

EH306: Monetary and Financial History Since 1750

Instructor: Dr. Olivier Accominotti (o.accominotti@lse.ac.uk)

Course content

What factors drive capital market integration in the long-run? Why do financial crises arise and how should they be solved? How do institutions and policies influence the process of financial globalisation and the outcome of financial crises? This course explores these issues by examining major developments on financial markets from the late 18th century to the recent financial crisis. The first part examines the emergence of an integrated international financial system during the 19th century. The second part explores the monetary reconstruction that followed WWI and the causes of interwar financial instability and the Great Depression. Finally, a third part examines major developments in the international monetary system from the Bretton Woods conference to the recent financial crisis. The purpose of the course is to present a long-run view on major phenomena in financial economics (eg. financial globalisation, exchange rate regimes, banking panics, currency crises, lender of last resort policies etc.) as well as to provide historical perspectives to modern policy debates surrounding the recent financial crisis.

Assessment

Three hour unseen examination in the Summer Term (100%).

Formative coursework

During the year, students will prepare three essays or equivalent pieces of written work, and make classroom presentations. However, none of these will form part of the formal examination grade. The readings provided for every topic below serve as guidance for individual preparation.

Course outline

Part I. 1750-1914

1. Introduction and overview

- Group work (in class)

Read chapter 2 of Kindleberger's book on the history of financial crises and answer the following questions: - what are the main characteristics common to all financial crises according to the author? - how does the 2007-2011 financial crisis fit into the model?

- Reading:

Kindleberger, C. P. (2005), *Manias, Panics and Crashes. A History of Financial Crises*, 5th edition, New York: Macmillan, chapter 2: "Anatomy of a Typical Crisis", pp. 21-32.

2. International capital markets in the 18th century

Key notions: market integration, market efficiency, bill of exchange

- Essay question:

Did financial development contribute to economic growth in the 18th century?

- Presentation topic:

Were international capital markets integrated in the 18th century?

- Readings:

Neal, L. (2000), "How it all began: the monetary and financial architecture of Europe during the first global capital markets, 1648-1815", *Financial History Review*, 7, pp. 117-140.

Neal, L. (1987), "The Integration and Efficiency of the London and Amsterdam Stock Markets in the Eighteenth Century," *Journal of Economic History*, 47, pp. 97-115.

Rousseau, P. (2003), "Historical perspectives on financial development and economic growth", *Federal Reserve Bank of St. Louis Review*, 85, pp.81-106.

Schnabel I. and Y-S. Shin (2004), "Liquidity and Contagion: The Crisis of 1763", *Journal of the European Economic Association*, vol. 2(6), pp. 929-968.

3. The classical gold standard, 1870-1913

Key notions: price-specie flow mechanism, gold parity, gold points, "rules of the game"

- Essay question:

What were the benefits and costs of the gold standard system?

- Presentation topic:

What room was left for monetary policy under the gold standard?

- Readings:

Bordo, M. (1981), "The classical gold standard: some lessons for today", *Federal Reserve Bank of St. Louis Review*, May 1981, pp. 2-17.

Eichengreen, B. (1996), *Globalizing Capital*, chapter 2: "The Gold Standard", pp. 7-42.

Hume, D. (1752), "On the balance of trade",

(<http://www.colby.edu/economics/faculty/jmlong/ec333/hume.pdf>)

Wolf, M. (2012), "Is the euro the 21st century gold standard?", *Economists' Forum*, 13 Aug 2012,

(<http://blogs.ft.com/economistsforum/2012/08/is-the-euro-the-21st-century-gold-standard/#axzz24ArTWVrO>)

4|. Global financial integration, 1880-1913

Key notions: sovereign debt, sovereign bond spread, "good housekeeping seal of approval"

- Essay question:

Two waves of financial globalisation: compare 1880-1913 and 1970-2012.

- Presentation topic:

Was the gold standard the cause of global capital market integration in 1880-1913?

- Readings:

Bordo, M., and F. Kydland (1995), "The Gold Standard As a Rule: An Essay in Exploration." *Explorations in Economic History*, vol. 32, pp. 423-464.

Bordo, M., and H. Rockoff (1996), "The Gold Standard as a 'Good Housekeeping Seal of Approval'", *The Journal of Economic History*, vol. 56, pp. 389-428.

Obstfeld, M., and A. Taylor (2002), "Globalization and Capital Markets", NBER Working Paper No 8846.

Flandreau M., and F. Zumer (2004), *The Making of Global Finance, 1880-1913*, OECD: Development Centre.

5. The British Empire and global capital market integration, 1880-1913

Key notions: Empire Effect, dependent colonies, self-governing colonies

- Essay question:

What was the effect of the British Empire on colonies' borrowing costs? How would you rate interest convergence in the Eurozone during 2000-2008 in the light of this evidence?

- Presentation topic:

Did British colonies enjoy privileged access to global capital markets in the 19th century?

- Readings:

Ferguson, N., and M. Schularick (2006), "The Empire Effect: The Determinants of Country Risk in the First Age of Globalization, 1880–1913." *Journal of Economic History*, vol. 66, pp. 283-312.

Accominotti, O., M. Flandreau and R. Rezzik, (2011), "The Spread of Empire: Clio and the Measurement of Colonial Borrowing Costs", *The Economic History Review*, vol. 64, pp. 385-407.

Accominotti, O., M. Flandreau, R. Rezzik, and F. Zumer, (2010), "Black Man's Burden, White Man's Welfare: Control, Devolution and Development in the British Empire, 1880-1913", *European Review of Economic History*, vol. 14, pp. 47-70.

6. Financial crises, 1880-1913 vs. 1973-2012

Key notions: stock market crash, currency crisis, sovereign debt crisis, banking crisis

- Essay question:

How has the nature of financial crises evolved since the late 19th century?

- Presentation topic:

Why were financial crises less frequent under the classical gold standard than in 1973-2012?

- Readings:

Bordo, M., Eichengreen, B., Klingebiel, D. and M. Soledad Martinez-Peria, 2001, "Is the Crisis Problem Growing More Severe?", *Economic Policy*, 16, pp. 51-82.

Reinhart C. M. and K. Rogoff (2008), "This Time is Different: A Panoramic View of Eight Centuries of Financial Crises", NBER Working Paper No. 13882.

7. Banking panics in the United States, 1863-1913

Key notions: bank run, currency-deposit ratio, random-withdrawal theory, asymmetric information theory

- Essay question:

Would banking panics have been less frequent in the US in 1863-1913 in the presence of a central bank?

- Presentation topic:

What were the main causes of banking panics in the US during 1863-1913?

- Readings:

Calomiris C. and G. Gorton (1991), "The Origins of Banking Panics: Models, Facts and Bank Regulation", in R. Glenn Hubbard (ed.), *Financial Markets and Financial Crises*, Chicago: University of Chicago Press.

Gorton, G. (1985), "Clearinghouses and the Origins of Central Banking in the United States", *The Journal of Economic History*, 45, pp. 277-84.

Odell K., and M. Weidenmier (2004), "Real Shock, Monetary Aftershock: The 1906 San Francisco Earthquake and the Panic of 1907", *The Journal of Economic History*, 64, pp. 1002-1027.

Moen, J. and E. Tallman (1990), "Lessons from the Panic of 1907", *Federal Reserve Bank of Atlanta Economic Review*, 75 (May/June 1990), pp. 2-13.

8. Lender of Last Resort: the Bank of England's financial stability policy, 1840-1913

Key notions: lender of last resort, illiquidity, insolvency, penalty rate

- Essay question:

What is the rationale behind Bagehot's rule?

- Presentation topic:

How did the Bank of England respond to banking panics in the 19th century?

- Readings:

Walter Bagehot, 1873, *Lombard Street: A Description of the Money Market*, London: H. S. King & Co, chapter 7: "A More Exact Account of the Mode in Which the Bank of England Has Discharged its Duty of Retaining a Good Bank Reserve, and of Administering It Effectually".

Michael Bordo (1990), "The Lender of Last Resort: Alternative Views and Historical Experience", *Federal Reserve Bank of Richmond Economic Review*

Vincent Bignon, Marc Flandreau and Stefano Ugolini, (2011), "Bagehot for Beginners: The Making of Lending of Last Resort Operations in the Mid-19th Century", *The Economic History Review*, forthcoming.

Martin, A. (2003), "What Would Bagehot Have Thought of the Fed's Policy after September 11, 2001" (<http://www.econlib.org/library/Columns/y2003/MartinBagehot.html>)

Part II. 1919-1945

9. The return to the gold standard, 1919-1928

Key notions: hyperinflation, currency stabilization, gold exchange standard

- Essay question:

Compare the interwar gold exchange standard to the classical gold standard. Which system worked better and why?

- Presentation topic:

Was it wise for the UK to return to the gold standard in 1925?

- Readings:

Eichengreen, B. (1996), *Globalizing Capital*, chapter 3: "Interwar Instability", pp. 45-61.

Keynes, J. M. (1925), *The Economic Consequences of Mr. Churchill*, London: L. and V. Woolf.

Nurkse, R. (1944), *International Currency Experience*, chapter 2: "The Gold Exchange Standard."

10. Monetary policy, the gold standard and the Great Depression

Key notions: monetary contraction, deflation, beggar-thy-neighbor

- Essay question:

Why did central banks fail to prevent a deepening of the Great Depression?

- Presentation topic:

What caused the global deflation of the 1930s?

- Readings:

Bernanke, B. (1995), "The Macroeconomics of the Great Depression: A Comparative Approach", *Journal of Money, Credit and Banking*, 27, pp. 1-28.

Eichengreen, B. (1992), *Golden Fetters*, Oxford: Oxford University press, Chapter 1 ("Introduction") and 2 ("The Classical Gold Standard in Interwar Perspective").

Eichengreen B. and J. Sachs (1985), "Exchange Rates and Economic Recovery in the 1930s," *Journal of Economic History*, 45, 925-946

Friedman M., and A. Schwartz (1963), *A Monetary History of the United States, 1867-1960*, Princeton: Princeton University Press, chapter 7, "The Great Contraction."

11. Did France cause the Great Depression?

Key notions: sterilization, gold sink, strategic undervaluation

Two-hour class debate. No student presentation this week.

- Readings:

Accominotti, O., (2009), "The Sterling trap: foreign reserves management at the Bank of France, 1928-1936", *European Review of Economic History*, 13, pp. 349-376.

Eichengreen, B. and C. Wyplosz, (1986), "The Economic Consequences of the Franc Poincare," CEPR Discussion Papers Nb. 136.

Prati, A., (1991), "Poincare's Stabilization: Stopping a Run on Government Debt." *Journal of Monetary Economics*, 27, pp. 231-239.

Sicsic, P., (1993), "Was the Franc Poincaré Undervalued?", *Explorations in Economic History*, 29, pp. 69-92.

Irwin, D., (2010), "Did France Cause the Great Depression?", NBER Working Paper no. 16350.

12. The 1929 stock market crash

Key notions: asset bubble, stock market volatility

- Essay question:

Were there rational causes to the US stock market boom and crash of 1929?

- Presentation topic:

Did the stock market crash of 1929 cause the Great Depression?

- Readings:

James, H. (2009), *The creation and destruction of values: the globalization cycle*, Harvard: Harvard University Press, Chapter 2: "Which Historical Analogy Applies: 1929 or 1931?", (on the 1929 stock market crash pp. 36-73 only).

Kindleberger, C. (1986), *The World in Depression, 1929-1939*, Berkeley: University of California Press, Chapter 5: "The 1929 Stock Market Crash."

Romer, C. (1990), "The Great Crash and the Onset of the Great Depression", *Quarterly Journal of Economics*, vol. 105(3), pp. 597-624.

White, E. (1990), "The Stock Market Boom and Crash of 1929 Revisited", *The Journal of Economic Perspectives*, vol. 4, pp. 67-83.

13. The 1931 global financial crisis

Key notions: twin crisis, contagion, bankers' acceptances

- Essay question:

Was the 1931 financial crisis a banking or a currency crisis?

- Presentation topic:

How did the 1931 financial crisis propagate internationally?

- Readings:

Accominotti, O. (2012), "London Merchant Banks, the Central European Panic and the Sterling Crisis of 1931", *The Journal of Economic History*, vol. 72(1), pp. 1-43.

Ferguson, T. and P. Temin (2003), "Made in Germany: The German Currency Crisis of July 1931", *Research in Economic History*, vol. 21, pp. 1-53.

James, H. (2001), *The End of Globalization: Lessons from the Great Depression*, Harvard: Harvard University Press, Chapter 2: "Monetary Policy and Banking Instability."

Schnabel, I. (2003), "The German Twin Crisis of 1931", *The Journal of Economic History*, vol. 64(3), pp. 822-871.

14. Banking panics in the United States during the 1930s

Key notions: bank run, illiquidity, insolvency, deposit insurance, Glass-Steagall Act

- Essay question:

Through which channels did banking panics affect economic activity in the US during the 1930s?

- Presentation topic:

Were the US banking panics of the 1930s due to illiquidity or insolvency?

- Readings:

Bernanke, B. (1983), "Non-Monetary Effects of the Financial Crisis in the Propagation of the Great Depression", *American Economic Review*, vol. 73, pp. 257-276.

Calomiris, C. (2011), "The Political Lessons of Depression-Era Banking Reform", *Oxford Review of Economic Policy*, forthcoming.

Calomiris, C. and J. Mason (1997), "Contagion and Bank Failures During the Great Depression: The June 1932 Chicago Banking Panic", *American Economic Review*, vol. 87(5), pp. 863-883.

Richardson, G. (2007), "Categories and causes of bank distress during the Great Depression, 1929-1933: The illiquidity versus insolvency debate revisited", *Explorations in Economic History*, vol. 44, pp. 588-607.

Part III. 1945-2011

15. The Bretton Woods System, 1944-1973

Key notions: current account, capital controls, SDR, dollar gap, Triffin dilemma

- Essay question:

Why did the Bretton Woods system collapse?

- Presentation topic:

How did the Bretton Woods system address the failures of the interwar gold standard? Was it successful?

- Readings:

Bordo, M. D. and B. Eichengreen (2008), "Bretton Woods and the Great Inflation", NBER Working Paper 14532.

Eichengreen, B. (1996), *Globalizing Capital*, chapter 4: "The Bretton Woods System."

Meltzer, A. H. (1991), "US Policy in the Bretton Woods Era", *Federal Reserve Bank of St. Louis Review*, May/June 1991, pp. 54-83.

16. European Monetary Unification, 1973-2012

Key notions: European Exchange Rate Mechanism, European Monetary System

- Essay question:

What caused the EMS crisis of 1992? What are the similarities and differences between this episode and the current crisis in the eurozone?

- Presentation topic:

Why did European countries opt for monetary integration after Bretton Woods?

- Readings:

Eichengreen, B. (1996), *Globalizing Capital*, chapters 5, "From Floating to Monetary Unification", pp. 136-175

Eichengreen, B. (2000), "The EMS Crisis in Retrospect", NBER Working Papers no. 8035.

Flandreau, M. (2011), "Agonising struggles in Europe resurrect memories of a similar crisis", *The National*, 25 September 2011, available at:

<http://www.thenational.ae/thenationalconversation/industry-insights/finance/agonising-struggles-in-europe-resurrect-memories-of-a-similar-crisis>

17. Financial crises in Latin America, 1980-2001

Key notions: sudden stop, hard peg, currency board

- Essay question:

Why has financial liberalisation been followed by financial instability in Latin America?

- Presentation topic:

Are fixed exchange rates responsible for the Argentinean debt crisis of 2001?

- Readings:

Calvo, Guillermo A., Alejandro Izquierdo, and Ernesto Talvi (2003), "Sudden Stops, the Real Exchange Rate and Fiscal Sustainability: Argentina's Lessons", NBER Working Paper No 9828.

De la Torre, A., Levy-Yeyati, E. and Schmukler, S. L. (2003), "Leaving and Dying with Hard Pegs: The Rise and Fall of Argentina's Currency Board", Policy Research Working Paper Series 2980, The World Bank.

Diaz-Alejandro C. (1985), "Good-Bye Financial Repression, Hello Financial Crash", *Journal of Development Economics*, vol. 19, pp. 1-24.

Levy-Yeyati, E. and M. Bleier (2010), "Leaving the Euro: What's in the Box?", VoxEU.org, 21 July 2010.

Mishkin, F. (1999), "Lessons from the Tequila Crisis", *Journal of Banking and Finance*, vol. 23, pp. 1521-1533.

18. The East Asian Financial Crisis of 1997/98 and contagion to emerging markets

Key notions: self-fulfilling panics, contagion, international lender of last resort

- Essay question:

Why are some financial crises contagious and others not?

- Presentation topic:

Was the East Asian financial crisis of 1997/1998 self-fulfilling?

- Readings:

- Berg, A. (1999), "The Asia Crisis: Causes, Policy Responses and Outcomes", IMF Working Paper 99/138.
- Mishkin, F. (2000), "Lessons from the Asian Crisis", NBER Working Paper no. 7102.
- Kaminsky, G., Reinhart C. and C. Vegh (2003), "The Unholy Trinity of Financial Contagion", *Journal of Economic Perspectives*, vol. 17, pp. 51-74.
- Radelet, S. and J. Sachs (1998), "The East Asian Financial Crisis: Diagnosis, Remedies, Prospects", *Brookings Papers on Economic Activity*, vol. 29, pp. 1-90.

19. The subprime crisis of 2007-2008

Key notions: securitization, subprime, shadow banking system, Credit Default Swaps

- Essay question:

Through which mechanisms did the US mortgage crisis transform into a general banking crisis?

- Presentation topic:

Was the 2007-2008 crisis typical or exceptional?

- Readings:

- Brunnermeier, M. (2009), "Deciphering the Liquidity and Credit Crunch of 2007-2008", *Journal of Economic Perspectives*, 23, pp. 77-100.
- Gorton, G. (2008), "The Panic of 2007", NBER Working Paper No. 14358.
- Calomiris, C., 2010, "Banking Crises Yesterday and Today", *Financial History Review*, vol. 7, pp. 3-12.
- James, H. (2009), *The creation and destruction of values: the globalization cycle*, Harvard: Harvard University Press, Chapter 3: "The Crash of 2008: The Weekends that Made History."

20. The European financial crisis, 2008-2012

Key notions: debt dynamics, European Financial Stability Facility, debt haircut

- Essay question:

What are possible similarities/differences between the current Eurozone debt crisis and earlier crises we have studied?

- Presentation topics:

Was the response of the EU/ECB/IMF troika to the European debt crisis optimal?

- Readings

- De Grauwe, P. (2011), "Managing a fragile eurozone", VoxEu.org, 10 May 2011.
- De Grauwe, P. (2011), "Why the ECB refuses to be a Lender of Last Resort", VoxEu.org, 28 November 2011.
- Eichengreen, B. (2007), "Eurozone breakup would trigger the mother of all financial crises," VoxEU.org, 19 November.
- Eichengreen, B. (2010), "Ireland's rescue package: Disaster for Ireland, bad omen for the Eurozone", VoxEu.org, 3 December 2010.
- Frankel, J. (2012), "Could Eurobonds be the answer to the Eurozone crisis?", VoxEu.org, 27 June 2012.
- Gros, D. (2011), "Eurobonds: Wrong solution for legal, political, and economic reasons", VoxEu.org, 24 August 2011.
- Wyplosz C. (2012), "The impossible hope of an end to austerity.", VoxEu.org, 14 May 2012.
- Wyplosz C. (2012), "One more summit: The crisis rolls on.", VoxEu.org, 30 June 2012.
- Wyplosz C. (2012), "End of Game: Don't Bet On It", VoxEu.org, 25 July 2012.

Wyplosz C. (2012), “Thanks to the ECB”, VoxEu.org, 30 July 2012.
To be completed (crisis is not over...)