

Lessons of the Great Depression

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Many thanks. I am very honored to be invited to speak here today.

We have just weathered the worst financial crisis and economic storm since the Great Depression.

Now it has to be said that financial crises are nothing new. They have been with us for a very long time, ever since the invention of credit. In fact the first documented financial crisis can be dated back to AD 33 when a run developed on the credit system of the Roman Empire and the Emperor Tiberius was forced to inject a million gold pieces of public money to keep the Imperial financial system from collapsing.

Not only have they been with us for a very long time, we have had a lot of them over the years. By one count there have been fifty different episodes since the South Sea Bubble of 1720, which by the way gave us the word bubble to

describe an out of control financial mania.

I suppose the good news is that we have always recovered from these financial spasms. The bad news is that we keep on making the same mistakes over and over again.

The frequency of these financial spasms seems to vary. During the 19th century and the early part of this century they seemed to occur about every 10 years. After the Second World War, the system seemed to go dormant from the 50s to the 70s, perhaps because banking and international capital flows were so tightly regulated.

Beginning in the mid 1980s something happened to reactivate the volcano and financial crises once again seemed to become an endemic feature of the economic landscape.

We had had a crisis in 1982 with the emerging market debt crisis; another mild one in 1987 with the stock market collapse, another in 1990 associated with the savings and loan debacle, one in 1994 in Mexico; then in 1997 and 1998, beginning with Asia, then Russia the Long Term Capital, in 2000 with the telecom

and dot com bubble and finally now.

It was in order to understand financial crises, why they start, how they develop, what to do about them and most importantly what not to do, that I began to research the mother of all crises that one that began in 1929 and led to the Great Depression.

As I read about the Great Depression, it became increasingly apparent there was nothing inevitable about the economic collapse that began in 1929. The Great Depression was not the result of the contradictions of capitalism or of some inexorable economic forces against which the people in charge were powerless. The Great Depression was the result of policy errors...plain and simple human error by central bankers and key economic officials.

In doing my research I stumbled across the fact that the four key central bankers of the era— Montagu Norman of the Bank of England, Benjamin Strong of the Federal Reserve Bank of New York, Hjalmar Schacht of the Reichsbank, and Emile Moreau of the Banque de France – were dubbed by the newspapers of the time, “the most exclusive club in the world.” It struck me that telling the story of the policy blunders of the early 1920 and 1930s, by looking over the shoulders as it

were of these four men would be a great way of highlighting the thesis that the Great Depression was the result of bad policy decisions.

Who were these four men?

In the early 20th century Britain and the pound sterling were the linchpins of the global financial system. The central figure in my book therefore was the Governor of the Bank of England, Montagu Norman. Most people now don't know his name. But in the early part of the 20th century, he was the most important central banker in the world. His name evoked the same sort of mystique that at his height Alan Greenspan's did. And very poignantly, his reputation cratered in much the same way and for some of the same reasons that Alan Greenspan has done.

Norman came from the British banking aristocracy. His father's family owned a bank called Martins Bank, which is now part of Barclays. His maternal grandfather was the senior partner of Brown Shipley, the English arm of Brown Brothers.

Both his grandfathers were on the board of the Bank of England—then and still quaintly known as the Court of the Bank—and one of his grandfathers also

became Governor. The Bank of England was then run like a private club. So the Governorship of the Bank of England was almost a hereditary position for him.

Norman was however a very unbankerly like man. In those days, bankers typically wore top hats and black frock coats. Norman insisted on wearing a big floppy hat and a cape. He sported of a big emerald tie pin. The New York Times once described him as "looking like the chief conspirator out of an Italian opera."

Though the fate of the British economy depended largely on his decisions, he did not believe in economics. He once told the Chief Economist of the Bank of England that, "Your job is not to tell us what to do, but to tell us why we did what we did." On the other hand he did believe in all sorts of esoteric religions and dabbled in spiritualism.

He also suffered from a major problem as a central banker. He suffered from severe manic depression. At times of crisis, he was simply unable to cope with the tension, would regularly have nervous breakdown and take to his bed. I don't have to tell you that that is not a good attribute for a central banker.

His best friend was Benjamin Strong, the Governor of the New York Fed,

who by the way had been one of the 4 bankers at that secret meeting on Jekyll Island. The Federal Reserve in those days was a very different institution. When Congress created the Fed in 1914, it had been worried about vesting too much power in a single institution. So it created 12 regional Federal Reserve Banks, in effect 12 mini-central banks. The Federal Reserve Board in Washington was essentially a supervisory board, a sort of a regulatory body. Woodrow Wilson, then President, had argued that the Board should not consist of bankers because they would tend to be biased in favor of the banking industry. As a result the Board was filled the minor political hacks and small town businessmen who knew nothing about finance or banking.

As the Governor of the New York Fed, the largest of the regional reserve banks, Benjamin Strong was essentially the most important financial official in the U.S. Appointed the head of the fed at the age of 41, he was part of a generation that were protégés of J.P. Morgan, had reached professional maturity in the years just before the First World War and believed that the U.S. should begin to exert its financial muscle on the world stage.

One of the fun things about writing a book is coming up with epigraphs at the beginning of chapters. The epigraph for the chapter that introduces Benjamin

Strong is a quote by F. Scott Fitzgerald, “Show me a hero and I will write you a tragedy.”

For all his success as a banker, Strong unfortunately had a very tragic personal life. His first wife committed suicide in 1905. He remarried a young woman half his age, an heiress, the daughter of the Chairman of Bankers Trust who by the way was his boss at the time. In 1916 his second wife left him, because in taking the job of head of the New York Fed, he had to take an enormous salary cut, and she found it difficult to cope with the change in lifestyle

That same year he developed tuberculosis after a trip to Europe. The disease was then the single most important cause of death. Before antibiotics, there was no cure. Doctors recommended patients move to sanatoria high up in the mountains because they believed the thin, dry air would allow your lungs to regenerate themselves

So here was Strong, after the First World War, trying to keep the world afloat, suffering from tuberculosis and at the same time having to spend months at a time in Colorado trying to recuperate. He started taking a lot of morphine for the pain and essentially destroyed his digestive system. In 1928, he was hospitalized

with diverticulitis and died tragically on the operating table. Many people, including such prominent economists as Irving Fisher of Yale and Milton Friedman of Chicago believe that had Strong lived, the Great Depression would not have happened and the history of the world in the 20th century might have been very different.

In the 20s, Ben Strong and Monty Norman became great friends. They would vacation twice a year together. Monty would come over to the States at Christmas, and they would go up to Maine for a few weeks. Then Ben would take a liner over to Europe in May, and he'd spend four months in Europe—this was a different era long before Black Berries. After visiting central bankers around Europe, Ben and Monty would go off to very nice resorts--one year to Biarritz, another year to the Hotel du Cap on Cap d'Antibes, which by the way if you have never been is in my view the most beautiful hotel in the world.

The third character of the plot was the President of the Reichsbank, Hjalmar Schacht, or to give him his full name, Horace Greely Hjalmar Schacht, so named because his father had once lived in Brooklyn and was a big fan of Horace Greely. Schacht was a brilliant man, but a complete opportunist. He came to power in 1923 and saved Germany by curbing hyperinflation. During the 1920s he oversaw the

German economic miracle. Despite gigantic reparations that Germany owed to the Allies, Schacht presided over a boom in Germany, fuelled by foreign borrowing. Schacht very deliberately allowed Germany to get into debt to American bankers figuring that he could then get them to exert pressure on Britain and France to lower their reparations demands on Germany.

In 1930, after the Great Crash, Schacht realized that Germany was bound to go through the wringer. So he resigned because he didn't want to be blamed for the Germany's troubles. By the way I should interject here that one of the most difficult things in writing history is attributing motives to why people act. There is often no ambiguity about what they did. Figuring out why they did what they did is very hard—in part because they are often not completely honest or because they often don't even know themselves.

Schacht resurfaced three years later in 1933 as Hitler's Minister of Economy. He presided over a second German economic miracle in the '30s, very different from the earlier one. This one was not built on borrowed money—Germany had defaulted on all the debts it had incurred during the 1920s. This economic miracle was based on autarchy and rearmament.

Schacht then fell out with Goring in 1939. He spent the war as a private citizen. Though he was part of the German resistance to Hitler, he was somewhat on the fringes because no one ever trusted him. A contemporary said of him that “Schacht is a man who has no friends, only enemies.” He was arrested by the Nazis following the July 20th plot in 1944 and sent to Dachau. When the Americans arrived in 1945, Schacht had every hope of being treated as a hero—he even harbored hopes that he might be invited to be President of a post war Germany. Instead the Americans arrested him, and he was one of the main people tried at Nuremberg. He was one of three to be acquitted and then lived to a ripe old age of 90-something and died in 1970. He was a man with nine lives.

The final principal character in the book is a Frenchman, Emile Moreau. Unlike the others, he was a civil servant, not a banker, a member of the elite French cadre of Inspecteurs des Finances. He was like a character out of Flaubert. He remained the mayor of this little town near Poitiers for 35 years, and while acting as the Governor of the central bank, he would go off periodically to run things in this little village.

Like so many Frenchman of the time, Moreau believed that international finance was an Anglo-Saxon conspiracy designed to exclude the French from their

rightful place in the world. Some things never seem to change. He refused to learn English. He hated Montagu Norman, whom he accused of plotting against France. Norman reciprocated the feeling and was very condescending and supercilious towards Moreau.

As you can tell these four personalities were all interesting in their own way. But they also provided a very nice frame for telling the story of the Great Depression. For three main reasons:

First, an important theme of the story is that the men in charge of economic policy are just human beings, as fallible as anyone else. Like all groups of men they have a tendency to be hampered by their own insular outlook and limited horizons. And that when put them on a pedestal and invest vast amounts of power in their hands disaster is inevitable. That it seems to be is a theme that should resonate today.

Secondly, by having 4 characters, one from each of the major economic powers of the times highlighted the fact that is often forgotten, especially in the U.S.: that the Great Depression was a global phenomenon. By that I mean not only that it affected the entire world. More importantly it had its roots in the

malfunctioning of the global economy. People forget that 1929 occurred only ten years after the end of the First World War. The causes of the Great Depression can be largely traced to the aftermath of that war, its legacy of reparations and war debts and the disruptions to the European financial system and structure of currencies caused by it.

Third, one of the difficulties in writing history is that while we now know how things turned out, what happened in the end, the people involved did not. Think about now. Do we know how the current situation is going to turn out? Are we out of the woods? Is another stimulus package necessary? Are we going to be condemned to a lost decade like that of Japan's? No one knows or can know. Only when it's all over will we find out. I thought that telling the story of the Great Depression by looking over the shoulders, as it were, of the key officials involved was a way of conveying the fundamental uncertainty of the lived-in moment.

What are the parallels between what happened 80 years ago and what has happened today? And what are the lessons? I would like to answer that by breaking up the chronology of events into three stages: the lead up to the crisis; the handling of the crisis; and finally the recovery.

Let me first focus on the lead up. The parallels between the lead up to 1929 and the lead up to the current crisis are eerie. In both cases, we had a bubble. Then it was in the stock market. This time, it was in real estate.

In both cases, the bubbles were created by a mistake in Fed policy. In both cases in my view the mistake was exacerbated if not caused by a malfunction in the international financial system.

In the 1920s, the problem was between Europe and the U.S. After the First World War, central bankers made a big error in economic policy—they took the world back onto the gold standard. They thought that by trying to turn the clock back to the golden age before 1914, they were rescuing the world from monetary chaos. Instead of saving the world however, they set the stage for and presided over the greatest economic collapse.

Let me spend a couple of moments on what happened. The first key problem with the gold standard was that gold supplies had not kept up with prices during the First World War. Going back to the gold standard was like putting the world back into too small a strait jacket. The second problem was that after the turmoil of the First World War, most of the world's bullion ended up in the U.S. International

finance was like a game of poker where one player ends up with all the chips and the game never gets off the ground.

Central bankers were only able to keep the world economy going by keeping credit in the U.S. artificially cheap and by trying to keep Europe, particularly Britain and Germany, afloat on borrowed money. The problem was that the same cheap credit that was necessary to keep Europe from bankruptcy also precipitated a bubble on the New York stock exchange. It was a system that held the seeds of its own destruction.

The Fed became torn between two conflicting goals—to keep propping up Europe or to control speculation on Wall Street. It tried to do both and achieved neither. Its attempts to curb stock speculation were too half-hearted to bring Wall Street back to earth but powerful enough to cause a collapse in lending to Europe, driving most of central Europe—especially Germany into depression. Eventually in the last week of October 1929, the stock market bubble burst, plunging the U.S. into its own recession.

In the 1920s, the problem was between Europe and the U.S. By contrast, the recent bubble was associated with the international imbalance between the U.S.

and Asia. Among other problems, this led to a massive accumulation of dollars in the hands of Asian central banks which ended up providing the fuel for the credit and real estate bubble.

In both cases, then and now, over easy credit and the bubble led to over leverage. Then it was in the vehicles for investing in stocks, especially in the investment trusts, which were essentially leveraged closed end funds, and pool operators, which functioned a little like the hedge funds of today. This time the over leverage was in what has come to be known as the “shadow banking system,” which includes investment banks, so called credit hedge funds, other funds known as “conduits” which were those mysterious off balance sheet special purpose investment vehicles set up by banks to avoid capital adequacy regulations. It is known as the “shadow banking system” because these institutions operate like banks—borrowing short term and lending long term—without the same regulations to which banks are subject.

Eventually both bubbles—the stock market in the 1920s and real estate earlier this decade—burst as bubble always. And both then and now the bursting of the bubble eventually led to a banking crisis. In the 1930s we had a conventional run on the banks. In the absence of deposit insurance, depositors lined up outside

banks to pull their money out and literally put it in their mattresses.

This time round, because we have deposit insurance, we did not see much of that, though we did see bank runs in the U.K. on Northern Rock, in the U.S. with Indy Mac and in Hong Kong with the Bank of East Asia.

This time we experienced a run on the "shadow banking system." Instead of people physically lining up outside banks there was a digital run. The shadow banking system any depend for its financing not on individual depositors but on wholesale sources of money. Institutional investors such as money market funds withdrew massive amounts of money from the shadow banking system overnight, literally hundreds of billions of dollars with the click of a mouse.

The mechanics of what happened were however very similar to the 1930s. As investors withdrew funds, these shadow banks were forced to liquidate assets in a falling market at fire-sale prices. Most like Bear Stearns or Fortis, the Dutch and Belgian bank, were rescued. Some like Lehman were driven into bankruptcy. Suppliers of credit, with no way of knowing which investment banks were ok and which were not, pulled their money out of all investment banks, good or bad, indiscriminately. This in turn caused credit availability right across the economy to

collapse.

Both after the bubble of the 1920s burst and today we had many of the same tales of financial skullduggery emerging into the open. Every financial crisis throws up a signature crook. This time it was Bernie Madoff.

The Bernie Madoff of that time was a Swedish industrialist by the name of Ivar Kreuger. He began as a manufacturer of matches, controlling a company called the Swedish Match Co.

In the early 1920s he became a sort of international banker. Because of the overhang of debts after the First World War, most countries had a hard time borrowing on international capital markets. The Swedish Match Co on the other hand had such a reputable business, that it could raise capital in New York at better rates than many countries. Kreuger decided to exploit this competitive position by raising money in New York, and offering to lend the money to countries in return for a national monopoly over match- manufacturing. Among the countries where he struck such deals were Ecuador, Peru, Poland, Greece, Hungary, Yugoslavia and Romania. In 1926 he negotiated a similar arrangement in France and in 1929 in Germany.

Kreuger was an interesting character. He had six or seven residences, apartments in London, Berlin, on Park Avenue in New York and on the Avenue Victor Emmanuel in Paris, in each of which he installed a different girlfriend. He was a confirmed bachelor who also went into the movie business and was the man who discovered Greta Garbo. In an interview with the Saturday Evening Post, he declared that he owed his success to three things—“one is silence; the second is more silence; and the third is still more silence.” You can see why I compare him to Bernie Madoff.

Eventually in 1932 the public woke up to the news that Krueger had been found in his apartment in Paris with a bullet wound through the heart. Initially, people attributed his suicide to the tension of the times, and felt sorry for him. Within a few weeks, it emerged that his accounts were completely bogus. His bond holders lost a total of \$400 million.

Then as now the effect of the bursting bubble, the banking crisis and the scandals that then came to light was to bring discredit on all those involved in running and regulating the financial system.

If you think outrage at the so-called greed of Wall Street is something new you should get this. In 1933, the Senate organized hearings on the causes of the financial meltdown. Each of the heads of the major banks was summoned to Capitol Hill. It turned out that the president of Chase, Albert Wiggins, had made a fortune during the Crash, \$4 million, equivalent today to several hundred million dollars, by shorting the stock of his own bank just before the market collapsed in October 1929. Talk about a conflict of interest!

Charlie Mitchell, the President of the First National City Bank, the precursor of Citibank, earned a million dollars a year and had not paid a cent of income taxes for three years because he would sell the stock in his company to his family at a loss, take the loss, and then buy it back from them. Similarly Jack Morgan, the son of J.P., was also forced to confess that he too had not paid taxes for three years. The popular press started calling bankers "banksters."

Finally in 1934 Andrew Mellon, the Secretary of Treasury under 3 presidents Harding, Coolidge and Hoover, once dubbed "the greatest Treasury Secretary since Alexander Hamilton" also by the way the third richest man in the country was indicted for having falsified his 1931 tax return. The Treasury demanded \$3 million in back taxes, which his estate eventually settled for

\$600,000. As you can see there are many echoes of the past in today's headlines of Wall Street's excesses

So much for the lead up. What about the handling of the crisis?

In December 1930, the world was then 16 months into what would become the Great Depression. The stock market was down about 50%, profits had fallen in half. World industrial production had fallen by close to 20%. It may surprise many of you to know that as of May, 16 months into the current recession, we were at about at the same place. The stock market was down about 50% as were profits. World industrial production was also down about 20%.

The difference is that in the 1930s, over the subsequent 18 months, that is between January 1931 and July 1932, the bottom fell out of the world economy. Stock markets ended up falling over 70% by the end; world industrial production fell by 40% by the end of the Depression.

This time, that is not happening. Instead markets have stabilized, financial institutions are not under the same threat anymore and we are beginning to see signs of economic stability.

The reason for this difference is the response of the authorities. The world economy collapsed in 1931 because the authorities applied the wrong medicine to what was already a very sick patient. They let the banking system go under; they tried to cut the budget deficit by raising taxes.

The height of all folly they even raised interest rates in the middle of the depression. You are probably asking why they would do such a thing. The reason was the gold standard. That meant that the amount of credit that central banks could provide was constrained by the amount of gold they held in their vaults. Countries losing gold were obliged to curtail credit and raise interest rates.

As a consequence, in 1931, in the middle of the Great Depression, there was a scramble for gold. Germany raised interest rates from 4 percent to about 12 percent in order to hang onto its gold. Britain then did the same. And in the fall of 1931, the U.S. joined the scramble and also raised interest rates.

It was in fact an even more perverse system than this would suggest. Because gold is very heavy and expensive to transport and insure, they had stopped moving gold around the world. Many central banks stored their gold either with the

Bank of England and the Federal Reserve Bank of New York. Some of the Bank of France's gold for example was held in the vaults of Bank of England. So when Britain lost gold to France, what happened was that some workmen at the Bank of England went down to the vaults in the basement of the Bank of England, loaded some ingots onto a cart, trundled the cart over to the other side of the room, off loaded it and put a sign on the ingots, announcing that this gold now belonged to France.

Britain in effect had to curtail credit, raise interest rates and create mass unemployment because there was too much gold on one side of the vaults of the Bank of England and not enough on the other.

It was no wonder the global economy crumbled.

The advantage of having been through the Great Depression is that we now know what not to do. We are not repeating the same mistakes.

We are not letting the banking system collapse. Indeed authorities around the world have thrown an unprecedented amount of money at the problem in order to support the banking system.

Nor is there any attempt to curb budget deficits. Indeed governments around the world have allowed their budget deficits to expand by \$5 trillion over the next two years, the equivalent to about 6% of annual global GDP for two years.

Nor is any major economy planning to raise interest rates. No one is going to try and crucify their economy on a cross of gold or in defense of the currency.

These three major policy mistakes made during the Great Depression—allowing the banking system to collapse, trying to curtail the budget deficit and raising interest rates—were a reflection of the fact that policy makers then simply did not understand how their economies operated. They were like 18th century doctors who thought that the cure for illness was to draw blood from the patient. We now know better. This time round we are applying the right medicine — propping up the banking system, expanding the budget deficit and cutting interest rates.

What about the third stage: the recovery? What lessons does the experience of the Great Depression provide?

Here are the facts about the recovery. First, in contrast to what many conservatives argue there was a strong economic recovery after 1933. For example both in the U.S. and Germany industrial production doubled in the 4 years after 1933. The first Roosevelt term had the highest GDP growth of any peacetime Presidential term. Where the conservatives are right is that employment growth particularly in the U.S. lagged behind, largely because the New Deal raised the cost of labor.

Secondly, the recovery had very little to do with government deficit spending. Aside for Germany which under Schacht and Hitler did have a massive program of public works financed by government borrowing from the central bank, most countries remained very cautious in the use of fiscal policy. The primary tool used to stimulate the economy was easy money. Most countries recognizing that the gold standard had become a strait jacket broke from it and devalued against gold. This allowed them to cut interest rates massively.

One problem with use of easy money as a stimulus tool is that it works in part by causing your currency to fall, in effect stealing markets from your trade partners. The result was a spiral of beggar-thy-neighbor policies and competitive devaluations. Many economies responded to the competition by hunkering down

behind high tariff barriers, import controls, and restrictions on capital flows. The gold standard was replaced by a chaotic and disorganized system of floating exchange rates. The nations of the world lost confidence in the international financial system's ability to reconcile their conflicting interests and ambitions. The result was a disastrous backlash against globalization. It was a time of the worst sort of populism and nationalism.

So far it looks as if the authorities have learned the lesson of the 1930s. Countries have been more willing to rely on fiscal stimulus as a tool for getting economies going. In contrast to monetary easing which works in part by stealing market from your competitors, fiscal policy has a positive spillover effect on ones trading partners. There has been much more cooperation and coordination in monetary policy to try to minimize the competitive consequences. As a result despite the collapse in manufacturing output and trade, there are no signs as yet of the sort of protectionism that gave us the 1930 Smoot-Hawley tariff.

But there are enough parallels between the current situation and the 1930s to be worried.

In both cases global financial arrangements had become unsustainable. In

the 1930s the weak link was a Europe that was excessively dependent on US lending. This time the weak link is the U.S. consumer, who has acted as the primary economic engine for the world for so many years, and has now run of borrowing room. In response it looks as if the Asian economies are re-evaluating their strategy of relying so much on exports to drive their growth and are trying to restructure their economies, focusing more on domestic consumption. But the danger is that China finds it too difficult or politically costly to restructure its economy, and, despite the changes in the global market, keeps its foot on the export accelerator. Since the U.S. consumer cannot afford to keep buying, this would set off a cycle of trade wars as countries competing for contracting markets.

One of the best historians of the Great Depression, Charles Kindleberger used to argue that ultimately the problems of the 1920s and 1930s arose because of a failure of economic leadership on the world stage. He believed that a well functioning global economy required one country to act as the leader, to be the supplier of capital of last resort during crises and to act counter-cyclically as the economic locomotive for the world, in effect to do **more** than its fair share of keeping global economy moving fully recognizing that smaller countries will freeload off its efforts.

Before the First World War, Britain had assumed the role. But, almost bankrupted by the war, it was no longer able to fulfill that function. The mantle of leadership should have passed to the U.S. But the leaders of the U.S. were too parochial and insular to seize the opportunity. Thus during the 1930s the Britain was unable to lead and the U.S. was unwilling.

We seem to be at a not dissimilar transition point in world leadership. The U.S. has been sufficiently weakened by its accumulated current account deficits, its banking debacle and its foreign policy disasters that it is no longer in a position to be the primary engine of growth. The problem is that no other single country can take its place. China is still too small an economy to take on the leadership role. As a result we shall have to rely on global cooperation

Ultimately though the biggest challenges will come from those aspects of the situations where we find ourselves in uncharted territory, where the experience of the 1920s and 1930s cannot provide any lessons because the world is now so different.

Let me give you just one example. In the 1920s the size of the banking system was about \$50 billion, and GDP was \$100 billion. Bank assets amounted to

50 percent of GDP. Moreover it was a very plain vanilla system, very transparent—banks took deposits and made loans or investments. Now the banking system and the shadow banking system in the U.S. is 20 trillion dollars, 150 percent of GDP. The banking system in the U.S. is thus three times as large as it was in the 1920s. A corollary of the very large size of the financial system is the enormous overhang of consumer debts.

Moreover, over half the credit provided in the U.S. was securitized and channeled through the shadow banking system. That whole artery is now ruptured and no one quite knows what will replace it.

I fear that we may have created sort of a Frankenstein in the financial system, not only has it become too large, but a good part of it is now broken, and we don't know how to fix it. Thus we may be in a situation where the conventional tools that we use to get the economy moving, for example the economic stimulus package, have only a muted impact because consumers increase their savings and use the money the government is injecting into the system to pay down their debts.

After spending several years studying the central bankers of the 1920s and 1930s, the conclusion I came to was that the mistakes that they made, and

goodness knows they made plenty of them, did not stem from venality or stupidity or malevolence. Their primary problem was that faced with new realities they were simply unable to break free of the dogmas of the day. They were unable to think outside the box, look at the problems with a fresh eye.

I would like to end by quoting Montagu Norman. Towards the end of his life, after a Second World War, he came up with this poignant assessment of what he and the other central bankers had achieved: “As I look back, it now seems that, with all the thought and work and good intentions, which we provided, we achieved absolutely nothing...nothing that I did, and very little that old Ben did, internationally produced any good effect—or indeed any effect at all except that we collected money from a lot of poor devils and gave it over to the four winds.”

Let us hope that in a few years we are not repeating those words.