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978-1-107-03417-4 - A Concise History of International Finance: From Babylon to Bernanke

Larry Neal

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A Concise History of International Finance

Ever since the financial crisis of 2008, doubts have been raised about the future of capitalism. In this broad-ranging survey of financial capitalism from antiquity to the present, Larry Neal reveals the ways in which the financial innovations throughout history have increased trade and prosperity as well as improving standards of living. These innovations have, however, all too often led to financial crises as a result of the failure of effective coordination among banks, capital markets, and governments. The book examines this key interrelationship between financial innovation, government regulation, and financial crises across 3,000 years, showing through past successes and failures the key factors that underpin any successful recovery and sustain economic growth. The result is both an essential introduction to financial capitalism and also a series of workable solutions that will help both to preserve the gains we have already achieved and to mitigate the dangers of future crises.

LARRY NEAL is Emeritus Professor of Economics at the University of Illinois at Urbana-Champaign, Research Associate of the National Bureau of Economic Research, and Visiting Professor at the London School of Economics (2006–2014). Specializing in financial history and European economies, he is author of *The Rise of Financial Capitalism: International Capital Markets in the Age of Reason* (Cambridge University Press, 1990). His recent publications include editing *The Cambridge History of Capitalism* (Cambridge University Press, 2014); and “*I am not master of events*”: *The Speculations of John Law and Lord Londonderry in the Mississippi and South Sea Bubbles* (2012).

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Preface

For many years, I offered a graduate seminar in “Financial History” at the University of Illinois. The course always began with an overview of the most recent financial difficulties confronting the international economy. The first time I offered the course, I worked backwards from the present and ended as far back as student interest or my knowledge base allowed. It soon became clear, however, that instead of re-tracing a supposed evolutionary trail of financial development and disorders, I should skip back to “how it all began,” and then take the narrative arc forward to the present. But how far back was it necessary to go? That question was answered at first in terms of my limited knowledge. When I became fascinated by the events of 1720 with the Mississippi and South Sea bubbles in Paris, London, and Amsterdam, that was where I would begin the rest of the course.

When I took these ideas to the graduate students at the London School of Economics in 2006, there was definitely an air of triumphalism about the “Great Moderation” and the ongoing globalization of finance, but this changed rapidly over the course of the next five years as the “Great Recession” began in 2007 and kept unfolding. Increasingly, I had to explain how difficult it was to get different national financial systems coordinated effectively while financial innovations occurred. While trying valiantly to keep up the morale of the students, who increasingly came from the corps of continuing layoffs in the financial sector, I also had to go farther and farther back to begin a new, more nuanced, and much longer “narrative arc” for the material. The variety of international backgrounds and experiences of the LSE students, reflected in their research papers, helped greatly to expand my knowledge base back in time. To date, it only goes back to Babylon based on the ongoing work of ancient archaeologists. The intervening millennia suffer from lack of surviving written documentation comparable to clay tablets and *bullae* until the parchment records of medieval Europe appear. Even so, there are

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enough examples of successful financial innovations in the past to restore my faith that this crisis, too, shall pass.

The research papers from the students in my courses at the University of Illinois, California Institute of Technology, London School of Economics and Political Science, Sciences Po, and the University of California at Los Angeles has improved my grasp of the historical record. Seminar participants at CalTech, Cambridge, Chicago, Harvard, Michigan, Northwestern, Oxford, Toronto, and Yale over the years raised valid points. Continued interchanges with my colleagues at Illinois – Lee Alston, Jeremy Atack, Charles Calomiris, Virginia France, and Charles Kahn, as well as my work with Lance Davis and Eugene White, kept up my enthusiasm for the project over the years. Careful reading of earlier drafts by Richard Steckel, Mira Wilkins, and David Wishart will benefit readers of this book.