



## Economics

### Question

Write an essay of around 1,000 words on the following prompt:

*'Are financial crises inherent to modern economic growth?'*

### Background

Financial crises are a recurring phenomenon in the world economy. As I prepare this task, central banks are grappling with the proper way to respond to the collapse of Silicon Valley Bank and Credit Suisse. This new emergency comes on the heels of the Eurozone debt and liquidity crisis (2009-2015), the global financial crisis which triggered the Great Recession (2008-2009), the collapse of the dotcom bubble (2000), the 1997-1998 banking and debt crisis in East Asia, Russia, Brazil and Argentina, the Latin American debt defaults of 1994, and the Japanese financial collapse in 1990-1992—to name just the several most recent and most prominent episodes.

The aim of this question is to challenge you to think about the functions the financial system carries out in an economy and the reasons why it might be prone to instability. One of the basic functions of the financial system is to provide what is called *maturity transformation*: bundling together short-term investments (bank deposits, shares, bond purchases, etc.) to meet long-term purposes, particularly ones which have yet to bear a return (and may never do so: business ventures fail, debt is prone to default, and so forth). Think about the benefits and the disadvantages of this function: how it can help to get business ventures off the ground (it may be useful to think through this in terms of economies of scale and the investment that's necessary to achieve them), and, conversely, what happens when there is a rush to withdraw the short-term assets on which the system rests (such as a bank run, or the collapse of an asset bubble).

Your challenge is to form a reasoned argument about the benefits and drawbacks of the financial system in generating economic growth: is a financial system *necessary* for this growth to occur; and, if it is, can appropriate policy mitigate the risks while preserving the benefits, or are financial crises the price we have to pay for living in a growing economy? This is a broad—and challenging!—question, and there is no single 'right answer'. Creativity and original insight is the main thing we are looking for. The suggested readings below will get you started, but reading and above all thinking beyond them will make your work stand out.

You may have noticed that there is an *ethical* dimension to the question: for instance, one way policymakers have found to mitigate the effects of financial crises has been to bail out systemically important institutions when they are at risk of collapsing (even if this was due to those institutions' own poor business decisions), at the expense of taxpayers such as, eventually, yourself. (This is the problem of "too big to fail", or in economic jargon *moral hazard*.) Do not shy away from the ethical dilemmas! Economics is social philosophy as much as social science, and to be a good social scientist you must take the philosophy seriously.

## **Guidance**

This is a challenging question, which takes you far outside the core A Levels syllabus and into one of the biggest areas of macroeconomic debate. The readings provided should give you a starting point for orienting yourself in the debates, and give you some relevant historical context, but you are encouraged to—indeed, you will probably need to—draw on your own knowledge of the subject and economic commentary in the media.

I give you four readings (or three readings and a video) to start off with. Kindleberger's book is a classic (and opinionated!) work on the causes of financial crashes, from a broadly Keynesian tradition. The Eichengreen reading will provide useful historical perspective on financial crises both recent and remote, and the author is keenly concerned with drawing connections between them. The Janeway book offers a provocative argument that financial crises are *inseparable* from innovation, with implications for how (and whether) one can address them. Finally, the Dybvig Nobel Prize lecture (not a reading in the strict sense of the term!) should give a relatively accessible argument in support of the claim that a better understanding of financial crises can do much to prevent their occurrence.

Don't get bogged down trying to get your head around every last point. Read through quickly first to get the main ideas, and then go back and read more carefully the parts that you think might be useful for framing an argument.

Once you've read the papers, put all your outtakes on a sheet of paper—the larger, the better—and think about how they fit together. You may want to draw lines connecting them. Make sure to also include your own thoughts and responses. This should give you the raw materials to write the essay.

Then step away, at least to sleep on it but preferably for a few days. Keep coming back to your mind map and noting down new ideas that come to you. If there is any particular direction that's suggesting itself, do more reading and especially more thinking in that direction! The more creative your answer, the better!

Once you've let the ideas sit, it's time to formulate a *thesis statement*, which is a one-sentence answer to the question. For instance: "In this essay, I argue that being treated with dignity is necessary for innovation, and therefore dignity deserves to be called a factor of production." But this is just an example: feel free to disagree with the prompt, or to introduce your own angles to the discussion!

Then you will want to pick out three main points to anchor your body paragraphs. Each of these should be one argument in support of the overall case you're making, and it would be ideal if you could link them together into an overarching narrative. For instance, Point 1 could be from Eichengreen, that the free flow of capital between countries helps make international trade possible but has also historically been a source of financial instability. Point 2 could be your take on Janeway's argument that the bubbles that this free flow of capital encourages can be useful in that they help to generate the scale of investment needed for innovation to occur.

Once you've got your three points, it's time to start writing. Start with an introduction paragraph that puts the question in context and presents your thesis statement (that's your one-sentence answer to the prompt).

Then create *topic sentences* that explain how the argument you will be making in each body paragraph provides evidence for your thesis. Use each topic sentence as a starting point for the body paragraph, and then spend the rest of the paragraph backing up your point with evidence and your own critical discussion. (Again, you are very welcome to bring in views and perspectives from outside the readings!)

Finally, bring everything together in a concluding paragraph that summarises what you have argued and ideally takes everything one step further. For instance, if you agreed with Dybvig that policies such as

deposit insurance have succeeded in making bank runs much rarer than they must were, you might think about the extent to which the moral hazard generated by these policies must itself be addressed through regulation.

A note about referencing: *you will need to cite sources*. The most usual way to do this in economics is to use a footnote referencing system such as the Chicago style, with a bibliography at the end. [This](#) resource walks you through the process of using footnotes to reference material, and [this](#) page shows you how to make a bibliography. Using a citation manager program like Endnote, Mendeley, and Zotero is a major time saver and can automate much of the work for you. There is no reason for you to have to write out the bibliography entries by hand!

And there you go: that is how you write a Cambridge essay! It requires a lot of creative and independent thinking, but I've found the end result to be very rewarding. I hope you feel the same way when you're finished!

Good luck, and I heartily look forward to seeing what you come up with!

### **Suggested Readings**

Aliber, Robert Z., and Charles P. Kindleberger. *Manias, Panics and Crashes: A History of Financial Crises*. 7th ed. Houndmills, Basingstoke, Hampshire ; New York: Palgrave Macmillan, 2015.

#### **Chapters 1-2**

Eichengreen, Barry J. *Globalizing Capital: A History of the International Monetary System*. 3rd ed. Princeton ; Oxford: Princeton University Press, 2019.

#### **Chapter 1 and chapters 5-7**

Janeway, William H. *Doing Capitalism in the Innovation Economy: Reconfiguring the Three-Player Game Between Markets, Speculators and the State*. 2nd ed. Cambridge, United Kingdom ; New York, NY: Cambridge University Press, 2018.

#### **Chapter 9 (though all of Chapter 7 onward is directly relevant, if you have a lot of time and energy)**

Dybvig, Philip. *Multiple Equilibria*. Lecture. Nobel Prize Lectures in Economics. Stockholm, 2022. <https://www.nobelprize.org/prizes/economic-sciences/2022/dybvig/lecture/>.

If you would like access to these readings, please fill in [this form](#) and they will be provided to you via email.