

**Financial Meltdown: Past and Present
FALL 2019**

**Marc Flandreau
HIST 131-401/ECON 028-401
Tuesday/Thursday 12-1:30
Stiteler B26**



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Marc Flandreau's Office Hours: Tuesdays 1:45-2:45, (CH215A)

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. This course will take stock of the succession of financial meltdowns (going back to the Tulip-mania in the 17th century all the way to the Bit-coin mania). It will emphasize the repetition of patterns, but also the existence of significant differences across individual crises. The goal is to convey through case studies and inductive reasoning an understanding of the logic of financial meltdowns.

Special attention will be paid to historical evolutions and "policy responses," including market reform, central bank intervention and regulations. Economic history is increasingly recognized as a crucial source of policy advice and is invoked with growing frequency in public debates but does it speak in one voice? In particular, the subprime crisis in 2008 and after has generated a demand for "historical perspective" that would improve the understanding of the causes of financial turmoil and facilitate the prevention of comparable catastrophes.

This course offers a review of the principal features of a number of financial crises. It provides historical insights that shed light on crucial aspects of financial disasters. These insights inform economic ideas at the same time they are informed by economic ideas. As a result, we will spend some time discussing economic theories in an informal and intuitive way, especially inasmuch as this helps understand historical processes.

This is an interdisciplinary course, engaging with topics pertaining to history, economics, law and politics or 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. The goal is to develop a fact-based and historically-rooted understanding of the mechanisms of financial speculation and panics. Ultimately, students enrolling in this course are expected to achieve a command of the history of financial turmoil. Students interested and concerned about their ability to follow the course are encouraged to contact the instructor.

Course requirements

1. Involvement. It is assessed, among other things, through students posting every week before Sunday midnight, one paragraph about what they have learnt during the week. The goal is not to simply upload a brief summary. Instead, students are expected to engage with one question of their choice. To allow for students joining in after the start of the semester, posting is only required from registered students until the end of September. After this, there is only one weekly opt-out, allowing for exceptional circumstances; Participation during debates, reports etc. also play a role (20%).
2. Midterm exam. To be administered on October, 9 2018 (15%).
3. Team work. Commentary of documents, Reports, etc., (group grading, student receive group's grade) (30%)
4. An in-class final exam during exams week. Upenn website currently indicates that courses meeting 12:00 Tuesday-Thursday will have the exam Tuesday December 17, 12:00 p.m. - 2:00 p.m. (**HOWEVER THIS IS A PROVISIONAL DATE**) (35%)

Course organization:

Each week will be broken down into two parts. The dates given below for the "week" corresponds to the date of the Monday of that week. Meetings take place on Tuesday and Thursday.

The first meeting (Tuesday) usually consists in a lecture devoted to an episode of financial turmoil. It has assigned reading (shown as "background reading" marked with an asterisk "*"). Additional readings are given for reference, in order to enable more strongly motivated students to deepen their understanding, but these are not mandatory readings.

The second meeting (Thursday) provides an opportunity to add perspective in a variety of ways and develop additional skills. We will project documentaries, learn how to discuss historical documents, organize debates, listen to guest lecturers, etc.

Reference works (available in the Van Pelt reference area):

Kindleberger, Charles P. *Manias, Panics and Crashes. A History of Financial Crises* is an excellent reference book. The version you will find online on the library website (ebook) is the sixth edition, 2011, published with Palgrave Macmillan. It is revised by Robert Z. Aliber and has the advantage of covering the crisis of 2008. However, I would still recommend using an earlier version – any of those with Kindleberger alone: 1978, 1989, ... -- which you can buy online at a cheap price. I just saw one on Abebooks, free shipping,

for US\$ 3.99. Students with no background in economics will find it easier and more user-friendly than the later editions.

Neal, Larry, *A Concise History of International Finance: From Babylon to Bernanke* (Cambridge, Cambridge University Press, 2015). This is an interesting resource to use for students who wish to boost their understanding of the broad history of financial capitalism. It is not required reading at all, however.

Schedule

PART I. THE MECHANICS OF CHAOS

Week 1. Week of August 26. Financial Crises in History and Theory

First Meeting (August 27): Perspectives on financial crises: Charles P. Kindleberger's Theory of Financial Crises.

- Background reading: "Financial crises, a hardy perennial," and "Anatomy" in Kindleberger, *Manias, Panics and Crashes*, pp. 1-20.

Second Meeting (August 29): Perspectives on Financial Crises: Gary Gorton's Theory of Financial Crises.

- Background reading: "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.

Week 2. Week of September 2. Of Bulbs and Bubbles: The Tulipmania

First Meeting: "Bubble!" – The Case of the Tulip-Mania

Background reading:

* Mackay, Charles. *Memoirs of Extraordinary Popular Delusions and the Madness of Crowds*. 2d ed. 2 vols. London: Office Nat. Illustrated Library, 1852

* Garber, Peter M., "Tulipmania," *Journal of Political Economy*, Vol. 97, No. 3 (Jun., 1989), pp. 535-560.

* Thompson, Earl, "Tulipmania, Fact or Artifact?," *Public Choice*, 2007.

Second Meeting: Testing for Bubbles

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

Also:

N. W. Posthumus, "The Tulipmania in Holland in the Years 1637 and 1637," *Journal of Economic and Business History*, 1929, reprinted Eugene N. White (editor), *Stock Market Crashes and Speculative Manias*, Edward Elgar Publishing, 1996,

Anne Goldgar, *Tulipmania: Money, Honor, and Knowledge in the Dutch Golden Age*, Chicago: University of Chicago Press, 2008.

Week 3. Week of September 9. Driving a Bubble: Politics, Society and Speculation

First Meeting (September 10): John Law and the Mississippi Bubble (18th century)

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

Also: Larry Neal, *The Rise of Financial Capitalism, International Capital Markets in the Age of Reason*, Cambridge: CUP, 1993, Chapters 4 and 5 (and appendix to chapter 4) on international aspects of the Mississippi Bubble:

Second Meeting (September 12): **GROUP WORK**: How to Read a Historical Document. Teams produce small reports. Text: John Law on John Law

Week 4. Week of September 16 Why Do Crises Spread?

First Meeting (September 17): The Problem of the International Financial Architecture.

- Marc Flandreau, Christophe Galimard, Clemens Jobst, Pilar Nogués-Marco, "Monetary geography before the Industrial Revolution", *Cambridge Journal of Regions, Economy and Society*, Volume 2, Issue 2, 1 July 2009.

Second Meeting (September 19): The Crisis of 1763

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

For the curious mind, a nice paper: Stephen Quinn and William Roberds, "Responding to a Shadow Banking Crisis: The Lessons of 1763," *Federal Reserve of Atlanta Working Paper*, 2012-08, 2012.

Week 5. Week of September 23 Sovereign Debt Crises

First Meeting (September 24): The First Foreign Debt Bubble – And the Next Ones...

- Marc Flandreau and Juan H. Flores, 2009, "Bonds and Brands: Lessons from the 1820s," *Journal of Economic History*, 3, p. 646-684.
- Marc Flandreau, Juan H. Flores, Norbert Gaillard, Sebastián Nieto-Parra, "The End of Gatekeeping: Underwriters and the Quality of Sovereign Bond Markets, 1815-2007," *NBER Working Paper No. 15128*, 2009.

Second meeting (September 26): **GROUP WORK** – commentary of a historical document and class discussion: Intermediaries' Reputation and Sovereign Debt Crises

Week 6. Week of September 30. Preparation for mid-term

First Meeting (October 1, 2019): Review session

Second Meeting (October 3, 2019): No Meeting

Lila Goldenberg and Alex Royt are available to students with further questions on how to train for the exam.

Week 7. Week of October 7 Mid-Term

First Meeting (October 8): Mid-Term

Second Meeting (October 10): Fall Break (October 10-13)

PART II. POLICY RESPONSES

Week 8. Week of October 14 Dealing with the Culprits

First Meeting (October 15): The New Deal and the “Banksters”

- Ott, Julia, *When Wall Street Met Main Street*, “The Problem with Financial Securities”, Chapter 1, Harvard University Press, 2014.
- DeLong, Bradford, “Did J.P. Morgan's Men Add Value? A Historical Perspective on Financial Capitalism,” in Peter Temin, ed., *Inside the Business Enterprise: Historical Perspectives on the Use of Information*, Chicago, IL: University of Chicago Press for NBER, 1990, pp. 205-36).

Second Meeting (October 17): Class discussion_Also: Douglas, William O., “Investment Banking,” p. 32-45 in *Democracy and Finance*, Yale University Press, New Haven, 1940.

Background: Flandreau, Marc, “Reputation, Regulation and the Collapse of International Capital Markets, 1920-1935,” in Peter L. Rousseau and Paul Wachtel (eds.) *Financial Systems and Economic Growth*, Cambridge: Cambridge University Press, 2008.

Week 9. Week of October 21: Trading Risks in a Financial Markets

First meeting (October 22): Trading Risks in the London Stock Exchange

- E. V. Morgan and W. A. Thomas, “The development of an organized market,” *The Stock Exchange: Its History and Functions*, (London, 1961), pp. 58-78.
- Edward B. Stringham, “The Evolution of Rules in Exclusive Clubs,” p. 61-78 from his book *Private Governance: Creating Order in Economic and Social Life*, Cambridge: Cambridge University Press, 2015.

Second meeting: (October 17): A Case study: The Failure of Moses Montefiore (1806) (documents/group work).

Week 10. Week of October 28: Central Banking

First meeting (October 22): The Emergence of the Lender of Last Resort in Britain, in 1866.

- Goodhart, Charles A.E., *The Evolution of Central Banks*, Chapter 1, Cambridge, MA: MIT Press, 1988.

- 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.

Second Meeting (October 24): GROUP WORK: The Crisis of 1866

Documents extracted from Marc Flandreau and Stefano Ugolini, “The Crisis of 1866,” in N. Dimsdale and Anthony Hotson (eds.) *British Financial Crises since 1825*, Oxford: Oxford University Press.

Week 11. Week of November 4. Rating Agencies

First Meeting: Rating Agencies: What for?

- Frank Partnoy. 2006. “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.
- Flandreau, Marc & Gabriel Geisler Mesevage, “The separation of information and Lending and Rise of Rating Agencies in the USA (1841–1907)” *Scandinavian Economic History Review*, 2014, 62: 3, 213-242.

Second Meeting: Credit Rating Agencies and the Financial Crisis of 2008
Viewing of interviews, and debate

PART III. MODERN MESSES

Week 11. Week of November 11 Twin Crises

First Meeting (November 12) Two Views 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

Second Meeting (November 14) Invited conference: Howard S. Marks, “The Art and Science of Contrarianism”

CAREFUL!! CHANGE OF VENUE!!!: ROOM: COLLEGE 200

Week 12. Week of November 18: The East Asian Crisis

First Meeting (November 19): The Sub-Prime Crisis: Conflicting Diagnoses

- Steven Radelet, Jeffrey D. Sachs, Richard N. Cooper and Barry P. Bosworth, “The East Asian Financial Crisis: Diagnosis, Remedies, Prospects,” *Brookings Papers on Economic Activity*, Vol. 1998, No. 1 (1998), pp. 1-90

Second Meeting: Investing in distressed markets: History, present: Students discuss reports and learning from previous conference.

Week 13. Week of November 25: **Understanding the Rise of Sub-Prime Securities**

First Meeting: (November 26) Michael Milken and the Case of Junk Bonds
Braddock Hickman, "Summary Findings," *Corporate Bond Quality and Investor Experience*, Princeton: NBER, 1958.

Chancellor, Edward, "Cow Boy Capitalism from Bretton Woods to Michael Milken," chapter 8 of *The Devil Takes the Hindmost*.

Second Meeting: Viewing of *Inside Job*, by Charles Ferguson. (Students can skip meeting if they watch it at home)

Background: James B. Stewart' Pulitzer Price winning book, *Den of Thieves* (New York: Touchstone Books, 1991).

Week 14. Week of November 26 **The Sub-Prime Crisis in Historical Perspective**

First Meeting (November 27): The Sub-Prime Crisis: Conflicting Diagnoses
Shiller, Robert, "Introduction" *The Subprime Solution; How Today's Global Financial Crisis Happened, and What to Do About It*, Princeton: Princeton University Press, 2008.

Second Meeting (November 28): Debate: The Subprime crisis in the light of history (students prepare and post reports).

Week 15. Week of December 2: Review, exam;

First Meeting (December 3): Review Session with Professor Flandreau

Second Meeting (December 5): Reading day or final exam (students majority decision). Officially scheduled exam: Tuesday December 17, 12:00 p.m. - 2:00 p.m.