History is typically written with hindsight; many years after events take place, historians pick the ones that made a difference *ex post*, and these are the events that end up in history books. But it is often unclear if contemporaries shared the views of later historians regarding the importance of certain events. For example, is it clear that certain events in Europe, the Balkans and North Africa that, with hindsight, were often described as leading “inevitably” to World War I were really viewed as signals of an impending catastrophe by contemporary observers? The battle of Gettysburg, from today’s perspective, was clearly decisive; but were there other battles and turning points in the Civil War that contemporaries regarded as important at the time but did not reach modern textbooks? One way to approach these questions is to read commentaries and text written by contemporaries; another approach, the one taken in this chapter, is to observe the behavior of financial markets and the pricing of traded assets around the time of major events. This enables researchers to infer from the behavior of contemporary investors what they thought about on-going events.

For example, Willard, Guinnane, and Rosen use data on fluctuations in the gold price of “greenbacks,” a currency issued by the Union during the American Civil War, to assess the perception of war-time events by contemporary investors. They find significant differences between what contemporaries regarded as important (that is, events that resulted in substantial changes in the prices of “greenbacks”) and what historians writing about the Civil War many years later described as crucial. Similarly, one of today’s most prolific historians, Niall Ferguson uses data on several European stock markets in the years preceding World War I to...
refute some of the claims about the inevitability of the war, at least as far as contemporary investors were concerned. 

Assessing the perception of Meiji Japan by British investors using data from the London Stock Exchange is also an exciting intellectual exercise. Japanese government bonds were traded in London starting in the early 1870s, and events taking place in Japan were reported regularly in the British press. What events, then, impressed British investors and made them change their minds about the credit worthiness of the Japanese government? What types of news from Japan were interpreted as credible signals of development and modernization?

In this chapter we use data on prices and yields of Japanese sovereign bonds traded in London between 1870 and 1914 to establish the importance of Japan’s victory over Russia in this respect, both in absolute terms, and relative to other events of the Meiji period. We argue that the variety of reforms and new institutions established between 1870 and the beginning of the twentieth century did little to affect the way Japan was perceived by British investors, at least not in the short term (one exception to this statement will be discussed below). Neither did the war with China have a major effect on the image of Japan in the London Stock Exchange. By contrast, Japan’s victory over Russia in 1905 did far more to establish Japan’s reputation as a trustworthy borrower than most of the preceding events of the Meiji Period; indeed, in the first decade of the twentieth century the Japanese government was, by some measures, the largest foreign borrower on the London market, and borrowing terms (cost of debt, collateral required, and so forth) were better than at any time in the preceding four decades.

Our empirical analysis focuses on what economists and financial observers usually call the “risk premium.” In general, a risk premium is the additional interest payments a risky borrower has to offer investors in excess of the risk-free rate in order to be able to borrow. In the context of sovereign debt, risk is typically the risk of default – the likelihood that a country will not be able to pay off its debt, as has happened many times in many countries throughout history. In the context of Meiji Japan, the risk premium is defined as the yield differential between Japanese government bonds traded in London and British government “consols” (perpetual bonds with no redemption date) which were regarded as risk free. Using stock market data from The Times, London we measure the risk premium on Japanese sovereign bonds at the end of each calendar month between 1870 and World War I. This enables us to derive an objective measure of the impact of events taking place in a given month on the risk premium. In other words, changes in the risk premium measure changes in the perception of Japan’s country risk in the eyes of British investors.

In general, we find that the risk premium, or yield differential (typically called “spread”) between Japanese and British government debt declined substantially during the period from 1870 to World War I. In addition, Japan’s ability to raise capital and borrow abroad increased