating government insurance of defined benefit plans, eliminating congressional control of funding requirements by delegating this power to the Fed or another independent regulatory agency. Comment on the influence of politics in the development of this crisis.

**Oct. 10-12: Populism and Regulatory Structure: Why the US, Unlike Others, Has One Regulator for Securities, Another for Futures.**

Readings:


Recommended:


**October 17: Executive Compensation and Politics**

Readings


Recommended:


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Class exercise: Research the Fannie Mae case. What went wrong in the privatization of Fannie Mae? Should Fannie Mae have remained in the public sector?


Readings:


Polarized America, chapter 5.

Recommended:


**Oct. 26: Don’t Trust the Courts**

Readings:


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Recommended:


**Oct. 31: Finance for the Masses: Borrowing, Pensions, and Social Security**

Readings:


*Choi, James C., David Laibson, and Brigitte C. Madrian, 2004 “Plan Design and 401(k) Savings Outcomes”, forthcoming, National Tax Journal

_Polarized America_, chapters 6-7.

Recommended:


Federal Trade Commission, Proposed consent agreement: Sears Roebuck and Co: Analysis to Aid Public Comment (Washington, D.C.: GPO, 10 June 1997); available from CQ Federal Register Service. This document and several other items picked off the web will be placed on the seminar web site.

**Nov. 2-9: Political Intervention in Credit Markets**

Readings:


*Polarized America*, chapters 3, 4.

Recommended:


Assignment: Use Voteview to examine congressional voting on debt repudiation. Was there a division in Congress? Why do the votes seem inconsistent with Kroszner’s conclusions about financial markets? Can you reconcile the observations about voting with the observations about securities prices?

**Nov. 14-16 Preliminary Student Presentations of Work on Class Project.**

**November 21: “Midterm” Examination**

**Nov. 28-30: National Elections and Equity Markets—Cause and Effect**

Readings:


Recommended:


**Dec. 5-12: Conclusions and Final Presentations of Class Project**

Reading, Entertaining.