



Discussion

The European Crisis in the Context of the History of Previous Financial Crises

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**A comment by
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Shortcomings of the interwar Gold Exchange system:

1.No central coordination

League of Nations was a very weak policy institution

2.No credit provision mechanism for countries in stress

The asymmetry problem: Over- and Under-acumulation,

3.No central concern with recession and unemployment

Social tensions multiplied beyond control

Consequences: Financial, economic, social, political



How much recovery after abandoning the Gold Exchange System?

A layman's test:

**Check how much GDP improved within 2-years after
leaving GES, as opposed to 2-years prior of devaluation**

Use Maddison GDP series of 1990 US Dollars

- *For the periphery: Surprisingly little*
- *For the core countries: More improvement, but...
Not for all, not quickly*

Countries leaving GES:

Wandschneider (2008), Bernanke and James (1991), Eichengreen (1992).

LESS

DEVELOPED

	OFF	Period	T-2	T-1	T	T+1	T+2	2aft/2bef
Yugoslavia	1931	1929-33	19,363	18,995	18,430	16,712	17,228	-11.52
Bulgaria	[1933]	1931-35	8,876	8,933	9,084	8,308	7,928	-8.83
Brazil	1930	1928-32	37,333	37,415	35,187	34,401	35,599	-6.35
Hungary	1931	1929-33	21,250	20,789	19,786	19,260	21,003	-4.23
Czechosl-kia	1934	1932-36	37,886	36,276	34,889	34,556	37,387	-2.99
Argentina	1929	1927-31	45,567	48,414	50,623	48,531	45,160	-0.31
Finland	1931	1929-33	9,302	9,194	8,970	8,932	9,526	-0.21
Romania	1932	1930-34	17,235	17,640	16,657	17,447	17,640	0.61
Portugal	1931	1929-33	10,789	10,656	11,204	11,422	12,194	10.12
Greece	1932	1930-34	14,342	13,746	14,912	15,784	16,173	13.77
Poland	1936	1934-38	47,439	48,107	49,504	58,980	67,788	32.68

Countries leaving GES:

Wandschneider (2008), Bernanke and James (1991), Eichengreen (1992).

GDP Levels million 1990 International Geary-Khamis dollars

ADVANCED

Canada	1931	1929-33	52,199	50,454	42,667	39,630	36,801	-25.54
Austria	1931	1929-33	24,647	23,967	22,044	19,769	19,113	-20.02
Germany	1931	1929-33	262,284	258,602	238,893	220,916	234,778	-12.52
UK	1931	1929-33	261,680	249,551	236,747	238,544	245,507	-5.32
Sweden	1931	1929-33	25,338	26,400	26,128	25,322	26,088	-0.63
Norway	1931	1929-33	9,468	10,181	9,385	9,852	10,099	1.54
USA	1933	1931-35	709,332	615,686	602,751	649,316	698,984	1.76
Denmark	1931	1929-33	17,855	18,917	19,127	18,625	19,220	2.92
Switzerland	1936	1934-38	24,642	24,543	24,626	25,796	26,785	6.90
Belgium	1935	1933-37	38,525	38,202	40,563	40,854	41,404	7.21
France	1936	1934-38	175,843	171,364	177,866	188,125	187,402	8.16
Japan	1931	1929-33	128,116	118,801	119,804	129,835	142,589	10.33
Italy	1936	1934-38	121,826	133,559	133,792	142,954	143,981	12.35
Netherlands	1936	1934-38	40,078	41,575	44,195	46,716	45,593	13.05



Why periphery failed after abandoning the GES ?

- **No export-led growth**

Industry: few comparative advantages

Agriculture: few exportables

Protectionism on the rise everywhere

- **Peripherality: Thin domestic market**

- **Strong employment hysteresis**

- **No loan facilitation: Credit remained stagnant**

- **Weak institutions led to social unraveling and political fragmentation**



The vicious feedback

1. Sudden stop in credit provision:

- ➔ Countries forced to repudiate external debt
- ➔ Further exclusion from the financial markets
(for some countries for decades)

2. Thin domestic markets ➔ Very low borrowing ability

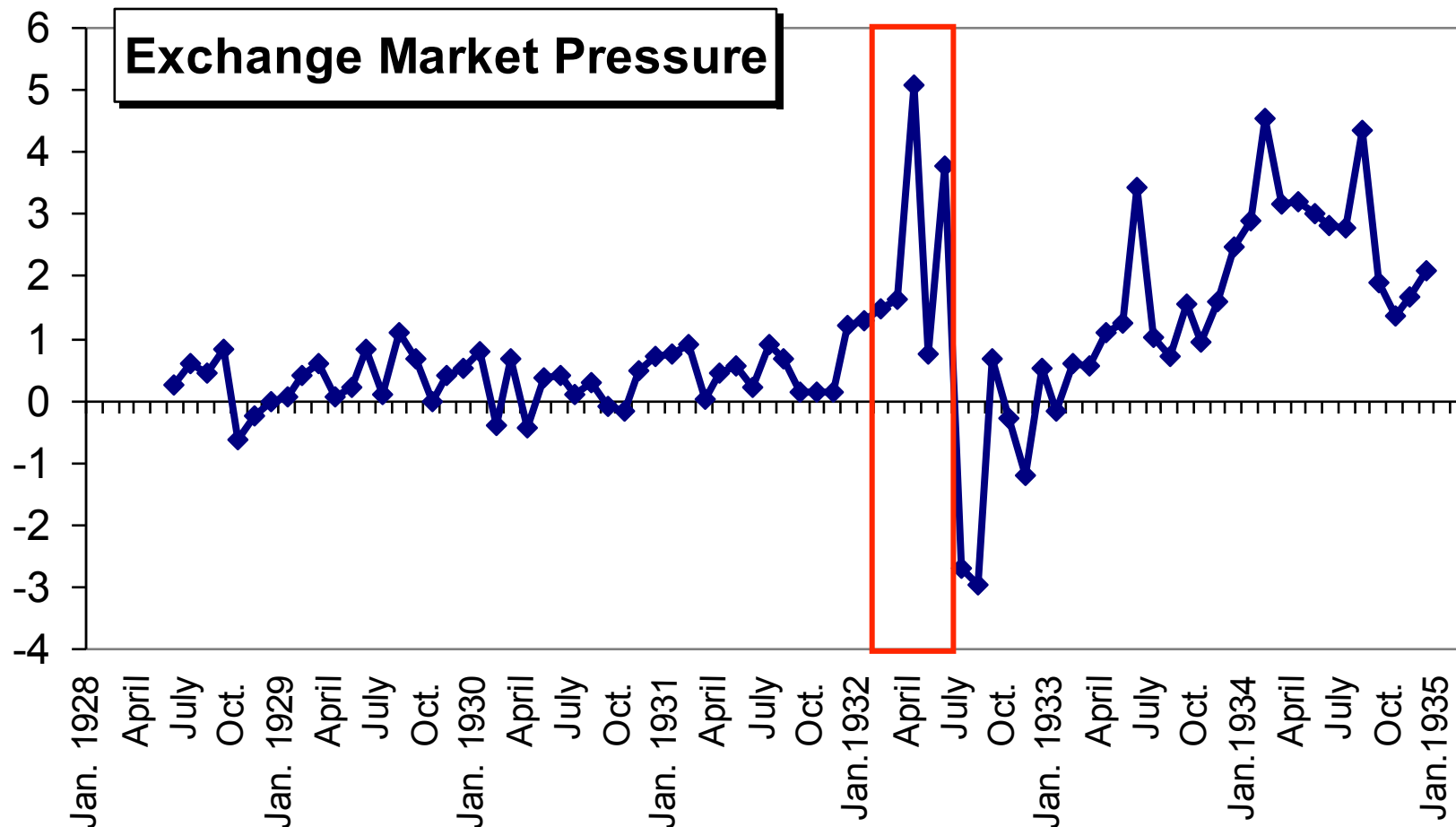
Result: Financial asphyxia

➔ *Perpetuation of the “sudden” stop*

Greece: Exch Market Pressure unabated after the collapse

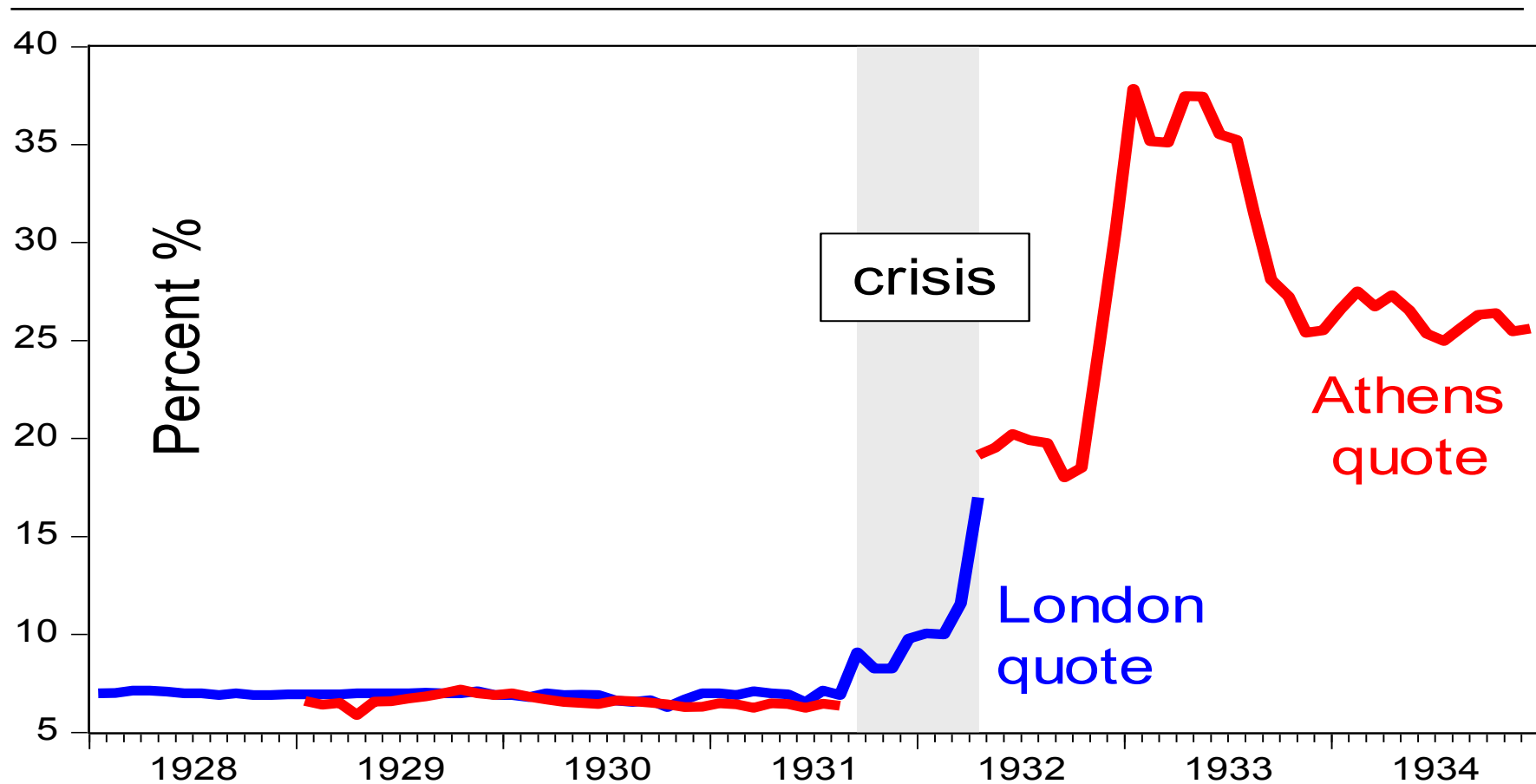
Eichengreen, Rose and Wyplosz (1995)

$$EMP = \frac{\%depreciation}{STD(exch_rate)} + \frac{\%spread}{STD(spread)} - \frac{\%\Delta Reserves(t-1)}{STD(Losses)}$$



Sovereign bond yields soared long after devaluation

Source: **Athens:** average yield of bonds, various issues
London: Global Financial Data, GFD



In fact, Greece returned to the international bonds market only in 1998!

Periphery mainly under autocratic regimes

LESS DEVELOPED

Before

After

Yugoslavia

Repression

Bulgaria

Repression

Brazil

Repression

Hungary

Repression

Czechoslovakia

Democracy

Argentina

Repression

Finland

Democracy

Romania

Repression

Portugal

Repression

Greece

Democracy



Repression

Poland

Repression



Advanced countries mainly under democratic regimes

ADVANCED

Canada	Democracy	
Austria	Democracy	→→ Repression
Germany	Democracy	→→ Repression
UK	Democracy	
Sweden	Democracy	
Norway	Democracy	
USA	Democracy	
Denmark	Democracy	
Switzerland	Democracy	
Belgium	Democracy	
France	Democracy	
Japan	Repression	
Italy	Repression	
Netherlands	Democracy	



Periphery mostly suffered

Peripheral economies did not confirm the prevailing view that

“abandoning exchange rate stability automatically results to recovery and more employment”.

This happened in core economies, not in the periphery.

Keynes: the currency liberation from the “golden fetters”

**For the periphery,
it was perhaps the imposition of the “iron fetters”
that made unemployment to decline and output to grow**



Lessons

Asymmetry: *Now ECB*

Credit stagnation: *Bridge financing (ESM)*

Bail-outs

(though belated, and recessionary)

Peripherality: *Cohesion funds, now too little*

Social impact: *Verbal concern. Poor record.*