EnpRisk - Lecture Notes Week 8

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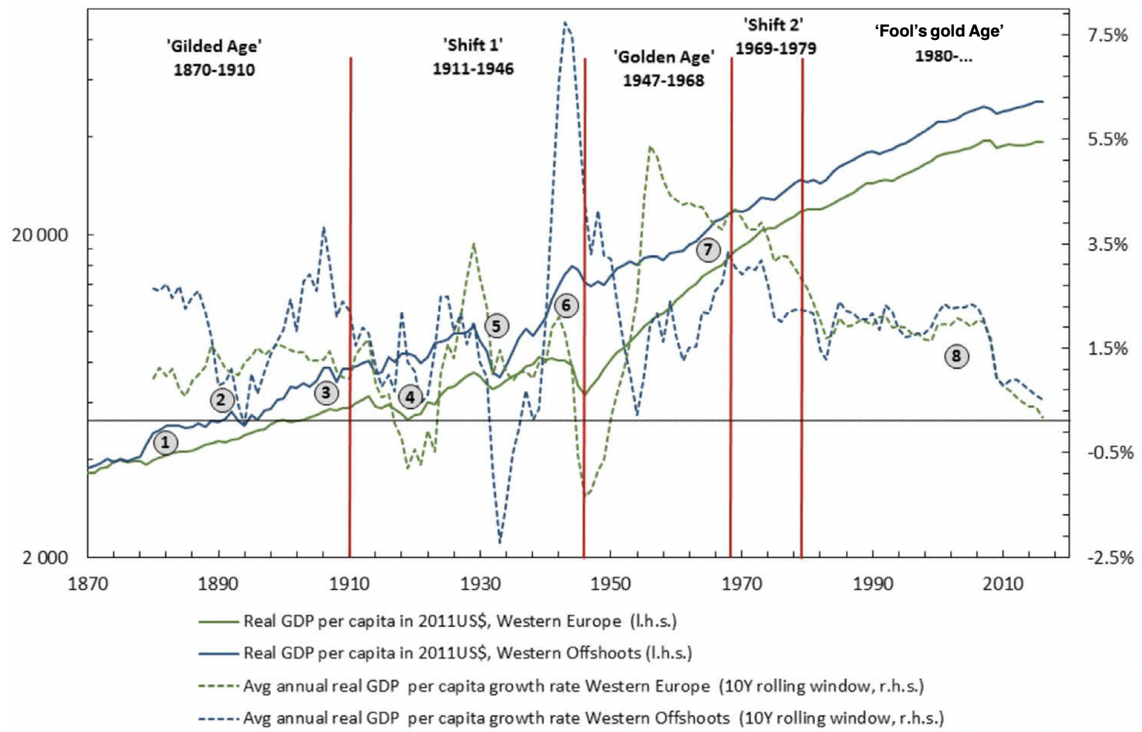
# 1 150 Years of Society, Economy and Technology

## 1.1 Overview




When one structural economic regime passes into another, the economic system goes through a shift. Because each shift experiences the end of one era and the beginning of another, it always comes with *geopolitical, financial and economic disruption and distress.*

However, during these shifts, also reform takes place, where the seed are planted from which a new structural regime takes root.

## 1.2 The Gilded Age (1870-1910)

*"A gilded object looks shiny from the outside. But when you scratch the surface, the underlying material is revealed, and it is certainly not golden."*

In short, the **gilded age** is described by the following points:

- Era of rapid expansion of heavy industries and infrastructure
- Accelerated innovation from the *Technological Revolution* led to interconnected growth such as telegraphs, railroads, transatlantic ship routes, etc.

- First wave of *globalization:* Rise of the "haute finance", centered around the Gold Standard, with the British Pound as reserve currency
- The stock market, during these times, was solid, with high earning qualities and a strong underlying economic growth
- The balance of power, between the newly created nation states, guaranteed geopolitical stability. This prevented the occurrence of any wars between the Great Powers ("Belle Epoque" in France)

However, *inequalities were at a historical high:*

- Urbanization and migration led to an oversupply of labor in the cities
- There was a stagnation of real wages
- There was a decline of the proportion of GDP going to labor

This robber baron capitalism and winner-takes-it-all markets created monopolies: The fruits of progress stayed in the hands of the happy few.

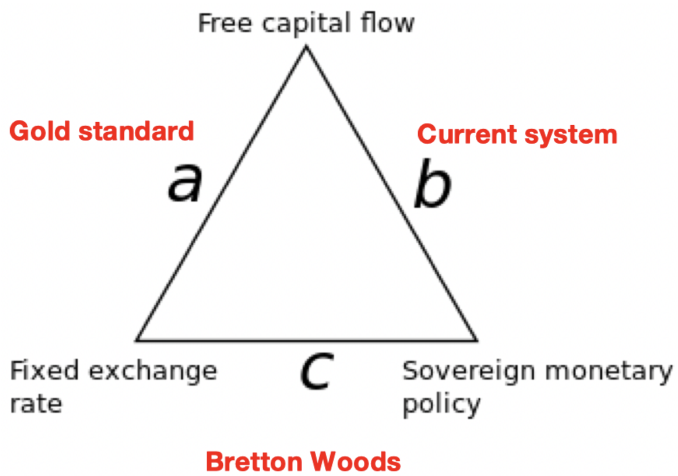
In general, the Gilden Age was a period of wild financial and economic expansion with a *lack of institutions and regulations* to smoothen boom and fight bust. As a result, we see multiple cycles of boom, panic and depression:

- 8 years of overinvestment and speculation, and a railroad boom after the end of the American Civil War (1865) ended in the panic of 1873
- This was followed by the *Long Depression* which lasted until 1879
- A new boom started, pushed by the Technological Revolution, which lasted until the panic of 1893, ensued by another depression which lasted until 1897
- This was then followed by another boom, which ended in a massive banking crisis in 1907

Economic policymakers want to achieve three goals:

1. Open their country's economy to international flows of capital to allow the nation's citizen to diversify their investments abroad.
2. Follow an independent monetary policy to stabilize their economy and support employment in times of need.
3. Have a fixed foreign exchange rate which brings stability and trust in the international trade and investment.

However, the *trilemma of international finance* states you can only have two out of the three:



## 1.3 The First Shift (1911-1946)

During the **first shift** (1911-1946), there was an institutional reform with Roosevelt's New Deal (1933-1939):

- Stabilizing the banking system through bank reform acts
- Suspension of the Gold Standard, with freely floating US Dollar and increase of money in circulation by Federal Reserve
- Increase transparency in the stock market by mandatory publication of balance sheet, profit and loss statements, etc.
- Public works and relief: Hire unemployed to build schools, municipal buildings, waterworks, sewers, streets, etc.
- Social security act establishing a permanent system of pensions, unemployment insurance, etc.
- National Labor Relations Act: guaranteed workers the right of collective bargaining through unions
- Fair Labor Standards Act set a maximum of 44 hours of work per week and minimum wages, child labor under 16 was forbidden
- Wealth Tax Act: Redistribute wealth by imposing a tax of 79% on incomes over 5 million USD

Finally, in the summer of 1944, 730 representatives of 44 countries gathered at the **Bretton Wood** conference with the goal of *redesigning the international monetary system.* The new system should:

- Replace the monetary chaos of interwar period with a new international system that would support trade through stable exchange rates
- Free trade was preferred to free capital flows, especially in short-term "hot money" flows and capital flight. As such, it was explicitly recognized that countries need to impose capital controls
- Each country could still follow an independent monetary policy to fight recession and stimulate employment