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LORDS OF FINANCE

1929, THE GREAT DEPRESSION, AND THE BANKERS WHO BROKE THE WORLD

RESEÑA DEL LIBRO DE LIAQUAT AHAMED

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¿Qué tiene de interesante el libro?

Libro altamente recomendado para todos aquellos economistas, profesores de historia e historia económica, así como cualquier persona interesada en conocer la crisis económica denominada "La Gran Depresión", que comenzó en 1929. Aborda los orígenes, el desarrollo y las consecuencias que tuvo la crisis, y lo hace de una forma original con un ensayo biográfico de los cuatro banqueros centrales más importante de la época.

Estos son:

- Montagu Norman, presidente del Banco de Inglaterra.
- Benjamín Strong, presidente de la Reserva Federal de Nueva York.
- Hjilmar Schacht, presidente del Banco Central alemán.
- Emile Moreau, presidente del Banco Central de Francia.

A través del desarrollo narrado de sus biografías (modelo ensayo, no novela), va tejiendo el desarrollo progresivo de lo que se convirtió en la crisis que moldea la respuesta actual ante la crisis de 2007.

En el devenir de las vidas de estos cuatro hombres, se cruzan otros pro-hombres de la época: Winston Churchill, John Maynard Keynes, Herbert Hoover, Irving Fisher, Clarence Hatry, Andrew Mellon, Eugene Meyer, Charlie Chaplin, Franklin D. Roosevelt, Billy Durant (creador de General Motors), John Pierpont Morgan, Paul Warburg, Charles Gates Dawes, Adolf Hitler.

Todos los planteamientos económicos de reacción ante crisis económicas se hacen desde el prisma de la Gran Depresión. Conocer la historia nos ayuda a entender lo que actualmente se ha hecho y, a nivel particular, aprender de ella para no repetir errores del pasado.

El presente libro fue uno de los más aclamados en 2009 en materia de negocios y todavía no ha sido publicado al español, por lo que este resumen-crítica constituye una exclusiva.

Resumen y crítica:

"Has there ever been anything like this before? Yes. It was called the Dark Ages, and it lasted four hundred years" – John Maynard Keynes, sobre la Gran Depresión

a) Could it ever happen again?

Between 1929 and 1933, real GDP in the major economies fell by over 25 percent, 25% of adult male population was thrown out of work, commodity prices fell in half, consumer prices declined by 30 percent, wages went down 30%, bank credit in the United States fell by 40 percent. No other period of peace-time economic turmoil since has even come close to approaching the depth and breadth of that cataclysm.

b) A combination of crises

Part of the reason for its extent was that it was not just one crisis, but a sequence of crises, ricocheting from one side of the Atlantic to the other.

1) It started with the contraction in the German economy in 1928.
2) The Great Crash on Wall Street in 1929.
3) The serial bank panics that affected the United States from the end of 1930.
4) The crash of European finances in the summer of 1931.

c) Each of these episodes has an analogue to a contemporary crisis

The first shock, the sudden halt of American capital inflow to Europe in 1928 which tipped Germany into recession has its counterpart in the Mexican peso crisis of 1994. During the 1990s, Mexico borrowed too much short-term money. When U.S. interest rates rose sharply in 1994, Mexico, like Germany in 1929, found it very hard to roll over its loans and was confronted with the choice between deflation and default. Germany had just emerged from a terrible bout of hyperinflation, so they could not choose devaluation and had to default.

The second crisis, the Great Crash, has a parallel in the fall of the stock market in 2000. In both cases, Stocks completely lost touch with economic reality, becoming grossly overvalued (by 30-40%). The reaction of the authorities was not that dissimilar – rates fell from 6% to 2% (1929) and 6,5% to 2% (2000).

The third crisis, the 1931-1933 banking panics that started with the failure of the Bank of United States has many of the same characteristics as the current global financial crisis that began in the summer of 2007. The both originated with doubts about the safety of financial intermediaries that had sustained large losses. In 1931-1933 those fears precipitated a series of bank runs, as depositors puller their money out of banks and hoarded currency. The present turmoil has also led to a mass run on the financial system – this time not by individuals but by panicked investors and bankers pulling their money out of financial institutions of all stripes, not only commercial banks but also investment banks, money market funds, hedge funds and other "off-balance sheet" vehicles.

In some aspects the current crisis is even more virulent than the banking panics of the thirties. In 1931 most depositors had to line up physically outside their bank to get their money. Nowadays it is a click away. Moreover, the world's financial system has become both larger compared to GDP and more complex and interconnected. There is much greater leverage, and many more banks rely on short-term wholesale sources of funding that can evaporate overnight.

Offsetting this has been the response of central banks and financial officials. In 1931-1933 the Fed stood passively aside while thousands of banks failed, thus permitting bank credit to contract by 40%. In the current crisis, central banks and treasuries around the world, drawing to some degree on the lessons learned during the Great Depression, have reacted by injecting gigantic amounts of liquidity into the credit market and provided capital to banks. Without these measures, there is little doubt that the world's financial system would have collapsed as dramatically as it did in the 1930s. Authorities seemed to have at least staved off a catastrophe, although we are not yet sure of the consequences in the future.

The fourth crisis, the European financial crisis in 1931 also has its modern-day counterpart in the "emerging markets" crisis of 1997-1998. The evaporation of confidence in European banks and currencies caused Germany and much of central and Eastern Europea to impose capital controls and default on their debts. The contagion forced Britain to abandon the gold standard. The sequence was similar in 1997, when South Korea, Thailand and Indonesia had to suspend payments on hundred of billion dollars of debt. Asian currencies collapsed against the dollar. Eventually, the lack of confidence in emerging market economies led to the default of Russia in 1998 and Argentina in 2000. Imagine these four equivalents at the same time. That was the 1929 Great Depression.

d) A mistake that could have been avoided

"The most dramatic sequence of collective blunders ever made by financial official" – Liaquat Ahamed

For many years people believed – even today many continue to do so – that an economic cataclysm of the magnitude of the Great Depression could only have been the result of mysterious forces that even governments could not resist, as if it were a natural disasters for which no single individual could be blamed. On the contrary, this book demonstrates that the Great Depression is a result of a series of misjudgements by economic policy makers, some made back in the 1920s, others after the crises set in.

Who then was to blame?

1) The first culprits were the politicians who presided over the Paris Peace Conference (end of the Great War – First World War). They burdened a world economy still trying to recover from the effects of war with a big overhang of international debts. Germany began the 1920s owing some $12 billion in reparations to France and Britain; France owed the United States and Britain $7 billion in war debts, and Britain in turn owed $4 billion to the United States. The equivalent today would be 200 times that amount (e.g. Britain owing $800 billion). These massive claims consumed the energies of financial statesmen form much of the decade and poisoned international relations.

2) The second group to blame were the leading central bankers of the era. Even though they, especially Schacht and Norman, spent much of the decade struggling to mitigate some of the worst political blunders behind reparations and war debts, they were responsible for the second fundamental error of economic policy in the 1920s: the decision to take the world back onto the gold standard. Gold supplies had not kept up with prices and the distribution of gold bullion after the war was badly skewed in favour of the United States. The result: a dysfunctional gold standard that was unable to operate as smoothly as it had done before the war. Even worse, Europe went back to gold at exchange rates that were extremely misaligned, with a high exchange rate for Britain and a very low one for France. The consequential petty feud between Britain and France further undermined international cooperation. The quartet of central bankers did succeed in keeping the world economy going by holding U.S. interest rates down and by keeping Germany afloat on borrowed money. It was bound to come to a crashing end because it held the seeds of its own destruction. Eventually, the policy of keeping U.S. interest rates low precipitated a bubble in the stock market. By 1927, the Fed (Ben Strong) was torn by two conflicting objectives: propping up

Europe or controlling speculation on Wall Street. It tried to do both and achieve neither. Its attempts to curb speculation were too halfhearted to bring stocks back to earth but powerful enough to trigger a collapse in lending to Germany (hence the first crisis). This set in train deflationary forces around the world. In the last week of October of 1929, the bubble burst, plunging the United States too into the recession. The U.S. stock market bubble had a double effect: on the way up, it created a squeeze in international credit, sucking credit badly needed by Germany. On the way down, it shook the U.S. economy.

3) But it was not necessary for the crisis to metastasize into a worldwide catastrophe. Central bankers had been dealing with financial crises for more than a century. They had absorbed the lesson that while in general the economy works well in the care of the invisible hand, however, during panics, that hand seems to lose its grip. To re-establish sanity in fearful markets required a visible head to guide the invisible hand. It required leadership. After 1929, responsibility for world monetary affairs was in hands of a group of men who were not aware of this:

a. George Harrison, who succeeded Benjamin Strong, tried his best to fill his shoes but did not have the personality or the stature. Strong had controlled the Fed, but with Harrison power shifted to passive-actors who thought the economy would return by itself to an even keel. They even failed to fulfil even the most basic central banker's responsibility: to act as lender of last resort and support the banking system in a time of panic.

b. Norman and Schacht understood what was needed, but their two central banks (England and Reichsbank) were too short of gold and could not manoeuvre. For all of Norman's prestige and Schacht's creativity (he was in fact the thinker behing Hitler army build-up and the brain behind Germany's economic miracle of the thirties with an innovative pre-keynesian policies), they were hamstrung by the gold standard and were locked in with the United States, deflating as it did.

c. The only central banker outside the Fed with enough gold (thanks to the convenient exchange rate it had set) was Moreau at the Banque de France. But unfortunately he was more intent on using France's newfound strength for political rather than economic ends. Its inaction and gold hoarding proved counter-effective for the recovery.

d. Fisher was the first of many economists and historians to raise the tantalizing counterfactual that things could have turned out differently if Benjamin Strong had lived. It is true Strong was responsible for many of the errors surrounding the reestablishment of the gold standard, and for the easy money policy that led to the stock market bubble. But there is little doubt that in early 1931 he would have acted more vigorously and with greater effect than his successor, to prevent the cascade of bank runs. Additionally, in the quartet of central bankers, he was the only member with the necessary combination of ability, brains, vision and economic firepower

(Fed's enormous gold reserves) to have assume the leadership of the world economy.

e. So, all in all, the Great Depression was caused by a failure of intellectual will, a lack of understanding about how the economy operated. No one struggled harder in the lead up to the Great Depression and during it to make sense of the forces at work than John M. Keynes. He believed that if only we could eliminate "muddled" thinking in economic matters, then society could allow the management of its material welfare to take a backseat to what he thought were the central questions of existence, "human relations, of creation, behaviour and religion". "Trustees, not of civilization, but of the possibility of civilization", he said. The testament of his legacy is the sixty-odd years after the Great Depression in which the world, armed with his insights, avoided an economic catastrophe (the Bretton Woods conference is also covered in the book, as well as Hitler's rise to power).

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