COURSE: Our aim in this course is to introduce students to the finance, economics and law of government fiscal crises and the resulting implications for citizens and the private economy. The focus will be on the causes of fiscal crises, a careful detailing of who wins and who loses, and then on how such crises might be resolved and, perhaps most importantly, how they might be prevented in the future. The course will draw upon the fiscal experiences of U.S. local governments (New York, Philadelphia, Detroit, Orange County, Puerto Rico), utilities (WPPSS) and states (Illinois), and the international experience from such countries as Greece, Brazil, and Argentina. The costs of such crises for citizens, pensioners, and bond holders can be significant. We seek to understand the underlying economic, political, and legal/regulatory causes of such events so that they may be prevented in the future. The importance of private information and public regulation for disciplining the fiscal performance of democratically elected governments will be a central concern. We believe strongly that diagnosing and treating the “disease” of fiscal mismanagement is an interdisciplinary endeavor drawing on finance, economics, political science, and the law. Students with backgrounds in any of these disciplines are welcome. As a seminar class enrollment will be limited to a total of 40 students, divided (about equally) between Wharton and Law students.

ASSIGNMENTS AND GRADING: Students will be responsible for the readings for each class and will be expected to participate actively in class presentations and discussions. Students will be responsible for a midterm examination (week of March 29) and a paper at the end of the semester. The paper will be a maximum of 14 pages, double spaced (excluding appendices), double-spaced. Grades will be based upon class participation (30 percent), the mid-term examination (30 percent), and the paper (40%). The course is scheduled for 3 hours (with a break) once a week and will be taught in seminar style. Classes often will entail one “session” for faculty presentation and a second “session” for group discussion. Students will be expected to actively participate in class discussions.

READINGS: Required and optional readings for each class will be noted before class. Readings marked with an * are more technical and will be summarized in class, but introductions and conclusions should at least be skimmed for an understanding of their core ideas. We will be available to discuss those readings in detail – with an obvious division of labor.
COURSE SCHEDULE

I. Introduction: When Do Governments Default and Should We Care? : January 18


II. Economics and Politics of Public Debt: January 25 and February 1

   A. Economic Theory of Public Debt:

      H. Rosen, Public Finance “Taxation” (Chapter 13) and “Debt” (Chapter 18).

   B. Political Theory of Public Debt:


   C. Legal Theory of Public Debt: When Is Debt Odious?


III. Fiscal Crises in Historical Perspective Feb. 8

   A. The Founders’ Debt Debate

      Alexander Hamilton, Report on Public Credit, Jan. 9, 1790

   B. Trade-offs in the 19th Century

      David Schleicher, States of Insolvency, Chapter 1-2.
IV. How to Have a Fiscal Crisis February 15 and 22, March 1.

A. The Path to a Fiscal Crisis


B. Economics Fundamentals and Fiscal Crises

Nathan Bomey, *Detroit Resurrected: To Bankruptcy and Back* (2016), Chapters 1 and 2.

C. Political Causes of Fiscal Crises


D. Financial Causes of Fiscal Crises

Philippe Jorion, *Derivatives and Bankruptcy in Orange County: Big Bets Gone Bad*, Chapters 1-10.


E. Legal Causes of Fiscal Crises


V. Consequences of a Fiscal Crisis: March 15 and 22

A. Economic Consequences (Static)


B. Economic Consequences (Dynamic)


C. Fiscal Consequences


D. Financial Consequences


VI. Managing a Fiscal Crisis: March 29 and April 5

A. Austerity


B. Bailouts:


C. Fiscal Oversight:


D. Bankruptcy:


VII. Preventing a Fiscal Crisis I: Information: April 12

A. Hidden Debt


B. Accounting Standards


C. Rating Agencies


J. Leigland and R. Lamb, “A Case Study in WPPSS Credit Analysis,” in *Who Is to Blame for the WPPSS Disaster*.

D. Market Information and Fiscal Efficiency:

Itay Goldstein and Haresh Sapra, “Should Banks’ Stress Test Results be Disclosed? An Analysis of the Costs and Benefits,” *Foundation and Trends in Finance*, 2013. (As you read this article, substitute the word “government” for “bank” and it will be a perfect fit for our agenda.)


E. Transparency and Political Accountability


VIII. Preventing a Fiscal Crisis II: Regulation and Balanced Budget Rules: April 19


IX. Investing in Distressed Credits:

(Supplemental Class, Readings will be distributed to the class and we are happy to meet to discuss as convenient for those interested.)

A. Predicting a Crisis

B. Predicting a Bailout


C. Predicting a Settlement


D. Case Study:

Donald Keim, “The Risk and Return Characteristics of WPSSS 4/5 Bonds.”