Comments on “Responding to a Shadow Banking Crisis: the Lessons of 1763”

Conference to Honor Warren Weber
February 18. 2012

Ellis Tallman
Oberlin College and Federal Reserve Bank of Cleveland
Overview of the paper

• A relevant liquidity crisis to investigate

• A rich data set

• Central question –
  – How did Bank of Amsterdam avert “contagion” failures?
What a data set!

• Cross-bank payments data
  
  • $X_{ikt}$
    
    — $X$ represents a transfer (amount)
    — $i$ is bank receiving the transfer
    — $k$ is the bank sending the transfer

• Many uses for this data – main one here
  
  — Analyze the contagion effects of a big failure
Use of data

• Illustrate the liquidity needs of *banquiers*
  – Volume of payments relative to average balances
  – Reliance of the “parvenus” on new credit lines

• Seems like an “excess reliance” on refunding
  – *Sounds familiar* –
  – *Certainly* 2007-2009
  – But also 1873 and 1907
Case of 1763

• How does the fringe intermediary earn profit?
  – Low per transaction return
  – High turnover – high leverage

• Interconnections – they have them in data
  – A parvenu failure can have large knock on effects
  – And “running out of balances” at the Bank of Amsterdam would be all that is necessary
Institutional knowledge shared

- Intensive analysis of existing contract design
- Comparison to modern securitized loans
- Question: How much is necessary to examine the issue of liquidity the provision of which may have prevented contagion?
Provocative statement

• Bullion window lending as key to solution
  – Small channel => disproportionately large effects

• Simulation exercise and graphics display it

• The “why” of disproportionate effects
  – Accounts at the Bank of Amsterdam could never run out of bank money (no overdrafts)
Figure 10: Simulated balances with no bullion window + 2 failures
The value of liquidity

• That last unit of account that would have prevented a negative balance
  – Important in these circumstances

• Relaxation of collateral standards
  – Crucial for increasing the supply of liquidity
  – May seem small –
  – But without it bad things could happen
Transactions outside

• Runs on banks of deposit

• Extreme demand for coinage (not just for BoA collateral, but for day to day purchases)

• Description of the balance between bullion value as collateral vs bullion for minting
  – Fiscal and monetary policy coordination?
Analogues in the National Banking Era

• Collateral requirements in panics
  – Issuance of clearing house loan certificates
  – 75 percent of “market” value of collateral
    • “Temporary” liquidity – exchanged at par at the clearing house (6 percent interest paid by borrower to the bearer of the loan certificate)

• What was used as collateral?
  – Assets that normally were not liquid
Assets Scaled to Week 0

Weeks Before and After Major Failure
0=1 August, 1763 and 0=10 September, 2008
Much liquidity added

• Bank of Amsterdam increased liquidity more through the normal discount of coin
  – In 1763 production of Bank discountable coin increased by about 45 percent (my guess)

• But the marginal addition of bank money by bullion collateral was still crucial

• This issue should be central to the revision
Source of growth in Bank of Amsterdam Deposit Balances

- Dollars and Gold
- Dutch Coin
- Bullion
Final Comments

• Fight the urge to do more –
  – Try to maintain aim at contagion issue

• There is material to address many questions
  – Other papers can take on those questions

• Great feat of economic history reconnaissance
  – My hat is off to y’all