**Financial Meltdown, Past and Present**

**FALL 2022**

**HIST 1731-401/** **ECON 0620-401**

**Tuesday-Thursday**

**1:45 PM-3:15 PM**

**ANNS 109**

**Caution: This Syllabus is Regularly Updated on CANVAS**

**THIS VERSION: AUGUST 24, 2022**

**Marc Flandreau**

**HIST 131-401/ECON 028-401**

**Tuesday/Thursday 12-1:30**

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Instructors :

Marc Flandreau, Howard S. Marks Prof. of Economic History, [mfl@sas.upenn.edu](mailto:mfl@sas.upenn.edu)

Maylis Avaro, Post-doctoral Visiting Professor, [avaro@sas.upenn.edu](mailto:avaro@sas.upenn.edu).

Graders:

Teddy Chappell, PhD Candidate, Dept of History, [chedward@sas.upenn.edu](mailto:chedward@sas.upenn.edu)

Ryan Zalla, PhD Candidate, Department of Economics, [ryanzalla@gmail.com](mailto:ryanzalla@gmail.com)

**Course Overview**:

The subprime crisis in 2008 and the subsequent debt crisis in Europe were just the latest of a long series of episodes of financial turmoil spanning several centuries. As this syllabus is being composed, capital markets after having tumbled in the aftermath of the COVID 19 crisis and recovered on the back of massive support operations by central banks, were then battered during the year 2021-2022, as yet another episode of “irrational exuberance” led to the collapse of the crypto market.

This course takes stock (pun intended) of the succession of financial meltdowns (going back to the Tulip-mania in the 17th century all the way to the modern era). It will emphasize the repetition of patterns, but also the existence of differences across individual episodes. Through case studies and inductive reasoning, to convey an understanding of the logic of financial speculation and meltdowns both. Special attention will be paid to historical evolutions and “policy responses,” including market reform, regulation and above all central bank intervention.

At a higher level, economic history is increasingly recognized as a crucial source of policy advice and invoked with growing frequency in public debates, but does it speak in one voice? In particular, the subprime crisis in 2008 and its aftermath have generated a demand for "historical perspective" that would improve the understanding of the causes of financial turmoil and facilitate the prevention of comparable catastrophes. The precedent of the Influenza prompted economists to try and understand market responses to the COVID crisis. And when the crypto crash occurred, some mentioned parallels with the “Tulip mania.”

This course offers a review of the morphology of important financial crises. It provides historical insights that shed light on crucial aspects of financial disasters. Because such insights inform economic ideas while at the same time, they are informed by economic ideas, we will spend time discussing some economic theories that grew in response to historical episodes.

This is an interdisciplinary course, engaging with history, economics, law and politics and political science. Students with the most diverse backgrounds are welcome. They are expected to benefit from this course through acquiring a concrete knowledge of the historical evolution of fundamental institutions of financial capitalism. Ultimately, students enrolling in this course are expected to achieve proficiency in historically informed discussion of the mechanisms that were played out in the subprime crisis and beyond.

The course is self-contained, in that students need not have a prior training in economics, history, or finance. Students interested and concerned about their ability to follow the course are encouraged to contact the instructors.

**Course organization:**

The course is set up in the following way (but please look carefully into the syllabus for VARIATIONS around the general rule): Each week is devoted to the discussion of a “theme.” A theme comprises an important question, which we will study through three instruments. (Please refer to material below for how this is will be played out):

* A *Tuesday* lecture emphasizing the key ideas of the week.
* A *Thursday* workshop providing opportunity for individual or group work, leading to weekly posts reviewed by a team of graders who offer feedback.
* *Required* weekly readings (about two texts per week). For students for whom the topic is totally new and who fear to struggle, the recommended approach is the following: Readings should be done twice. Once before the Tuesday lecture “with a pen in hand” trying to make your way the best you can in the text. And once after the lecture, this time, trying to articulate the key ideas.

**Course requirements**

1. Involvement is assessed through student posts on Canvas every week before Sunday midnight.
   1. The post can consist in questions, either in the shape of simple test-like questions (to help you check your understanding) or in the shape of mini-essays (for instance, commentary of a text). In all cases the prompt on Canvas provides a clear statement of the assignment. The length is left to your appreciation – different students have different style. Both the quality and the quantity of the material posted is assessed in order to “validate” your post.
   2. The weekly posts are a very important tool for your learning. The goal is for you to articulate your own understanding. For us, it is indeed the only way to be able to observe in real time whether you are progressing and also to be able to help. If you experience difficulties, you are welcome to ask for an appointment with the instructors but we recommend that you first try and articulate your difficulties – stating the nature of the obstacle and showing proof that you first tried to address the problem on your own – in writing while reaching out.
   3. If we feel you have fulfilled the basic requirements for the post, you will receive a minimum overall A-. Grades above A- are a reward for quality postings, insight etc. You are allowed a maximum of 2 misses NQA in the entire semester, *starting from your day of registration*. This includes insufficient posts, missed deadlines (posting MUST be done before the assigned deadline or they are not counted) and personal issues such as disease etc. In clear, we expect all posts to be made, but in the interest of expediency we add a margin of toleration. Please do not consider it to be an opt out right, since you might end up caught up at the end of the semester, if for instance you fall sick, but have already “used up” your misses. (50%).
2. Midterm exam, administered during a Thursday session: Course questions and commentary of document (20%)
3. Final exam: Course questions and commentary of document. (30%).

**Reference work** (available online through the library):

Kindleberger, Charles P. *Manias, Panics and Crashes. A History of Financial Crises* is a foundational book (though we will also move past it) and should be read by everyone.

Note: The version you will find online on the library website (ebook) is the sixth edition, 2011, published with Palgrave Macmillan. It was revised by Robert Z. Aliber and covers the crisis of 2008, which is principle a good thing. However, I recommend using an earlier version – *any of those where Kindleberger is the only author*: 1978, 1989, … – You can buy these online for very cheap. I just saw one on abebooks.com, free shipping, for US$ 3.99. Just be careful with the edition you pick. The library also holds some of these older *paper* editions. Students with no background in economics will find these more user-friendly than the later editions with Aliber.

**Schedule**

**Week 1.** Week of August 29. **Financial Crises in History and Theory**

Tuesday: Presentation of the Course. Objective, Methods, Syllabus & Assessment. How to work for this course. Q&A

Thursday: Lecture: **The Science and History of Meltdowns: Charles P. Kindleberger’s and Gary Gorton’s Theories of Meltdown**

* Reading:
  + Kindleberger, “Financial crises, a hardy perennial,” and “Anatomy” in *Manias, Panics and Crashes*, pp. 1-20.
  + Gorton, “Slapped in the Face by the Invisible Hand,” Chapter 2.

Weekly Post: Keynes Beauty Contest

**Week 2.** Week of September 5. **The Mother of All Bubbles**

Lecture: Of Bubbles and Bulbs:Tulip-Mania Redux

* Mackay, Charles. *Memoirs of Extraordinary Popular Delusions and the Madness of Crowds*. 2d ed. 2 vols. London: Office Nat. Illustrated Library, 1852 (first edition 1841).
* Garber, Peter M., “Tulipmania,” *Journal of Political Economy*, Vol. 97, No. 3 (Jun., 1989), pp. 535-560.

Workshop: Testing for Bubbles

* Flood, Robert P., and Peter M. Garber, "Market Fundamentals versus Price-Level Bubbles: The First Tests." *Journal of Political Economy*, 88 (August 1980): 745-70.

Weekly Post: TBA

**Week 3.** Week of September 12. **Speculation and Information**

Lecture: On Politics and Information: The Amsterdam Stock Exchange (late 17th century)

* Jonathan Israel, ‘The Amsterdam Stock Exchange and the English Revolution of 1688’, *Tijdschrift voor Geshiedenis*, ciii (1990), pp. 412-40.

Workshop: Group discussion of de la Vega’s “Dialogues”

* Joseph Lopes de la Vega, *Confusion de Confusiones, Portions Descriptive of the Amsterdam Stock Exchange*, 1688.

Weekly Post: TBA

**Week 4.** Week ofSeptember 19. **Anatomy of the Mississippi Bubble**

Lecture: John Law and his “System”

* Velde, François R. “John Law's System,” *The American Economic Review*, Vol. 97, N° 2, (May 2007): 276-279.

Workshop: Pondering Law: Was it a Bubble?

* Velde, François R. “Was John Law's System a bubble? The Mississippi Bubble revisited”, in J. Attack and L. Neal (eds.) *The Origins and Development of Financial Markets and Institutions; From the Seventeenth Century to the Present*, Cambridge: Cambridge University Press, pp 99-120, 2009.

Weekly Post: TBA

**Week 5.** Week of September 26: **Asset Side Contagion**

Lecture: The Crisis of 1763 in Perspective

* Isabel Schnabel and Hyun Song Shin, 2004. “Liquidity and Contagion: The Crisis of 1763.” *Journal of the European Economic Association* 2(6): 929-968 (focus on historical section).

Workshop: 2008 in the Mirror of 1763

* Stephen Quinn and William Roberds, “Responding to a Shadow Banking Crisis: The Lessons of 1763,” Federal Reserve of Atlanta Working Paper, 2012-08, 2012.

Weekly Post: TBA

**Week 6.** Week of October 3: **Reputation**

Lecture: The First Sovereign Debt Crisis (1825-1826)

* Marc Flandreau and Juan H. Flores, 2009, “Bonds and Brands: Lessons from the 1820s,” *Journal of Economic History*, 3, p. 646-684.

No Workshop: Fall Term Break

Weekly Post: TBA

**Week 7**. Week of October 10: **Lending of Last Resort**

Lecture: Historical Emergence of the Lender of Last Resort`

* Bignon, Vincent, Marc Flandreau and Stefano Ugolini, “Bagehot for Beginners: The Making of Lending of Last Resort Operations in the Mid-Nineteenth Century”, *Economic History Review*, 65:2, 2012, pp. 580-608.
* Marc Flandreau and Stefano Ugolini, “Where it All Began: Lending of Last Resort and the Bank of England During the Overend, Gurney Panic of 1866,” in Michael D. Bordo; William Roberds, *Origins, History and Future of the Federal Reserve, A Return to Jekyll Island*, pp. 113-161. Cambridge University Press, 2013.

Workshop: Research and Discuss the role of the Fed during the Covid Crisis. Does it bring parallels with the past?

Weekly Post: TBA

**Week 8.** Week of October 17. **Rating Agencies**

Lecture: The Rise and Rise of Rating Agencies.

* Frank Partnoy. “How and Why Credit Rating Agencies Are Not Like Other Gatekeepers”, in Yasuyuki Fuchita, and Robert E. Litan (eds.), *Financial Gatekeepers: Can They Protect Investors?* Brookings Institution Press, 2006.
* Marc Flandreau and Joanna Kinga Slawatyniec, 2013, “Understanding rating addiction: US courts and the origins of rating agencies’ regulatory license, Financial History Review, p. 237-257.

Workshop: Legal Origins of Rating Agencies

* Scott Sandage, “Misinformation and its discontents”, p. 159-189, *Born Losers: A History of Failure in America,* Cambridge, MA: Harvard University Press, 2005.

Weekly Post: TBA

**Week 9.** Week of October 24. **Margin Calls**

Lecture: 1907, or the Mechanics of Disaster

* Moen, Jon and Ellis Tallman. “Lessons from the Panic of 1907.” *Federal Reserve Bank of Atlanta Economic Review* 75 (May/June 1990): 2-13.

(See also <https://www.federalreservehistory.org/essays/panic-of-1907>)

* Robert F. Bruner, Sean D. Carr, “Crisis on the Exchange,” pp. 97-104, in *The Panic of 1907: Lessons Learned from the Market's Perfect Storm*, John Wiley & Sons, 2009.

Workshop: William M. Kingsley on the causes of the panic of 1907, in *The Ticker and Investment Digest*.

* “Wall Street Observations. The Stock Exchange, Panics of the Last Quarter Century” [I](https://archive.org/details/sim_magazine-of-wall-street_1909-07_4_3/page/112/mode/2up) & [II](https://archive.org/details/sim_magazine-of-wall-street_1909-08_4_4/page/174/mode/2up)

Weekly Post: TBA

**Week 10**. Week of October 31. **The Great Crash and the Great Depression**

Lecture: The Great Crash of 1929.

* Eugene N. White, “Anticipating the stock market crash of 1929: The view from the floor of the stock exchange,” 2010, in J. Atack and L. Neal, *The Origins and Development of Financial Markets and Institutions From the Seventeenth Century to the Present*, pp. 294-318, 2009.
* Christina D. Romer, “The Great Crash and the Onset of the Great Depression,” The Quarterly Journal of Economics, Vol. 105, No. 3, pp. 597-624, 1990.

No Workshop: Midterm

Weekly Post: TBA

**Week 11**: Week of November 7. **Twin Crises**

Lecture: On the German Crisis of 1931

* Thomas Ferguson and Peter Temin, “Made in Germany: The German Currency Crisis of July, 1931,” MIT Dept. of Economics Working Paper No. 01-07, 2001.
* Isabel Schnabel, “The German Twin Crisis of 1931,” *The Journal of Economic History*, Vol. 64, No. 3 (Sep., 2004), pp. 822-871

Workshop: TBA

Weekly Post: TBA

**Week 12**. Week of November 14. **The New Deal’s Financial Acts**

Lecture: FDR and the “Banksters”

* Chernow, Ron, “Midget” pp. 346-377 in Ron Chernow, 1990, *The House of Morgan*, Atlantic Monthly Press.
* Douglas, William O., “Investment Banking,” p. 32-45 in *Democracy and Financ*e, Yale University Press, New Haven, 1940.

Workshop: Viewing and discussion of selected YouTube excerpts of interviews of the “Permanent Subcommittee on Investigations: Wall Street and the Financial Crisis” (accessible online through the document “Senate Hearings on Rating Agencies”):

* + Discuss historical parallels/differences between post 2008 Permanent Subcommittee and Pecora hearings (look at Chernow’s “Midget”).
  + Discuss the defense offered by the various interviewed individuals

Weekly Post: TBA

**Week 13**. Week of November 21: **“Junk” Bonds and Distressed Assets**

Lecture: Michael Milken and the Case of Junk Bonds

* Braddock Hickman, “Summary Findings,” *Corporate Bond Quality and Investor Experience*, Princeton: NBER, 1958.
* Chancellor, Edward, “Cowboy Capitalism from Bretton Woods to Michael Milken,” chapter 8 of *The Devil Takes the Hindmost*.

No Workshop: Thanksgiving Break

Weekly Post: TBA

**Week 14**. Week of November 28: **The Subprime Crisis**

Lecture: Understanding 2008

* Gorton: “Slapped in the Face by the Invisible Hand: Banking and the Panic of 2007,” Chapter 2 of *Slapped by the Invisible Hand: The Panic of 2007*, 2010, Oxford: Oxford University Press.

Course Guest: Howard S. Marks (No Workshop).

Weekly Post: What did you learn from meeting with Howard Marks?

(alternatively: From section “Spillover effect” in the chapter “The Bailout of AIG” (from the *The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States*, 2010). Answer the following questions:

* What is the Financial Crisis Inquiry Commission? When was it active? What was its mandate? (search online)
* What was AIG? Why did it fail?
* Explain the reasons for the authorities’ concerns with the prospect of AIG’s failure
* What were the “private sector solutions”? In what did they consist? Why did they fail?

**Week 15**: Week of December 5: **On the Crypto Crash**

Lecture: The Crash of Crypto Currencies in the Mirror of History

Workshop: TBA

Weekly Post: TBA