Econ 210a: 19th Century Globalization and Financial Crises (DeLong)

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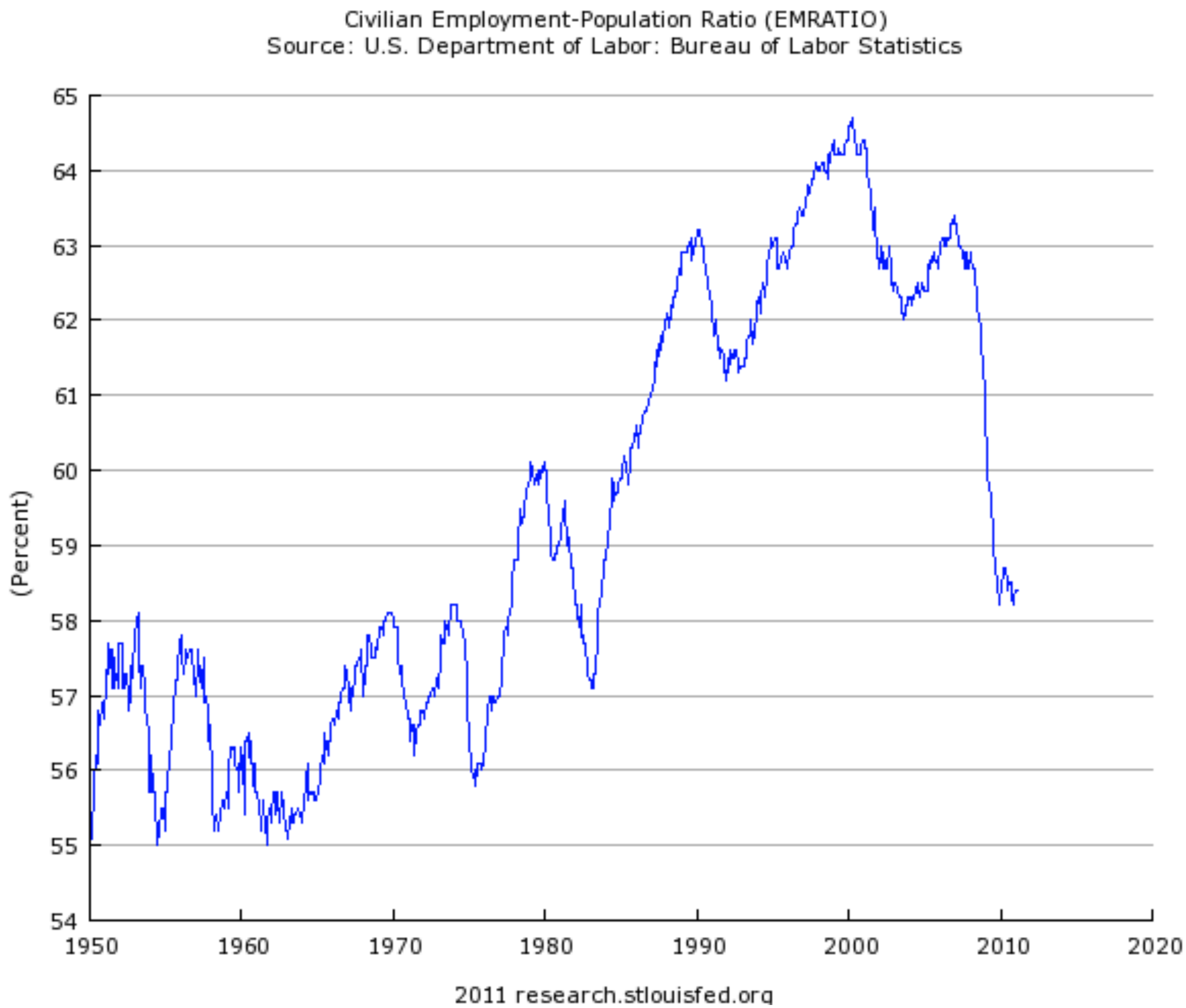
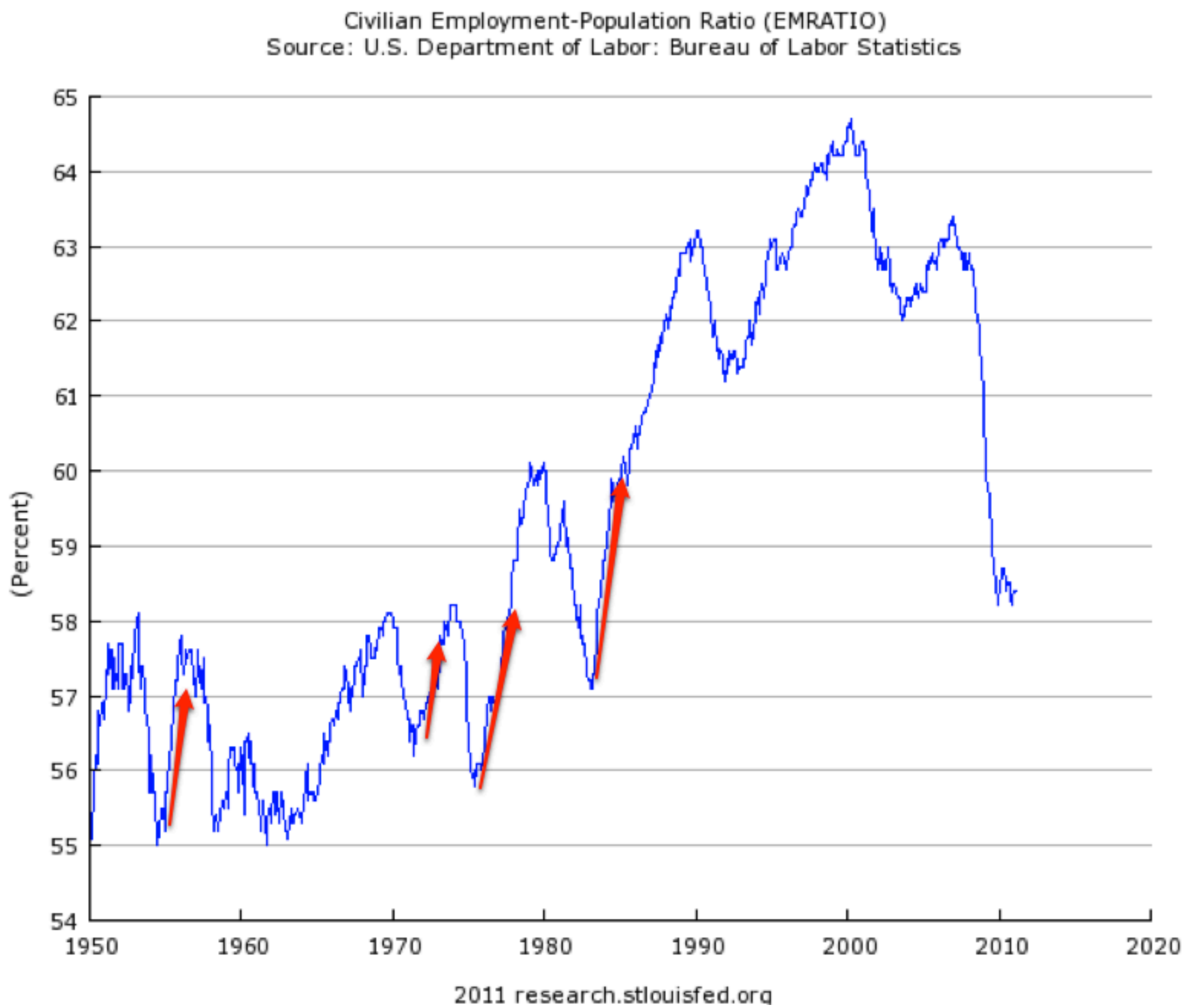
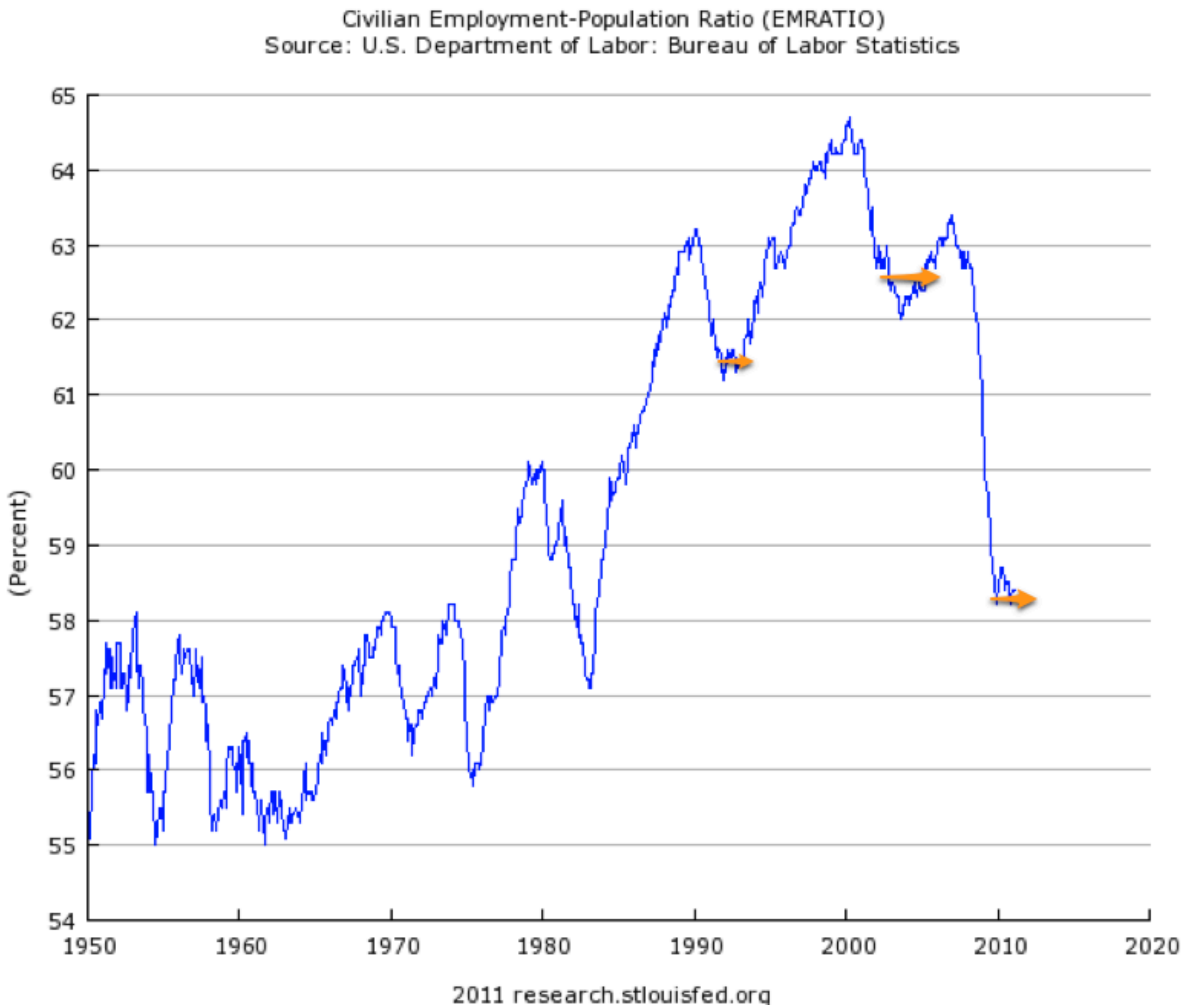
U.S. Employment-to-Population Ratio



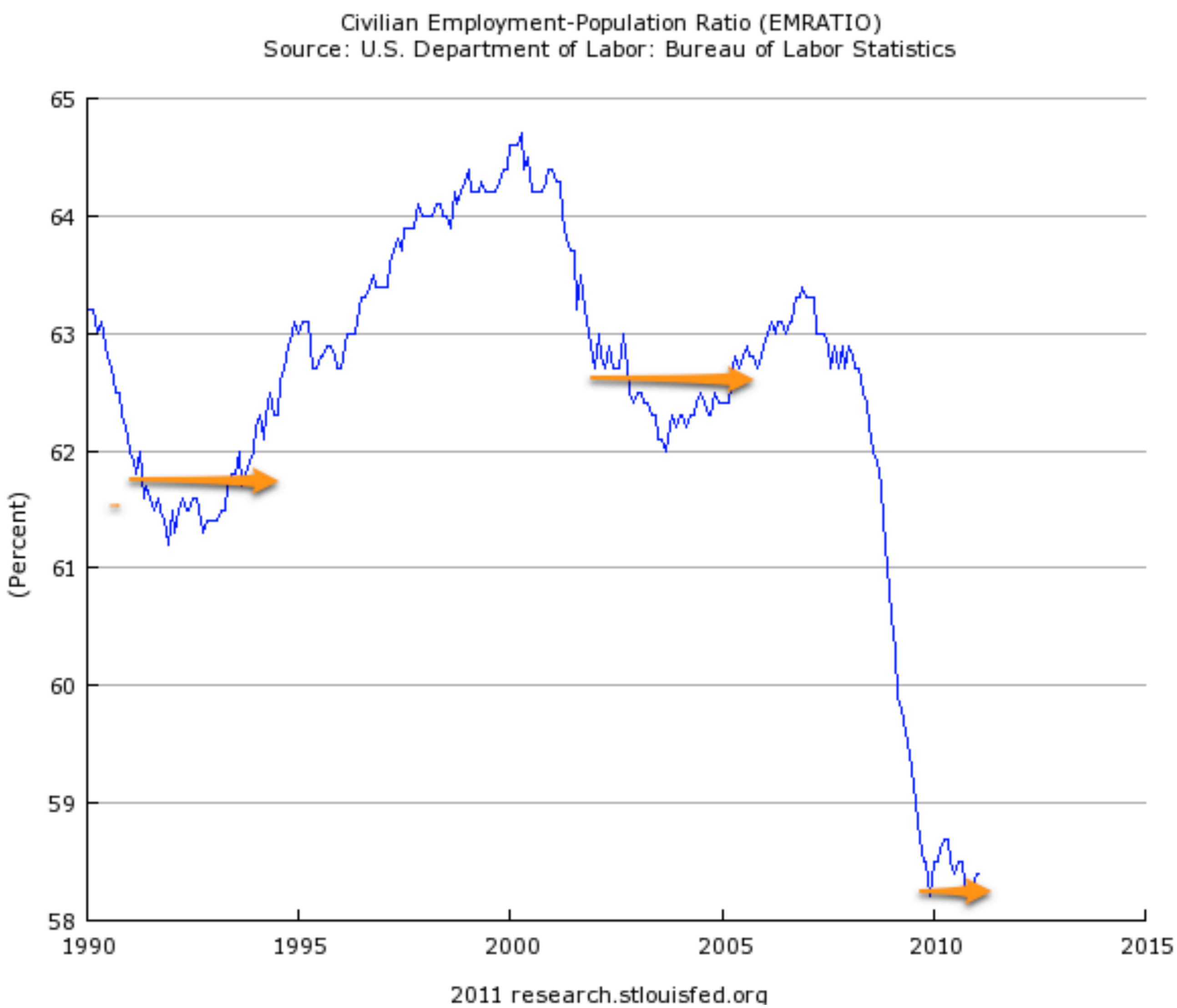
Inflation-Control Recessions Are Vs



Financial Panic-Generated Recessions Are Ls



Financial Panic-Generated Recessions Are Ls



Jean-Baptiste Say 1803

- Say's (or Walras's) Law: excess demands sum to zero, so the idea of an "aggregate demand shortfall" is incoherent: *A Treatise on Political Economy*, Book I, Chapter XV:
  - [T]o say that sales are dull, owing to the scarcity of money, is to mistake the means for the cause.... Sales cannot be said to be dull because money is scarce, but because other products are so. There is always money enough to conduct the circulation and mutual interchange of other values, when those values really exist. Should the increase of traffic require more money to facilitate it, the want is easily supplied, and is a strong indication of prosperity—a proof that a great abundance of values has been created, which it is wished to exchange for other values. In such cases, merchants know well enough how to find substitutes for the product serving as the medium of exchange or money...

Thomas Robert Malthus 1819

- It sounds good in theory, but what about practice? *Principles of Political Economy*:
  - It may be said... that the cotton trade happens to be glutted; and it is a tenet of the new doctrine on profits and demand, that if one trade be overstocked with capital, it is a certain sign that some other trade is understocked. But where, I would ask, is there any considerable trade that is confessedly under-stocked, and where high profits have been long pleading in vain for additional capital?... [T]he removal of capital... is seldom long in taking place, if it be tempted to remove by great demand and high profits; but if it be only discouraged from proceeding in its accustomed course by falling profits, while the profits in all other trades, owing to general low prices, are falling at the same time, though not perhaps precisely in the same degree, it is highly probable that its motions will be slow and hesitating...

Jean-Baptiste Say 1829

- Britain in 1825-6 suffered an aggregate demand shortfall triggered by a financial crisis and an excess demand for safe and liquid assets: *Complete Course on Political Economy*:
  - The Bank [of England]... [t]o limit its losses... ceased to put new notes into circulation... Cease[d] to discount commercial bills. Provincial banks were in consequence obliged to follow the same course, and commerce found itself deprived at a stroke of the advances on which it had counted, be it to create new businesses, or to give a lease of life to the old. As the bills that businessmen had discounted came to maturity, they were obliged to meet them, and finding no more advances from the bankers, each was forced to use up all the resources at his disposal. They sold goods for half what they had cost. Business assets could not be sold at any price. As every type of merchandise had sunk below its costs of production, a multitude of workers were without work. Many bankruptcies were declared among merchants and among bankers, who having placed more bills in circulation than their personal wealth could cover, could no longer find guarantees to cover their issues beyond the undertakings of individuals, many of whom had themselves become bankrupt...

John Stuart Mill 1829

- Walras's Law: an excess demand for safe and liquid financial assets is a deficient demand for currently-produced goods and services—and labor: draft of *Essays on Some Unsettled Questions in Political Economy:*
  - It must, undoubtedly, be admitted that there cannot be an excess of all other commodities, and an excess of money at the same time. But those who... affirmed that there was an excess of all commodities, never pretended that money was one of these commodities; they held that there was not an excess, but a deficiency of the circulating medium... a superabundance of all commodities relatively to money.... [P]ersons... from a general expectation of being called upon to meet sudden demands, liked better to possess money than any other commodity. Money, consequently, was in request, and all other commodities were in comparative disrepute.... [T]he result is, that all [other] commodities fall in price, or become unsaleable. When this happens to one single commodity, there is said to be a superabundance of that commodity; and if that be a proper expression, there would seem to be in the nature of the case no particular impropriety in saying that there is a superabundance of all or most commodities...

Karl Marx

- *Theories of Surplus-Value:*
  - [T]hose economists... who (like John Stuart Mill) want to explain the crises by... the separation between purchase and sale [in a monetary economy]... explain the possibility of crises... [but not] their actual occurrence. They do not explain why the phases of the process [i.e., aggregate production and aggregate demand] come into such conflict that their inner unity can only assert itself through a crisis, through a violent process. [...] Simple circulation of money and even the circulation of money as a means of payment—and both come into being long before capitalist production, while there are no crises—are possible and actually take place without crises. These forms alone, therefore, do not explain why their crucial aspect becomes prominent and why the potential contradiction contained in them becomes a real contradiction. This shows how insipid the economists are who, when they are no longer able to explain away the phenomenon of overproduction and crises, are content to say that these forms contain the possibility of crises, that it is therefore accidental whether or not crises occur and consequently their occurrence is itself merely a matter of chance...

Karl Marx

- *Neue Reinische Zeitung Revue:*
  - [Robert] Peel himself has been apotheosized in the most exaggerated fashion... One thing at least distinguished him from the European 'statesmen' -- he was no mere careerist.... [T]he statesmanship of this son of the bourgeoisie... consisted in the view that there is today only one real aristocracy: the bourgeoisie.... [H]e continually used his leadership of the landed aristocracy to wring concessions from it for the bourgeoisie... Catholic emancipation... the reform of the police... the Bank Acts of 1818 and 1844, which strengthened the financial aristocracy... tariff reform... free trade... with which the aristocracy was nothing short of sacrificed to the industrial bourgeoisie.... His power over the House of Commons was based upon the extraordinary plausibility of his eloquence. If one reads his most famous speeches, one finds that they consist of a massive accumulation of commonplaces, skillfully interspersed with a large amount of statistical data...

Karl Marx

- *Theories of Surplus-Value:*
  - [Crises] are due to an over-production of fixed capital. [...] What the workers in fact produce, is surplus-value.... [T]hat they are able to consume is by no means due to their having produced an equivalent for their consumption. On the contrary, as soon as they produce merely such an equivalent, their consumption ceases.... Their work is either stopped or curtailed.... [T]hey do not consume an equivalent of what they produce... because they receive too little of their product for themselves.... [T]he majority of the producers, the workers, can consume an equivalent for their product only so long as they produce more than this equivalent, that is, so long as they produce surplus-value or surplus-product. They must always be over-producers, produce over and above their needs, in order to be able to be consumers or buyers within the limits of their needs...

Readings

- Walter Bagehot (1873), *Lombard Street: A Description of the Money Market* http://www.econlib.org/library/Bagehot/bagLom.html
- Richard Baldwin and Philippe Martin (1999), "Two Waves of Globalization: Superficial Similarities, Fundamental Differences," NBER Working Paper no. 6904 (January) http://www.nber.org/papers/w69047
- Barry Eichengreen and Michael Bordo (2002), "Crises Now and Then: What Lessons from the Last Era of Financial Globalization?" NBER Working Paper no. 8716 (January) http://www.nber.org/papers/w8716

Lombard Street

- Walter Bagehot (1873), *Lombard Street: A Description of the Money Market* http://www.econlib.org/library/Bagehot/bagLom.html
  - Millian world...
  - Lender of last resort...
    - Lend freely
      - Signalling that no possibility that you will stop
      - Collateral that would be good in normal times
    - Penalty rate
      - Government support only if you need it...
      - Costly to borrow...
      - Insolvent... : jobs of executives; equity; nationalize and then reprivatize; political risks
      - Regulation... Reserves...
- What do we know that Bagehot did not?
  - Explicit rather than implicit knowledge of moral hazard
  - More freedom of action/gold standard
  - Personnel for regulators/central bankers