

**CHAPMAN UNIVERSITY**  
**University Honors Program**  
**One University Drive**  
**Orange, CA 92866**

**COURSE SYLLABUS**

**HON 337**  
**Credit, Growth and Economic Cycles**

**Spring 2010**

Catalog Description:

*Prerequisite: acceptance into the University Honors Program, or consent of instructor.* This course examines the interaction between credit and economic development, the impact of limitations of existing credit systems over the past millennium, responses undertaken to alleviate observed weaknesses of the credit system, and the tendency for the economy to grow and contract with credit cycles. (Offered as needed.) 3 credits.

Course Objectives:

Credit is a fundamental element of economics, because it simultaneously allows some individuals and organizations to accumulate resources in a reserve against future needs (i.e., to save) and it allows other individuals and organizations to acquire resources in the present and put them to productive use (i.e., to borrow). Systems of credit, though, are fragile because loans are made against uncertain income streams and because banks and financial institutions need to use their loan payments to pay their own creditors (such as depositors). When too much lending takes place in some markets and defaults escalate, banks and financial institutions can become unstable, as we recently saw when widespread defaults hit the mortgage market.

The purpose of this course is to investigate:

- how credit markets have functioned
- how breakdowns have occurred
- how credit market institutions have developed to safeguard the credit system over the past 800 years.

Content:

Credit is one of the primary means that society employs to undertake projects that involve significant outlays of resources. From medieval trade ventures across the

Mediterranean to the nineteenth century construction of railroads across North America, credit played a central role in the aggregation of resources for large enterprises. In the past eight centuries, credit has undergone one transformation after another: as its scale increased new problems repeatedly appeared in the credit system and new arrangements have been devised to cope with emerging problems and opportunities.

Growth of credit in the thirteenth century challenged the capacity of bankers to manage account information and led them to develop double-entry bookkeeping. The need to move funds between commercial centers without the risk of moving gold or silver led to the creation in the early fourteenth century of the bill of exchange, which ultimately proved to be the basis for most modern financial instruments. Credit practices appear to have changed little between the late fourteenth and the early seventeenth century. All this time, credit was primarily used to finance imports and exports, but most goods were produced by artisans who financed their own production or operated only with small loans from local bankers. By the middle of the seventeenth century, the English began to use credit not only to finance trade, but also to finance production. In the seventeenth century merchants developed the practice of transferring credit instruments by endorsement (technically called 'negotiability'), which allowed the bill of exchange to be transferred from person to person. This turned credit instruments into a circulating medium of exchange - that is, paper money.

At every step, market-based economic activity and the credit system have developed together. The adaptation of credit to production finance in seventeenth century England began a process of consolidation of manufacturing that laid the foundation for the industrial revolution. In the past two centuries especially, credit systems have been employed to solve ever more challenging problems, breakdowns have repeatedly appeared, and institutions and practices have been developed to manage vulnerabilities. The large outlays for the canals and railroads that spanned North America in the nineteenth century required the deployment of capital for many years, whereas credit for trade only needed to be deployed for months. These projects often involved massive investments into sparsely developed areas, which involved much more uncertainty than the trade ventures that began centuries earlier or even the industrial investments of a half century earlier. Breakdowns of the credit system were frequent, and numerous innovations in the system of credit were tried over the course of almost a century to prevent future problems and raise the capital needed to expand a transportation network across the continent and develop ever larger industrial

enterprises. Without these developments, integration of the American economy and its rapid growth would have been impossible.

Although developments in credit markets contributed to the growth of the American economy in the nineteenth century, much of the evidence suggests that business cycles were more volatile in the nineteenth century than they have been in the twentieth century. One problem was that, prior to the establishment of the Federal Reserve banks in 1914, most currency was issued by banks, so the money supply would contract during business downturns when bank lending fell. The primary objective of the Federal Reserve System was to inject money into the financial system when it was needed to prevent deflation. So the Federal Reserve System – a central element of our financial system – is essentially a credit operation that is used to manage the availability of money and promote stable growth of money and credit.

The purpose of this course is to examine the evolving nature of systems of money and credit from the middle of the eleventh century through the early twenty-first century. The course will emphasize three interrelated problems. One problem is the interaction between credit and economic development. Another is the impact of limitations of existing credit systems over the past eight centuries, and the private and public responses undertaken to alleviate observed weaknesses of the credit system. The third problem is the tendency for the economy to grow and contract with credit cycles, the problems of control of the credit system that this tendency has generated, and the private and public responses that have developed to manage economic cycles.

#### Current Required Texts:

Pirenne, Henri (1925). *Medieval Cities: Their Origins and the Revival of Trade*. Princeton: Princeton University Press.

Rogers, James Steven (1995). *The Early History of the Law of Bills and Notes: A Study of the Origins of Anglo-American Commercial Law*. Cambridge: Cambridge University Press.

Friedman, Milton and Anna Jacobson Schwartz (1965). *The Great Contraction, 1929-1933*. Princeton: Princeton University Press.

#### Instructional Strategies:

Instruction will be based on lectures, discussions, experiments, and readings. Readings will cover a wide historical range, from the development of sophisticated credit networks in medieval Italy to the recent and continuing economic crisis, which was triggered by serious miscalculations in credit markets.

There are few benefits from the ongoing problems in the U.S. economy, but one of them is that we can comfortably dispense with the idea that there is a canon of work on credit markets that explains their operation and that provides reliable guidance for policy makers and financial market professionals. Credit is not only an important economic function; it is also one that requires critical thought.

Methods of Evaluation:

Evaluation will be based on homework exercises, exams with both short problems and short essays, and a paper of about five pages. Written work will be evaluated not only on the basis of content but also structure and style. Clear presentation, organization, and a persuasive argument are all keys to effective writing and the development and dissemination of influential ideas.

Chapman University Academic Integrity Policy:

Chapman University is a community of scholars which emphasizes the mutual responsibility of all members to seek knowledge honestly and in good faith. Students are responsible for doing their own work, and academic dishonesty of any kind will not be tolerated anywhere in the university.

Students with Disabilities Policy:

In compliance with ADA guidelines, students who have any condition, either permanent or temporary, that might affect their ability to perform in this class are encouraged to inform the instructor at the beginning of the term. The University, through the Center for Academic Success, will work with the appropriate faculty member who is asked to provide the accommodations for a student in determining what accommodations are suitable based on the documentation and the individual student needs. The granting of any accommodation will not be retroactive and cannot jeopardize the academic standards or integrity of the course.

**Prepared by:**

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August 10, 2010

**Last revised on:**

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