

Federal Reserve Bank of Atlanta – Center for Financial Innovation and Stability

Sovereign Debt and Default after the Financial Crisis of 2007-2008

November 28-29, 2011

Discussion on “What We Can Learn From U.S. Economic History?” by John J. Wallis

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This is the first macro/money conference I have attended so if I am a bit raw it is because I probably do not speak the local dialect. Yet, I do not come entirely unprepared. I have a Masters from Chicago, where in the spring of 1963 I read through the Monetary History with Milton Friedman. I then moved on to Penn to do an economic history PhD where I had several classes with Lawrence Klein. If there were two economists in the mid-1960s who were more opposed, I would be glad to hear about them. I accommodated this gap with the rationalization that the role of economic theory was to supply me with tools to understand economic history and I thought both Friedman and Klein could help me with one cycle or another.

With my PhD in Economic History on British overseas investment in the late 19<sup>th</sup> and early 20<sup>th</sup> centuries in hand, I moved on to Columbia and Queens College where for 30 years I taught intermediate macro. About ten years ago I quit teaching macroeconomics, first, because I was bored, and, second, I could not find a text book that accommodated my increasing dissatisfaction with latter day macro-money modeling, diverse as it was and remains. No one seemed to deal with macroeconomic fluctuations the way I found myself teaching macro topics in my economic history classes. For my bread and butter course obligations, I jumped to the Stigler side of my early training and took up teaching micro.

John Joseph Wallis does financial / macro history the way it should be done. First, each upturn and downturn has important and unique characteristics that matter to the timing, length and extent of their rise and fall. This makes total sense to me as a 19<sup>th</sup> century economic historian because different sectors of agriculture, industry construction and services were drawing and disgorging labor and capital each time causing unique regional and national disruptions and growth. Furthermore, in our huge country, development took place in both old and new locations, some much better developed in terms of labor and financial markets. New industries and newly located industries, however, were not well served by these labor and financial markets on the supply side; the agglomeration and other economies in the development of labor and finance have not fully developed. Each new industry had new risk and uncertainty characteristics that needed to be mastered by the smarter and luckier firms, banks and schools. Hayek's price signals were operating with a vengeance, some signals underperforming because of externalities. Mistakes were definitely part of the process with bankruptcy and unemployment to

follow. In the longer run businesses struggled to gain more control of output and input markets, as did labor and finance.

Finally, the ups and downs lived with changes in federal, state, and local government policies of one sort or another. Wallis' period is quite interesting because no one can blame a US monetary authority for the timing, length and extent of the falls. Of course one can always try to blame the Bank of England but Wallis has stumbled on one of the most important aspects of the US and the Atlantic economy in the 19<sup>th</sup> century. The regional and national markets of the US were a very blustery and they were an important source of international instability, especially as the US regional and national economies got larger and larger relative to Britain and the other European economies.

Furthermore, just when a sector and its locale (and its financial intermediaries) seemed to get a handle on its unique risk and uncertainties, new developments within and without required a new learning process. We now know that learning corporations in the 20<sup>th</sup> century were often among the best bets for 20<sup>th</sup> century growth. In the 19<sup>th</sup> century such learning fell on a highly disintegrated group of entrepreneurs and bankers. I have always thought a good thesis might investigate the benefits of regional economic information gathered by the regional Federal Reserve Banks. This study should, of course, be accompanied by examining what were the regional sources of information prior to 1914.

Let me shift my perspective a bit for my final comments. According to Wallis, state constitutions were altered after the defaults and other debacles of the early 1840s. These amendments mandated that tax revenues were to be much more strictly aligned with debt-based expenditures. There is a rather optimistic view of government reform and political wisdom buried here. I like to think that our early republic had a good idea or two among all the special interest legislation passed at the state level. But, I would have appreciated a table giving the date and content of every state constitutional amendment. It would also have been useful to have discussion on whether and when the New York and London capital markets readmitted the debt of the various states. How did these capital and money markets react to the passage of each US state's constitutional amendments in the market for outstanding debt? I know that the London market did not have a lot of US state debt in the mid-19<sup>th</sup> or late 19<sup>th</sup> century after the ups and downs of the 1830s and 1840s. US municipal debt appears in the 1870s but very little state debt.

I am also struck by how quickly these state legislatures responded. The spate of US financial regulation of the 1930s, for example, was not solely the consequence the Great Depression. Indeed, one wonders whether much of the legislation would have passed if there had been moderate cycling in the years from the 1890s forward. FDR had a public that had had one too many periods of 10% or more unemployment within voter memories. So, I am curious about the relatively short path to state constitutional reform. Was this typical of the 19<sup>th</sup> century period of state leadership in governmental economic regulation? Maybe I am underestimating the memories of the cyclical ups and downs of the Andrew Jackson's years. In any event, I need a bit more information about these constitutional reforms before buying a Whiggish view of state economic regulation. What I do know is that if Wallis does investigate further, such research will be properly grounded in a multi-state political economy.