

## Plagiarism: an exercise in spotting it

This is an exercise designed to highlight how plagiarism can occur – and, by implication, how to avoid it. Also, the exercise is intended to encourage the careful use of citations and the referencing of sources.

The following is an excerpt from an economics term paper in which there are several occurrences of plagiarism, together with bad practice that should be avoided. (This is not an exercise about how to structure a term paper – that’s a different exercise)

Your task: to identify plagiarism and bad referencing practice in the following excerpt. The source materials file should help.

**The term paper title:** *What are the characteristics of extreme asset price fluctuations, known as ‘bubbles’? Why do they occur? Illustrate your answer with reference to observed episodes in financial markets.*

Episodes of abrupt and unusually big changes in asset prices have been recorded throughout the history of capital markets. Most of the time prices appear to fluctuate within bounds that do not excite special comment. But, from time to time, dramatic movements shake financial markets, sometimes with wide and prolonged repercussions well beyond the markets themselves. Events such as the crash of October 1987 and the period of ‘irrational exuberance’ in the late 1990s are just two of the more recent incidents that have attracted the attention of practitioners and academics alike. Other well-known examples, analysed below, include ‘Tulipmania’ in 17th century Holland, the Mississippi and South Sea Bubbles, 1719/20, and the Wall Street Crash, 1929. (Kindleberger, 1978)

While asset markets appear prone to spells of price volatility, financial ‘bubbles’ are associated with identifiable characteristics. Typically they include: (a) a period of manic optimism or frenzy; (b) a crisis of confidence (when prices peak); (c) blatant fraud (which may cause the crisis of confidence or which is blamed for the crisis); (d) intense pessimism accompanied by economic distress (during which the majority opinion is that low prices are justified by ‘fundamentals’ – and, by implication, that the earlier optimism was misplaced). An issue that has yet to be resolved (and may never be) is the extent to which any theory can plausibly account the varied historical incidents, that is, to isolate those aspects that should be regarded as unique to each of the occurrences. In a trivial sense the Wall Street Crash was different from the crash of 1987 but in what (if any) ways were they driven by similar forces? In what ways did they differ? How successful are existing theories in explaining what happened? These are some of the questions addressed in this paper.

I will start by exploring what we know about the existence of asset price bubbles. Then I will discuss whether asset price bubbles are necessarily harmful. Both sections are meant to caution against quick calls for policy intervention whenever unusual and seemingly excessive asset price developments are observed. I will then list some

empirical stylised facts about past asset price boom and bust cycles to provide the background for reviewing the recommendations obtained from the economics literature on what is the best monetary policy reaction to asset price booms.

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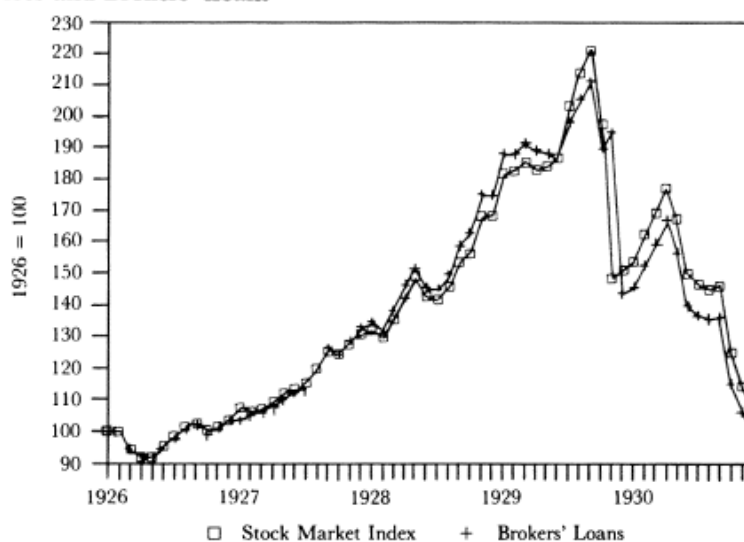
### The Wall Street Crash

Galbraith's famous book remains the accepted account of the rise and collapse of stock prices in 1929. He asserts that a bubble in American asset prices originated during the fast economic expansion of the 1920s. Galbraith argues that an irrational mania induced the public to buy stocks in the bull market before the crash. The boom in the stock market, according to Galbraith resulted from "the vested interest in euphoria [that] leads men and women, individuals and institutions to believe that all will be better." This enthusiasm to acquire shares was permitted by brokers who provided credit so that investors became too leveraged.

Kindleberger emphasises that these loans were a key cause of the mania. Galbraith argues that margin purchases lured investors into speculation. Investors were required only to pay a proportion of the necessary cost, to borrow the remainder, and then benefit from the whole capital gain minus the interest on the loan from the broker. Irving Fisher agreed that the opportunity for investors to obtain these loans caused "unwise speculation." (White, 1990).

Figure 1

**Stock Prices and Brokers' Loans**



Source: Board of Governors of the Federal Reserve system (1943) and the New York Stock Exchange Year Book (1931).

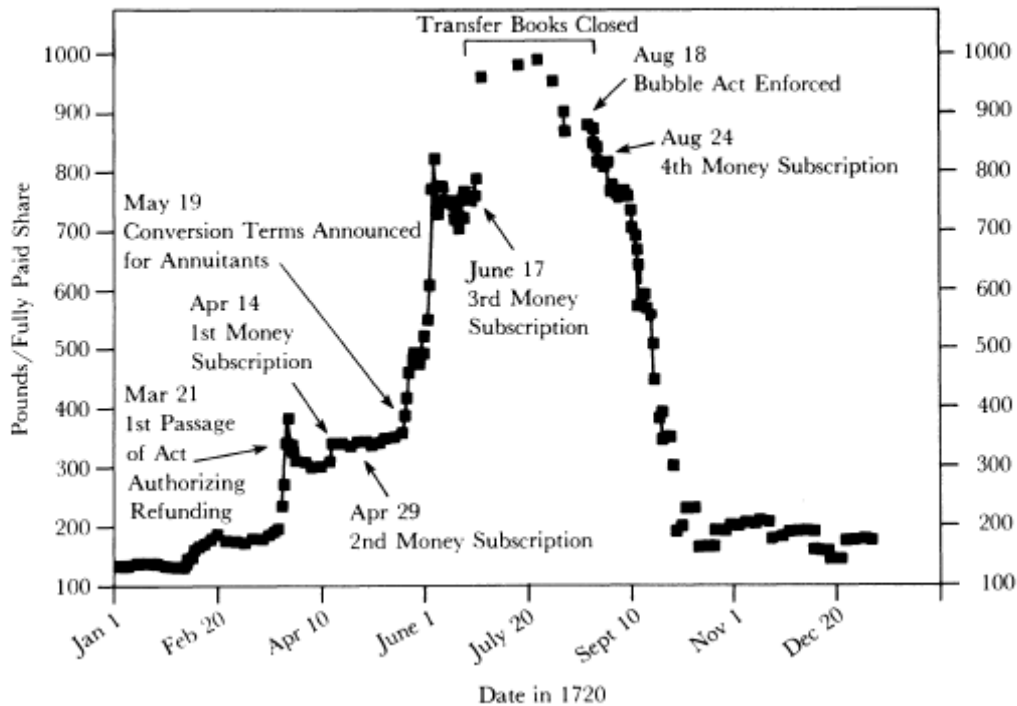
Figure 1 above shows the close correlation between Wall Street stock prices and the amount of brokers' loans to investors.

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## The Mississippi and South Sea Bubble, 1790/20

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*Figure 3*  
**South Sea Shares**



The South Sea Company's share prices are shown in figure 3. South Sea share prices collapsed from about 775 on August 31 to about 290 on October 1, 1720. Shares outstanding or to be issued to the public after subscribers were entered on Company registers numbered 212,012. Thus, the market value of all shares on August 31 was 164 million pounds and about 103 million pounds of that total evaporated in one month, an amount exceeding twice the value of the original, burdensome government debt.

The South Sea speculation triggered an upsurge in the prices of other Companies along with the creation of numerous bubble companies. The emergence of these companies, many of which were fraudulent, generated most of the amusing anecdotes about this speculation. Many of the companies born in the 1720 speculation were quite sound, however, in particular the Royal Assurance Company and the London Assurance Company. The channelling of capital into these companies alarmed the directors of the South Sea Company, which, having paid a high price to buy the Parliament, did not wish to see potential South Sea profits dissipated by the entry of unauthorized corporations. As a result, Parliament passed the Bubble Act in June 1720 to ban the formation of unauthorized corporations or the extension of existing corporate charters into new, unauthorized ventures. (Garber, 1990)

## Bubbles and Net Present Value

Kindleberger (1992, p. 243) contends that “the theoretical literature has yet to converge on an agreed definition of bubbles, and on whether they are possible.” I would argue that, yes, bubbles do exist, but that it is very hard to identify them with certainty and almost impossible to reach a consensus about whether a particular asset price boom period should be considered a bubble or not. In another paper, ECB staff defined asset price booms as simple deviations from trend beyond a given threshold<sup>[11]</sup> and classified the resulting boom periods as high-cost or low-cost depending on the depth of the post-boom recession. They found that broad money and credit developments are among the few early indicators of high-cost asset price boom periods.<sup>[12]</sup>

An attempt is made now account for bubbles via the Net Present Value (NPV) relationship. ...

In the following equation,  $p_t$  denotes the asset price at date  $t$ ,  $\delta_{t+i}$  is the discount factor  $d_{t+i}$  denotes dividends, and  $b_t$  represents the bubble:

$$p_t = \sum_{i=1}^{\infty} \delta_{t+i} d_{t+i} + b_t$$

The expression shows that an asset price bubble can be captured using the NPV relationship if the bubble term,  $b_t$ , grows at the same pace as the interest rate (which is implicit in the discount factor  $\delta_{t+i}$ ). ...

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