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Historical reflections on the causes of financial crises: Official investigations, past and present, 1873–2011

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ABSTRACT

In the present essay we review a set of enquiries and reports that were realized and published as a result of the major financial crises of the past and of the contemporary era. Generally these documents not only address the issue of the causes of collapse of bank and capital markets but also shed light on regulations proposed at different points in time to improve financial stability. We begin with reference to extensive hearings published by the British Parliament following what may be termed the first global financial crisis in 1873 and, then, proceed to a discussion of official reports on the crises of 1907, 1929 and above all that of 2008, which has produced the greatest outpouring of these types of publications. It is our hypothesis that one important avenue for a historical understanding of the great financial debacles of the past consists in a careful evaluation of official literature and documents that can complement the theoretical approaches of economists in search of explanations for these events.

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Reflexiones históricas sobre las causas de las crisis financieras: las investigaciones oficiales, pasados y presentes, 1873-2011

RESUMEN

En este ensayo revisamos una serie de investigaciones y reportes que fueron impulsados y publicados como consecuencia de crisis financieras del pasado y de la época contemporánea. Estos documentos suelen analizar las causas del colapso de determinados bancos o mercados financieros, pero, además, pueden echar luz sobre los procesos de ratificación de nuevas regulaciones establecidas para mejorar la estabilidad financiera. Comenzamos el trabajo con un resumen de importantes documentos que fueron publicados por el Parlamento británico a raíz de la crisis de 1873, que podría denominarse la primera crisis financiera global. Se sigue con un repaso de informes oficiales emanados de la crisis de 1907 en los Estados Unidos, la crisis de 1929 y, sobre todo, aquellos publicados a raíz de la crisis financiera de 2008. Es nuestra hipótesis que una comprensión histórica de los grandes colapsos financieros del pasado puede beneficiarse del estudio de esta literatura oficial, la cual puede complementar los enfoques más teóricos de los economistas que buscan explicaciones de las causas de estos grandes y destructivos eventos.

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Which are the best and the most important sources for understanding the outbreak as well as the immediate causes and consequences of a major financial crisis? They come in various

shapes and formats, including empirical, theoretical, legal and political texts and documents. Economic historians have been studying these kinds of texts for decades because it is necessary to combine a large variety of primary and secondary sources in order to fully grasp the complexity of a great financial collapse. It is worth noting that this literature has broadened remarkably in

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our own day as a result of the most recent crash of 2008, which is now known both familiarly and among experts as the Global Financial Crisis.¹ Indeed, the number of books, documents, articles and working papers on this recent financial cataclysm is not only expanding exponentially but also has become much more accessible worldwide due to the internet, and has even spawned a new kind of electronic publication, the “financial blog”, which also attracts great interest. Nonetheless, it should also be recognized that there are important historical antecedents dealing with prior crises that consist not only of books and articles, but also official documents and enquiries that can be identified and studied for many financial crises over the last century and a half.

Perhaps the first sources of study which historians habitually utilize to reconstruct financial crises of the past are newspapers, particularly the specialized financial press that publish articles providing a first-hand description of the daily events that occur on the outbreak of a major event of this nature. A second source are the more analytical articles that appear somewhat later in economic newsletters or journals (and today in web sites of *working papers* and *blogs*, as well), written in most cases by economists, financial experts or well informed financial journalists. A third source consists of reports circulated by banking institutions, particularly central banks and multilateral financial entities, gradually increasing in volume and regularity over the twentieth century.

But apart from the sources aforementioned, there were (and are) other complementary documents that may have more of a political origin, based on official efforts to “uncover” the causes of financial collapse of banks or stock markets and the key figures considered responsible for the debacle. Whether this objective is fulfilled or if there is actually a “cover-up” depends on a great variety of factors. In this case, historians need to focus on a fourth important repository of information which are the official enquiries realized generally by parliamentary committees or commissions soon published after the crisis that provide much information of interest, including the testimony of a large number of key financial actors. A complementary source – although generally less consulted except by legal experts – are the judicial records of court cases related to embezzlements or frauds by banks or financial agents. Finally, it may be suggested that major pieces of legislation ratified in the wake of a financial collapse should also be studied in the light of the important materials contained in parliamentary debates or in the laws themselves and in subsidiary documents.

Our essay covers a broad span of time in order to suggest the utility of these kinds of documents, but we focus, in particular, on the official enquiries on the causes of financial crises, the majority of them being the product of legislative commissions which operated in Great Britain and the United States at different moments during more than a century, although there have also been similar parliamentary investigations at different times of financial troubles in France, Canada and Australia, to name just a few countries. After a brief comment on mid-nineteenth century crises, we turn our attention to a most interesting official investigation in Great Britain directed at clarifying the presumed causes of the global financial crisis of 1873. We follow with a summary of enquiries carried out by the U.S. Congress in the late nineteenth century and early twentieth century. We also refer to the investigations promoted by the U.S. Senate after the financial crash of 1929 that inaugurated the Great Depression. Finally, and most important, we advance a set of comments and summaries of official documents that have been published in the last four years, as a result of extensive

investigations by governments or public banks that had the aim of explaining some of the causes of the global financial crisis that exploded in 2008, the consequences of which are still with us.

A recent essay by Marc Flandreau (2012) has covered some of this ground by analyzing several documents related to the crises of 1873 and 1929 but he does not mention additional enquiries and does not deal in depth with the official investigations on the contemporary financial debacle, which are also of enormous interest.² Flandreau suggests that, in the aftermath of the recent crisis, it appears that modern day enquiries do not include “clear requests to investigate the behavior of investment banks” as was the case in the 1930s. His interpretation, however, does not appear to be justified in the light of a review of publications such as the US Senate investigation, published in 2011, which addresses in great detail the role and truly flagrant and enormously risk prone behavior of both commercial and investment banks, as well as rating agencies in the United States prior to the financial debacle of 2008. In any case, the present essay – like that of Flandreau – suggests that reviewing the official documents published as a result of past financial crises is of considerable interest to compare and/or contrast with the present.

1. The financial crisis of 1873 and the select committee on foreign loans

Since the beginning of the nineteenth century there were various stock market and bank panics in Europe and North America, some of which had important effects internationally, particularly the collapses of 1825, 1837, 1846/47, 1857 and 1866. The bankruptcies of banks and important brokerage houses in important financial centers such as London, Paris, New York and Hamburg had the result of restricting the credit that greased the wheels of international transactions. The impact varied by country. For example, in October 1857, the downturn in agriculture in the United States led to financial troubles in New York which then rapidly spread to London and Hamburg: by November the credit crunch had begun to have an impact on the agents and correspondents of English merchant banks and German trading houses in North and Latin American ports. The impact of the crisis was so considerable that in Great Britain, the House of Commons instructed the formation of a *Select Committee on Bank Acts* to investigate the causes and nature of this mercantile and credit collapse. One important witness to this event and the official reports was Walter Bagehot, journalist and later editor of the *Economist*, who published an important essay on the subject (Bagehot, 1858). In the case of Spain, financial contraction of 1857 most deeply affected the agrarian sector leading to what was described as a subsistence crisis by Nicolás Sánchez Albornoz (1968) in a splendid essay that is considered a pioneer in the *historical* study of nineteenth century economic crises in the Iberian peninsula.³

In 1866 the failure of the powerful financial firm of Overend & Guerny in London caused great turbulence in the “City” among virtually all financial firms there and subsequently its effects spread abroad. The crisis was analyzed with particular incisiveness again by Walter Bagehot and underlay much of the text and the principal arguments of his classic work, *Lombard Street*, published in 1873. In this work, as is well known, Bagehot underlined a relatively new view concerning the role of central banks in crises – in this case of the Bank of England – which he held should liberally discount very good commercial paper, thereby increasing the availability of credit in times of economic contraction. This British banking panic had

¹ It is interesting to note that in the World Finance Conference held this year in Cyprus, the expression has become a standard reference among the leading financial experts and in paper after paper, the acronym for the Global Financial Crisis used is GFC.

² The author has researched in greater detail many of the documents reviewed in Marichal (1989) in chapters 4 and 8.

³ For additional bibliographical referents see (Martín Aceña, 2013, pp. 65–69).

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