2014 SIR LESLIE MELVILLE LECTURE
CENTRAL BANKS AND FINANCIAL CRISIS: SOME HISTORICAL EXAMPLES

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1. **Introduction**

It is a great honour to be invited to give this lecture. Sir Leslie Melville was such a distinguished figure in Australian public life and particularly in its monetary and financial life. He was a professor of economics at the age of 27 (even younger than Mervyn King – the last Governor of the Bank of England – who was appointed professor at the University of Birmingham in 1977 aged 29). And just two years after Leslie Melville became a professor he was appointed economic advisor at the Commonwealth Bank. This was extremely enlightened action on the part of the bank. It was more than thirty years later before the Bank of England consciously appointed an economist and that was under pressure from the Radcliffe Committee, and then he wasn’t allowed to do anything. It would be another ten years after that before they appointed an economic advisor. Sir Leslie was at the heart of economic policy-making in Australia from the 1930s onwards and for the post WWII years has been described as Australia’s leading monetary economist. (Schedvin)

I am going to be talking about central banks in history and need to begin by saying something on the definition of central banking. It is by no means straightforward, nor, for the early years is it easy to identify a central bank. It is often asserted that the Swedish Riksbank, founded in 1668, was the world’s first central bank. But by almost any definition there was no such thing as central banking at that time. There was hardly any modern fractional reserve banking at all. Clearly, central banks can be defined in a number of ways but in order for the definition to be useful it needs reasonable precision while at the same time allowing for slightly differing conceptions. Central banks at the beginning of the twenty-first century had a
relatively clear and agreed focus. They had two core purposes, the provision of monetary and financial stability. Some central banks still had mandates that required them to deliver, or at least keep in view, full employment and economic growth. But that aside, what had come to dominate was monetary or price stability, and in the pursuit of that many central banks had adopted inflation targeting. In the long period of steady growth that most OECD countries enjoyed in the last twenty years of the twentieth and the first years of the twenty-first century however, financial stability had drifted almost out of sight – it was taken for granted.

The two core purposes of central banks are intimately related. The first is monetary stability. Monetary policy, of course, does not exist in a vacuum. It depends crucially on the exchange-rate regime and is also closely linked to fiscal policy. A country with a floating exchange rate can have an independent monetary policy and government can have, via the central bank, control of the money supply. If a country operates within a fixed exchange-rate system it cannot have an independent monetary policy. It then lacks this control and must accept the monetary policy of the dominant country in the fixed exchange-rate system. The key is the money base, sometimes called high-powered money. (Some of the institutions that later became central banks were often referred to as banks of issue.)

When there is an independent monetary policy how the central bank executes its power will vary depending on factors that range over institutional arrangements, prevailing economic beliefs, and political preferences. It might aim to control the quantity of money directly
(as the Swiss central bank has done at times) or it might operate on prices, that is to say interest rates, as the majority of central banks have done. Or, as has been the case more recently, the central bank might approach matters differently to achieve a price or an inflation target. When the principal objective of the bank is price stability the operating procedure has usually been through short-term interest rates. How good an indicator of policy stance these are remains debatable. But by acting through short-term interest rates the central bank controls the growth of the monetary base and hence influences broad money, and that then has an impact on the economy. The influence over interest rates also means that the bank has some part to play in the determination of the nominal exchange rate since there is a relationship, albeit a complex one, between interest rates and exchange rates. Where there are exchange controls in place (as there were for much of the twentieth century) the central bank is often made responsible for administering such controls.

The institutions that are central banks today often have similar origins. The first institutions were usually established as government banks carrying out the business of government. That commonly involved lending to governments, often on favourable terms. Initially, they did not necessarily have sole right to issue notes but that was something they generally acquired. However, if the principal defining characteristic of a central bank is, as some would argue, its acceptance of its role as stabilizer of the financial system then their proper founding dates come later.
In this lecture I want to focus on that latter role, the second core purpose that of financial stability. I do this by looking at instability and begin by looking at the first great financial crisis of capitalism, that of 1825. I then turn to what was at the time the worst financial crisis ever, that in the United States in the 1930s. And I conclude with the most recent and by some measures the worst financial crisis of all. I make no apology for the history. Rather the reverse. If a better understanding of, and respect for, history had been held, the likelihood of crisis would have been lessened or even conceivably avoided altogether. But just before I embark on an examination of the great crises I point to some of the different kinds of criticisms of central bans that have been around for a long time.

2. Critical strains

There is a long and respectable history of criticising central banking. Critiques have ranged across a spectrum from those who would limit central bank functions to carrying out simple rules, to those at the other end who would get rid of central banks altogether. The principal alternative to central banks is a free banking system – something like that which prevailed in Scotland from the late seventeenth century to the middle of the nineteenth century. Discussion of it is seldom far away and it has been growing again in the last quarter of a century. Bagehot himself would have preferred a free banking system. In the 1930s Vera Smith’s classic study of central banking was an authoritative and sustained plea for free banking. (Smith, 1936)

After the abolition of free banking in Scotland by the state in England in the middle of the nineteenth century discussion faded for a while and
commercial banks seemed content to support the central bank. Some regard this as an example of capture – that the commercial banks had captured the central banks to serve their own interests.

One line of attack on central banks more recently has been that they have been responsible for inflation, the argument being that they have become institutions of government. Government has an incentive every so often to generate a surprise inflation and central banks have been manipulated to deliver this. Free bankers on the other hand place their trust in the commitment of commercial banks to maintain the convertibility of their liabilities (their notes) into an asset or basket of assets. Their strongest advocates believe that free competition would bring banking and monetary/price and financial stability. (for examples see Capie and Wood 1991). One particular piece of evidence is found in the 150 years of Scottish banking stability as against English instability across the same period.

A less extreme position is taken by Congdon. He accepts that modern economies could operate without central banks but believes they would operate with less efficient banking systems. He rejects Hayek’s and others’ proposals for the denationalisation of money. He accepts instead the need for an institution that ‘straddles the public and private sectors’ (p.178). And he poses a choice between a ‘narrow central bank’ (along the lines proposed by Ricardo), and a ‘broad central bank’ (p.183). The former would simply be an interest-rate setting and note-issuing institution. But a ‘broad central bank’ is preferred, one that could act as lender of last resort and therefore be able and obliged to impose some rules on its members. Additionally, he concludes that such an institution would be better if it were privately owned. It would be owned by the
commercial banks and accountable to them. But it would be ‘answerable by statute to the legislature to achieve monetary and financial stability’ (p.188). That is in fact a return to the kind of central bank that there was in Britain before 1946 and in fact close to the position of the Federal Reserve throughout its history even if its independent position has not always been sound.

3. **Financial crises**

So to financial stability. The term has proved hard to define. A helpful way of thinking about it is to define stability as the absence of financial crises. That, of course, requires a definition of crises. I choose one that has become a classic, that of Anna Schwartz: ‘A financial crisis is fuelled by fears that means of payment will be unobtainable at any price and, in a fractional reserve banking system, leads to a scramble for high-powered money … In a futile attempt to restore reserves, the banks may call in loans, refuse to roll over existing loans, or resort to selling assets. (Schwartz, 1986)

That definition contains the key. A fractional reserve banking system is necessary before a crisis can develop. That was not in place in sufficiently developed form until the beginning of the nineteenth century in England.

Let me begin then with what is sometimes called the first great financial crisis of capitalism that occurred in 1825. In many ways it was a template for the typical crisis that followed – monetary ease and expansion followed by stock-market boom, euphoria, some displacement, etc. - fits the model outlined. The background to the 1825 crisis was of
industrialisation and the development of the banking system throughout the eighteenth century. In the Revolutionary/Napoleonic Wars 1793-1815 with the gold standard suspended the Bank of England could issue notes without limit and appeared to profit from that. There was inflation across the period and a depreciation of sterling. After the end of the war deflation followed to allow for the restoration of the gold standard at the old parity as soon as could be achieved. But a period of recession followed before the gold standard was eventually restored in 1821.

The Bank of England was at the centre of a banking system made up of hundreds of unit banks, partnerships of limited size with unlimited liability. Many had failed in the deep post-war recession of 1815-17. There was the beginning of the emergence of discount brokers who would later become the discount houses (and provided an early interbank market). But with monetary stability re-established by 1821 vigorous economic growth resumed. An investment boom followed especially in infrastructure - gas lighting, canals, railways etc. The developing boom was reflected across domestic economic output with rapid increases in manufacturing, in cotton, wool, iron, hardware etc. In 1825 624 new joint-stock companies were formed. An export boom was not far behind.

The stock market boom came partly from foreign and particularly Latin American stocks. The boom was one of the earliest stock and bond crazes. As former Spanish colonies gained independence and believed prosperity was theirs they borrowed heavily. The distinguished and cautious Bank of England official, George Wade Norman, invested heavily. Everything seemed set fair. A new paradigm perhaps? Easy money and abundant credit prevailed. Between 1819 and 1824 there was a large gold inflow and the Bank of England was flush with reserves.
Bank Rate, which had been constant at 5% for the previous 50 years, was then lowered on 22nd June 1822. The Bank of England accommodated all the government’s fiscal demands. Moreover, there was the conversion of government debt to lower yields: in 1823 there was the conversion of £135m of 5% to 4%; in 1824 £80m of 4% to 3.5% was converted. All of this was done at a time when the total debt was around £800m and GDP around £300m and so a debt/income ratio of around 250 per cent.

Recipients of lower dividends sought higher returns elsewhere and there were plenty of schemes offering. Country banks joined in and issued notes freely. In 1822 Parliament extended the circulation of small notes of country banks until 1833. In 1824 country banks stamped twice as many notes as they had in 1820 and in 1825 notes were up 30 per cent on 1824. Then rising domestic prices led to a trade deficit and a gold outflow - of £7m. in 1825 (£3.6m. in August alone). Nevertheless, it was said that reserves were still sufficient for domestic needs.

The crisis broke without any identifiable trigger. At the beginning of 1825 the Bank had begun to worry about the extent of the expansion and in March sold Exchequer bills as a means contracting circulation. It continued to be cautious thereafter. The stock market crashed in April and that triggered commercial failures.

Commodity prices began falling and bank failures began to appear in late summer. The banking panic came in December. On 8th December the Bank of England afforded assistance (£300,000) to Pole Thornton and Co.; nevertheless on 13th December that bank failed. It was an important London bank and was agent for 47 country banks (The great banker, economist and parliamentarian Henry Thornton had a son who joined the
bank in early 1825.) On 13 December the banking system was poised on the edge of an abyss. Bank Rate was raised to its allowed maximum of 5%. In the following week four big London banks failed together with 60 country banks. By 16th December it was all quiet. The first of the great cyclical crises of capitalism was over; all the bank failures were over by the end of January.

The Bank of England’s response to the crisis had been in part constrained by the Usury laws. But it was slow to act, then reversed its policy and began to lend. Eventually, as Jeremiah Harman, a director of the Bank put it: ‘We lent it by every possible means and in modes we had never adopted before; we took in stock on security, we purchased Exchequer bills, we not only discounted outright, but we made advances on the deposit of bills of exchange to an immense amount, in short, by every possible means consistent with the safety of the Bank, and we were not on some occasions over nice. Seeing the dreadful state in which the public were, we rendered every assistance in our power.’ (quoted in Bagehot) (They weighed the gold coin to dish out to save time in counting it.)

Nevertheless, the criticism remains - Bank was slow to act, there were many failures and there was a serious recession in 1826. Unemployment soared and there was widespread rioting. The Bank was the main culprit. Its expansionary monetary policy fuelled the boom and its tight money ended it. It did not know how to act as lender of last resort or did not accept the role. The remedy had all been laid out before by Henry Thornton in 1802 and it was again by Thomas Joplin in 1825. On the evening of 13 December when the Bank was showing reluctance to lend Thomas Joplin published a letter in the newspaper, The Courier. His case
was, briefly, that the Bank had precipitated a liquidity shortage by its policy of monetary tightness. That resulted in completely abnormal increase in precautionary balances outside the bank. The Bank should respond said Joplin by increasing its note issue to offset the loss of circulation. This could be done safely because the increase in the money supply affected the price level and the exchanges only after a long lag and the extra notes could be withdrawn from circulation once the crisis had passed and long before prices were affected.

Thomas Joplin was from the north of England and described as a rough man from the timber trade and the suggestions are that the City of London did not want to acknowledge his claims. The banker Vincent Stuckey was a more acceptable figure. On the morning of 14th December he wrote to the Bank (12 hours after Joplin’s piece had appeared) pressing the case for a reversal of policy. He made the same point as Joplin that emergency additions to the money supply would not affect the price level. That morning the Bank opened its doors and proceeded to offer financial assistance on a hitherto undreamed of scale. (Stuckey was Walter Bagehot’s maternal uncle and both Bagehot’s father and Bagehot himself later on worked for the bank of Stuckey and Bagehot.) Bagehot made no reference to his uncle in his famous work *Lombard Street*.

It may seem unfair to put all the blame on the Bank of England for this particular disaster. It was still a private company and restricted by regulation that prevented it from behaving as it might. Nevertheless, it must accept the bulk of the blame. After 1825 it began to learn slowly how to behave. There were several similar crises – in 1836/39, 1847, 1857, and 1866 – in all of which the Bank of England played a similar role in accommodating a boom and then causing panic by tightening. In
the course of the 40 years after 1825 and through these several similar crises, and from promptings from commentators such as Bagehot, it arrived albeit somewhat reluctantly, at a position where it accepted that it was at the centre of the monetary system and the monopoly note-issuer, and as such the lender of last resort in a crisis.

Of course, the other parties had to learn their respective roles. The commercial banks had to find their way to appropriately structured balance sheets – sufficient capital and liquidity consistent with an acceptable profitability. And it was necessary too to have an appropriate regulatory environment. Joint-stock banking was allowed, the Usury laws were gradually removed, limited liability was permitted, the gold standard more clearly defined, and an understanding reached on how that could be relaxed in times of crisis.

When all these elements were in place, roughly from the late 1860s onwards, there followed over a hundred years of financial stability. There were years when a famous bank failed (e.g. Barings in 1890), or an exchange-rate crisis blew up (as in 1931), but there were no financial crises that meet with our definition.

One episode that does deserve some mention though is that of 1914. This was not in any way a typical financial crisis. There was no preceding boom and no monetary ease or state of euphoria. But on the outbreak of war the system froze and had most of the features of a typical crisis. On the outbreak of war there was a complete failure of remittance from abroad when London was the hub of an extensive international system. All parts of an already complex and inter-related system were affected. It
was not a pure liquidity crisis so other measures were required. But there was a liquidity crisis and so the lender of last resort was not redundant.

The measures taken are generally held to have been brilliant in their design and execution. Unfortunately, but as has frequently been the case, there are no archival papers on which to judge the Bank of England’s contribution to the resolution of the crisis. (Roberts, 2013) Sayers concluded that there was no sign that Cunliffe (the Governor), ‘brought into this task an inventive mind. Nor was he a man to formulate an elaborate policy, …’ (Sayers, p. 85)

1. Great depression

Let me next remind you of the great depression in the United States in the interwar years. It was against the generally fragile background of the 1920s that the great depression of 1929-32 took place, though it was far from inevitable. In the depression’s aftermath many explanations for its origins were proffered. One was that it was the unfortunate coincidence of the timing of the troughs of all the different economic cycles. Another that gained acceptance quickly was that there was an autonomous fall in investment. Yet another was that the gold standard had outlived its usefulness, or that the new version inspired no confidence. But after the work of Friedman and Schwartz there was a growing acceptance that it was a failure of monetary policy. A normal cyclical peak was reached in the middle of 1929 and a downturn followed. The downturn was made worse by the stock market collapse. But the real failure came when the Federal Reserve, reading the wrong signals or misreading the right ones, did nothing to prevent or alleviate the banking failures that came in 1930 and 1931. The monetary base was not supported and the money supply
collapsed. Later work by Schwartz (see Schwartz, 1981) argued that the Fed’s behaviour in 1928 had in fact brought the upswing to an end in 1929.

Of all the major economies the US had the worst experience of all. The American economy had long been volatile. In the nineteenth century it was always more volatile than the British economy and that certainly continued after World War I. But the scale of the depression in the US at the beginning of the 1930s had never been seen before. Data series are always being revised and in many cases remain contentious. But while there might be some debate over precise figures there is none about the general scale.

The scale of the collapse as captured in GNP is truly staggering. Money income fell by 15 per cent in the first year of the depression and by 20 per cent in the next, 27 per cent in the third and by a further 5 per cent in 1932-33. There were also price falls going on at the same time so the fall in real income was smaller. Nevertheless, the shock of these falls was considerable. Real GDP fell by 30 per cent. The fall in industrial production was even worse as is usually the case in industrial economies. It fell from peak to trough by something of the order of 47 per cent, the worst of any country in the world. (see Romer, 2003) These kinds of figures viewed in the context of the twentieth century as a whole were truly terrible. And the related unemployment figures tell a similar story. Unemployment in the US in the 1920s was settled at around 3-4 per cent. Again the robustness of the data is less than total but again there is no dispute about the general scale. Unemployment climbed steadily each year until in 1933 it was close to 25 per cent. At that point some 13
million people were out of work. Real GDP crawled slowly back to 100 in 1940.

Friedman and Schwartz maintain that the Federal Reserve’s failure to act as lender of last resort in the series of financial crises between 1930 and 1932 was crucial to the collapse of the system. So many US banks went out of business, or were taken over by other banks in successive waves of bank failures that there was a major monetary contraction. (Ben Bernanke, in a speech in 2002, when he was a governor of the Fed rather than its Chairman, apologized to Milton Friedman in the audience, on behalf of the central bank, saying, “We did it. We’re very sorry. But thanks to you we won’t do it again.” – quoted in Congdon 2011, p. 374)

Friedman and Schwartz point particularly to the acceleration in the pace of bank failures from November 1930. In that month Caldwell and Company of Nashville failed; this was the largest investment bank in the South, and its failure was followed by a wave of bank failures in agricultural areas. Then in December, the Bank of United States failed. The subsequent series of liquidity crises did not end until March 1933, when President Roosevelt closed all banks and suspended gold shipments abroad. Although there were uncertainties over the policies of the new administration, particularly over its attitude to the gold parity, these uncertainties are not a compelling candidate as cause of the wave of bank failures. Two explanations have been advanced for these failures – banking practices of previous years, and the behaviour of the Federal Reserve. Despite popular support even now for claims that commercial banks engaging in market trading was the source of the system’s problems, scholars from as early as Peach in 1941 have found that banks engaging in securities dealing was not what led to the wave of failures.
The main factor was a substantial and unremitting pressure on bank liquidity which the Federal Reserve did not relieve.

The Bank of England can largely be left out of this event. There was no great depression in Britain. Financial stability prevailed. There were no banking panics and no need for the Bank of England to do anything.

5. **Post-WWII**

There was a long period following the Second World War when central banks had little to do on either the monetary or financial policy front.

There was no monetary theory of inflation and insofar as it troubled anyone was regarded as a sociological phenomenon (unemployment was the chief focus of macro-policy). Inflation was seen as a cost-push consequence of powerful unions and monopolistic companies. Some attention was given to measures that would take the heat out of the economy. Banks were given directions as to where they should lend and where not. Ceilings were imposed on the amount of lending. Hire purchase arrangements were heavily relied upon. And new techniques were devised such as ‘special deposits’ in Britain, or ‘operation twist’ in the U.S.. Controls of all these kinds were in place across most of the OECD countries.

(Additionally, in many countries the banking systems were handicapped by being over-burdened with government securities, a legacy of war. In Britain, for example, where bank balance sheets had in normal times
carried private sector credit of 60 per cent of their assets that had been reduced to closer to 15 per cent, the remainder being gilts. Also restrictions on raising capital prevented them from expanding their balance sheets.)

But these were all arrangements that were increasingly seen as not working. Inflation had persisted and was on a rising trend. Controls had not prevented either the inflation or the concomitant never-ending sterling crises in Britain that culminated in devaluation.

The revulsion against inflation finally brought money back on stage. There was however, still a problem. The problem was that so long as governments ran central banks they could be, and were, abused for political purposes. Some central banks had greater freedom than others. The Fed had long claimed to be independent but it was really only with Volcker in 1979-82 that it demonstrated it. The Bundesbank and the Swiss National Bank would also have claimed it, and they could certainly demonstrate a better performance than most on inflation. New Zealand was an early pioneer in re-establishing independence. Britain took a step in the direction of independence with the new arrangements they introduced in 1992 – inflation targeting conducted under fairly open discussion between the Bank and the Treasury. Operational independence followed a few years later.

What was remarkable was the long period of low and stable inflation that was achieved around the world in the period from about 1990 onwards. Central banks were held in ever-higher esteem. Now that they had been allowed to do what they could do without interference they had delivered
with knobs on. Alan Greenspan was widely spoken of as a genius and the mastermind behind the world’s stability and prosperity.

It was believed that the central banks had cracked it. But they hadn’t.

6. Recent crisis

Which brings us then finally to the recent crisis. Without going too far into the origins it is clear that there were strong similarities with previous crises. Central banks presided over a period of rapid monetary expansion, abundant credit and the growing belief that another new paradigm prevailed. But it all crashed. When the British financial institution Northern Rock ran into difficulties in the summer of 2007 the Bank of England no longer supervised banks either formally or informally. So, unless someone told them, which the supervisory authority, the FSA, did not, they had no way of knowing the peculiar nature and high risk of Northern Rock's business model. In addition, their eye was off the "financial stability ball". Inflation had been the primary concern for some time, and there had been no financial stability problems for many years. And finally, even had other banks been willing to support Northern Rock (and all the indications were that they would not) events happened so quickly that there was no time to ask, and the call had to be on the government. The Bank had to go to its owner and ask for funds, and this had to be done in an ad hoc manner, and in haste. Why it was decided to support Northern Rock rather than follow the nineteenth century course and let it fail before providing the necessary liquidity to the market is a question worth asking. (see Milne and Wood) As the report of the Treasury Select Committee of the House of Commons made clear, there
was plenty scope for things going wrong and a serious banking run starting at many stages in the process. Why did this unhappy combination of events occur? There were several reasons. The old framework had gone. Worse, banks had somehow been led to believe they would be rescued if in difficulty – the socialisation of risk.

But additionally, there was an obvious information problem. Central banks need to be sure they are getting information on the health of banks. One way would be for central banks once again to engage in daily or more frequent transactions with banks, dealing in commercial paper as well as government paper, so as to get a feeling for how banks were trading and of the quality of their business. This is after all a long-standing tradition. When banks first emerged, they invariably required deposits and a relationship before they would make loans. That was the best way of getting to know their customers. It was a natural extension of how goldsmiths had behaved as they gradually drifted into the business of banking.

Another problem that emerged is that banks got into difficulties because they suddenly lost large amounts of capital when the value of assets they had bought collapsed precipitately. One response to this was that central banks should target asset prices as well as inflation. A less interventionist version of this is that central banks should monitor these prices, and intervene in asset markets when there is a bubble. This is of course in contrast with the traditional view that asset prices only matter for central banking when these prices collapse and then cause problems for the banking system. Tightening money would have surely very limited influence against irrationality.
Be all that as it may, when the crisis struck thoughts became focussed on dealing with it, and capital was required. There also appeared to be two lessons for the conduct of monetary policy, neither of them new. The first was to ask why, if any series is behaving in a way that is slightly surprising, it is doing so. In the run up to the crisis inflation was low despite a sustained economic boom and by many measures easy money. Had this question been asked, it might well have been answered that while measured inflation was low, this was the product of a sustained relative price change, the fall in the prices of consumer durables as a consequence of Brazil, China, India, and other developing countries emerging as major exporters of consumer goods. Such a relative price change could not go on for ever, and the low consumer price inflation was being produced by that means might well have triggered a reconsideration of the stance, and perhaps even the goals, of monetary policy. The second lesson for monetary policy is that this has been yet another demonstration of the folly of ignoring the monetary aggregates. These are certainly not an exact, day-to-day or even quarter-to-quarter, guide to future inflation, but sustained rapid monetary growth is invariably a sign of future inflation.

There are many similarities with both the Federal Reserve and the ECB. Both played a passive role in the build-up to the crisis. A fundamental problem according to Allan Meltzer (historian of the Fed) was the failure of the Fed ever in its history to set out its lender of last resort policy. On some occasions it would respond in one way and on another in another way depending on the views being taken at the time by either the Chairman or the board, thus generating uncertainty. Nowhere was this more evident than in the recent crisis.

7. **Conclusion**
The record of central banks on financial crises, I would argue, has not been good. The best we can say is it has been a chequered history. They have frequently caused, or at minimum allowed, crises to develop. This at least historically should not surprise us. Keynes once remarked that central banks liked crises. They benefited from them with increased profits. (After 1866 that was not true of the Bank of England, when it was obliged to pass profits from the crisis interest rates to the Treasury – but then, interestingly, there were no more crises after 1866!)

In the first great crisis of 1825 the Bank of England was in big part responsible for the preceding booming conditions that caused the crisis. And then it failed to resolve it sufficiently quickly. That pattern continued for several decades through several crises. The serious crisis of 1914 was not caused by anything other than the outbreak of war. The resulting problems were brilliantly resolved by the authorities. This was more the work of the Treasury than the Bank in Britain. The lack of records makes it difficult to make an assessment of the Bank’s part.

There is no serious objection to the view that the Federal Reserve was responsible for the financial crises of 1930-32 and concomitant great depression. The property bubble and bust of 1988-93 was not handled well. And so on. It should be added that there were occasions when the authorities averted systemic financial failure. The LDC debt problem of 1982 and the 1987 stock market collapse are two examples. (CGS, p.92) But over the whole history of financial crises central banks cannot be judged to have performed with great credit. They must accept the blame for causing many of the crises, and some for the failure of resolution. To some extent they can be excused on the grounds that they are constrained
by governments. They have almost always, when it came to the crunch (a crisis), been constrained by politics – the state.

We are still too close to the recent crisis to make a proper assessment. But we can surely ask if it would have helped had central banks taken financial stability more seriously. Some of them had deep suspicions about the financial system. But they needed to make these more widely known and drawn attention to the fault lines running through the system. That said, lessons were learned from history and the responses of the leading central banks may well have saved us from another great depression.
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