

Referee Report on:
Growing up to Financial Stability

This is a masterly and thought-provoking survey that I was glad to have the opportunity to read. Since academics are an argumentative lot (to put the matter politely), I must lend credibility to this assessment by providing evidence that I am not simply lazy.

Michael Bordo summarises the historical evidence on financial crises that he and some others have provided, with a view to casting light on recent emerging markets crises (though not the sub-prime crisis and the prospective fall of the dollar). Financial crises are defined to include banking, currency and debt crises and combinations of the three. He is particularly interested in crises where borrowings are in foreign currencies and when the exchange rate depreciates. He conjectures why some countries deal with financial crises and other do not, and how stable financial institutions emerge.

The survey of recent empirical evidence hints at a number of paradoxes. Michael Bordo et al's sample (p3) is increasingly prone to crises, and less output is lost, as we move from the generation before the First World War to more recent years. Western Europe had learned how to deal with financial crises by 1914, yet this did not seem to help later. Why was this? In the Great Depression bank collapses were kept under control in contrast to US but there were still currency and debt crises. Was not German hyperinflation, deficit spending and exchange depreciation a financial crisis largely independent of the US in the early 1920s? What happened there was quite different from US experience; the rise of European socialism, and political and economic disorganization stemming from the shock of total war.

Though not everything can be covered in one lecture I would be curious to know how Michael rates the performance of silver standard countries before 1914- these were typically poorer (emerging markets?), Japan, China and India for example.

The Bretton Woods system gets a poor press; financial stability was bought with financial repression according to Bordo. Does this imply that a regulatory ‘big bang’ after the Second World War would have been preferable, in the conditions of the Berlin blockade, the Korean War and the Cold War? Or simply that Bretton Woods should have been phased out earlier? If so when? The system did preside over a unique period of sustained and widespread economic growth at unprecedented rates, which must be a point in its favour.

Some cosmetic suggestions;

1. Section 7 would be easier for the reader to digest if themes rather than authors were the subjects of paragraphs and sentences.
2. Sometimes a little more detail would be helpful for those who have not read the cited and summarised paper(s). For instance in the conclusion, the UK 1976 crisis as an illustration of a crisis promoting institutional learning by tipping the balance of power in favour of reform. The crisis was a consequence of the policies pursued. The critical element in reform was the ability of the Chancellor to blame the IMF for the economic policies that should have been followed anyway but were unacceptable to much of the Labour Party. The crisis was endogenous and the Labour Party took another two decades to learn.
3. The ‘Celtic fringes’ might reasonably contest the accuracy of the use of the term ‘England’ rather than ‘Britain’ in section 6. The Tudors (and particularly the ‘son of prophesy’ Henry VII) were at least nominally Welsh. The allusion to the ‘financial revolution in England following the Glorious Revolution in 1688’ which chased out the Scottish Stuarts, neglects the financial revolution in Scotland that Rondo Cameron maintained was more effective than in England and Wales.
4. An eye watering metaphor- surely one peels off the layers of an onion (abstract and elsewhere), rather than ‘peels back’, as one might the sheets of a bed?
5. Spelling of ‘Britannica’ (p4).