The Origin and Development of Financial Markets and Institutions: From the Seventeenth Century to the Present

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This collection of fifteen papers is the result of a 2006 conference held in honor of Larry Neal on the occasion of his retirement from teaching at the University of Illinois. Three chapters were added after the conference (but before the severity of our current 'Great Recession' became evident), including an introductory chapter by Attack, on 'Financial Innovations and Crises: The View Backwards from Northern Rock,' as well as a concluding chapter by Neal, on 'Lessons from History for the Twenty-first Century.' Neal's chapter is especially interesting as it gives this highly respected economic historian's thoughts on how today's epochal financial capitalism is distinct from the period of financial globalization that occurred roughly between 1880 and 1915. Neal compares the crises that occurred in the two periods, discusses the institutions that developed in the interim (the Fed, the Security & Exchange Commission, the International Monetary Fund, the Society for Worldwide Interbank Financial Telecommunication, and the International Accounting Standards Board), and offers a dialectical prognosis on the practical limits to any international 'lender of last resort' proposal in the highly integrated global capital markets of today (and indeed of the earlier period).

The book does not cover the development of financial and capital markets in post-Soviet Russia and Eastern Europe, or in the booming post-Cold War economies of India and China, leaving half of the world's population outside its scope. The subtitle is a little misleading in that only one of the chapters covers the post-Great Depression period. These caveats notwithstanding, the papers are uniformly engaging and well-researched and will be of interest to both general readers in economic history, to specialists in financial history, and to policy-makers who would like to learn from the past.

Students of economic history are usually taught that the basic institutions of capitalism—money, accounting practices, rudimentary deposit-based banking, the partnership form of business enterprise, bills of exchange and other 'derivatives'—were in routine use in the Italian city-states of Venice and Genoa by the early 1200s. Industrialization, the growth of cities and the need for war finance gave rise to new financial and institutional requirements. The chapters in this book amount to case studies of these institutions as they became more developed after the emergence of the nation-state.

Stephen Quinn & William Roberds write about the Bank of Amsterdam, formed in 1609 in response to the debasement of the species-money which was drawn to Amsterdam by its commerce-friendly policies. According to Quinn & Roberds the development of 'open-market' trading in the Bank's fiat money instruments, and the clearinghouse functions performed by the Bank, make it the first central bank. (But in a later chapter, Richard Sylla treats the 'lender of last resort' function as a defining feature of a true central bank. None of the contributions considers the historical development of the role of the central bank as rescuer of institutions that are 'too big to fail.') The silver content of coins fell by nearly 100% during the Dutch revolt against the Holy Roman Empire between 1568 and 1609. The war debt was paid off in devalued coins. The Bank of Amsterdam developed its fiat money only after independence was achieved and after the further development of public debt instruments. Oscar Gelderblom & Joost Jonker continue this Dutch story by showing how a nascent field of institutional investing emerged out of efforts to meet the financing needs of social welfare organizations like hospitals, orphanages and poorhouses by diversifying from real estate holdings in parallel with the development of public and private debt and private equity (originally the Dutch East India Trading and the South Sea Companies).

The next two chapters are on the Mississippi and South Sea Bubbles of 1720, respectively. Françoise Velde questions the conventional interpretation of John Law's Mississippi scheme as at least partially the result of deliberate fraud, on the ground that Law invested his own fortune in Mississippi land, though her evidence for this is not altogether clear. Then Gary Shea uses the legal case of Sir George Caswell vs the Duke of Portland (which Neal compares to Jarndyce vs Jarndyce), which was brought to court after the South Sea Bubble burst, to show that the bubble may have been caused by rent-seeking aimed at gaining a monopoly over the financing of British government debt after the Glorious Revolution. Shea makes the case that the fallout from the South Sea Bubble clarified the need for more explicit laws concerning property rights, government finance and private financial contracts. In the 'The Bell Jar: Commercial Interest Rates between Two Revolutions, 1688–1789,' Marc Flandreau, Christophe Galimard, Clemens Jobst & Pilar Nogues-Marco argue that accurate historical estimates of commercial interest rates might be derived from the prices of commercial bills of exchange because financial markets develop around international trade patterns, not through domestic policy.

Chapters 10–13 are concerned with the 20th century's interwar period. Eugene White writes that the rapidly increasing market volume on the New York Stock Exchange prior to the 1929 crash was unsustainable for the limited number of brokers able to trade. This then led seat-holders to sell their seats on the exchange: 'older and perhaps wiser men,' including John D. Rockefeller and two Morgans, anticipating the disaster ahead, sold their seats to younger investors before the crash. Richard Burdekin & Marc Weidenmier show that President Roosevelt's politically-motivated silver purchase program helped bring the silver states of the West more quickly out of the Depression than non-silver states. Alan Dye & Richard Sicotte challenge the conventional wisdom that US imperialism in Cuba reinforced the monopoly rents of foreign investors in the Cuban sugar market; in fact, protectionist US tariff policy prevented above-normal profits. In a chapter that parallels the work of Peter Temin, Kirsten Wandschneider finds that politics played a large role in the ineffective interwar 'gold exchange standard period.' Among the 'periphery' countries Austria, Czechoslovakia, Hungary and Poland, only non-democratic Hungary's central bank 'showed some willingness to adjust the bank rate so as to adjust gold flows. The democratic countries, as we might expect, 'were more responsive to domestic economic conditions than autocratic ones,' with, for example, the Austrian and Czechoslovakian central banks responding to local prices.

The final paper prior to Neal's concluding chapter is Michael Bordo & David Wheelock's 'When Do Stock Market Booms Occur? The Macroeconomic and Policy Environments of Twentieth Century Booms,' a study of fifty-five booms (defined as annualized stock market growth higher than 10%) in ten developed countries during the 20th century. Bordo & Wheelock attempt to fill a gap in the literature—the dearth of historical studies of asset price booms, in contrast to the abundance of studies on market busts. They find that stock market 'booms generally occurred during periods of above-average economic growth and below-average inflation, and that they typically ended when monetary policy tightened in response to rising inflation.' They note also that stock market booms became positively correlated across the ten countries only in the mid-1980s, an indication that an epoch of financial integration similar to the 1880–1915 period had begun.

Keeping history in mind as we confront the issue of financial market reform today, Larry Neal cautions that we ought to be wary of regulatory overreach during periods of crisis. This warning is counterbalanced by Jeremy Attack's apt observation in the book's introductory chapter: 'Even though governments have tended to kill the financial goose…, in the long-run a growing number of countries have managed to "get it right", thanks to the strength of private incentives and the creativity of the human mind in working around regulations and problems and finding creative new solutions.'

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