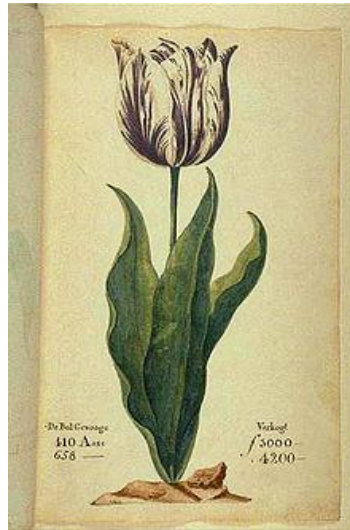


Financial Meltdown: Past and Present

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



Marc Flandreau, mfl@sas.upenn.edu
Graders: Alberto Gamboa, Toshiki Kawashima
Office Hours: Tuesday 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. Special attention will be paid to historical evolutions and “policy responses,” that is, to the co-development of crises and institutional remedies. 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 (two weekly opt-out for the semester); 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 (date to be communicated by UPenn, not known at this stage) (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) consists in a lecture devoted to an episode of financial turmoil. It usually goes along with assigned reading ("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 are not required.

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 academic guest lecturers or practitioners, etc.

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

Kindleberger, Charles P. *Manias, Panics and Crashes. A History of Financial Crises* (Hoboken: Wiley, (5th edition with Robert Z. Aliber) 2005.

Neal, Larry, *A Concise History of International Finance: From Babylon to Bernanke* (Cambridge, Cambridge University Press, 2015).

Schedule

Week 1. Week of August 27 Course introduction and motivation: What is a financial crisis?

First Meeting (August 28): Giving Historical Perspective: 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 30), Viewing of *Inside Job*, 2010, documentary by Charles Ferguson on the 2008 crisis.

Week 2. Week of September 3 Bubbles vs. Fundamentals

First Meeting: The Case of the Tulip-Mania (17th century)

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.

Also:

Posthumus, N. W., "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.

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.

Week 3. Week of September 10 Driving a Bubble: Politics, Society and Speculation

First Meeting: 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: **NO COURSE THIS DAY: PROFESSOR FLANDREAU IS AT A CONFERENCE**

Week 4. Week of September 17 Why Do Crises Spread?

First Meeting: Contagion and Liquidity: 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.

Also:

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.

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

Second Meeting: How to Read a Historical Document. Teams produce small reports. Theme: TBD

Week 5. Week of September 24 Governing Trading Risks in a Stock Exchange

First Meeting: "Lame Ducks" and 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 Governace: Creating Order in Economic and Social Life*, Cambridge: Cambridge University Press, 2015.

Second Meeting: Discussion of the group essays.

Week 6. Week of October 1 Mid-Term Preparation Week

First Meeting: **REVIEW SESSION WITH ALBERTO GAMBOA AND TOSHIKI KAWASHIMA.**

Second Meeting: Fall Break

Week 7. Week of October 8 Exam

First Meeting: Midterm Exam. (Definitions and commentary of a historical document).

Second Meeting: (October 11, 2018), Discussion of the documents

Week 8. Week of October 15 Sovereign Debt

First Meeting: 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: Group work – commentary of a historical document and class discussion: Intermediaries' Reputation and Sovereign Debt Crises

Week 9. Week of October 22 The Rise of Central Banking

First meeting: 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.

* 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.

Second Meeting: Joan Dejean, Trustee Professor of Romance Languages and author of *The Queen's Embroiderer. A True Story of Paris, Lovers, Swindlers, and the First Stock Market Crisis*, New York: Bloomsbury Publishing, 2018, will discuss social aspects of the Mississippi Bubble. Please do the readings uploaded.

"Upward Mobility.2: Purveyors to the crown: The Magoulets: 1638-1678" chapter 2 from *The Queen's Embroiderer*

"The invention of the prostitute" (draft)

Week 10. Week of October 29, On Rating Agencies (or, the US Road to Financial Disaster)

First Meeting: From Financial Architecture to Financial Disaster

* Partnoy, Frank. 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.

Also:

Marc Flandreau, "The First Weapon of Mass Destruction," *Monthly Review*, February 2013.

Second Meeting: Prof Larry Neal, author of *"I Am Not Master of Events" The Speculations of John Law and Lord Londonderry in the Mississippi and South Sea Bubbles*, a leading world specialist of the history of international finance and a visitor at Penn where he works on a project on the Louisiana purchase will give a

conference on the history of derivative products (background paper to be posted online).

Week 11. Week of November 5 Twin Crises

First Meeting: 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: Debate: Structural Instability in the Interwar and the Emergence of the IMF. Students organize groups and prepare presentations supporting one view or the other (assignment of views made by instructors).

* Charles P. Kindleberger, "The international lender of last resort," in *Manias*, p. 211-238.

* Eichengreen, Barry, "Hegemonic Stability Theories of the International Monetary System," NBER Working Paper No. 2193.

Week 12. Week of November 12 Dealing with the Culprits

First Meeting: 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).

* 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.

Also: Douglas, William O., "Investment Banking," p. 32-45 in *Democracy and Finance*, Yale University Press, New Haven, 1940.

Second Meeting: Invited conference: Dr. Damian Clavel, Howard S. Marks Postdoctoral Fellow, University of Pennsylvania, "On Fraud."

Week 13. Week of November 19 Understanding the Rise of Sub-Prime Securities

First Meeting: Michael Milken and the Case of Junk Bonds

Hurduzeu, Gheorghe and Maria-Floriana Popescu, "The History of Junk Bonds and Leveraged Buyouts," *Procedia Economics and Finance*, Volume 32, 2015, Pages 1268-1275.

James B. Stewart, *Den of Thieves* (New York: Touchstone Books, 1991, 1992), Chapter TBD.

Second Meeting: **Thanksgiving**

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

First Meeting: The Sub-Prime Crisis: Conflicting Diagnoses

Gorton, Gary, "Slapped in the Face by the Invisible Hand: Banking and the Panic of 2007," mimeo 2009 <https://signallake.com/innovation/gorton.pdf>

Shiller, Robert, *The Subprime Solution; How Today's Global Financial Crisis Happened, and What to Do about It*, Princeton: Princeton University Press, 2008.

Second Meeting: Guest lecture by Howard S. Marks, Oaktree Capital, author of *Mastering the Market Cycle: Getting the Odds on Your Side* (October 2018)

PREPARATION READING (LOOK ON CANVAS) THE DEVIL TAKES THE HINDMOST

Week 15. Week of December 3: **LAST WEEK OF CLASSES; Debates and controversies on the subprime crisis**

First Meeting: Review Session

Second Meeting: Final exam (in class)