What just happened

Crashed
How a Decade of Financial Crises Changed the World
Adam Tooze
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Robin Ramsay

I once heard a history professor describe another history professor I knew as 'a very good, old-fashioned narrative historian'. I wasn't entirely sure what he meant but I got the pejorative message. Well, call me old-fashioned as well, because I like a historian who sets out to tell me *what happened*. Which is exactly what Professor Tooze does.[1]

Tooze is new to me but his previous books had great reviews and this one has, too.[2] Tooze is a 'Left-liberal historian' (p. 21), who understands economic theory, economic history, banking, international finance and what is conventionally called political economy, but which might be better called the politics of economics – as in, for example: why did the German state behave the way it did during the banking crisis of 2007-10? All those elements are woven together in this dense, exhilarating history of much of the world in the last decade. Some sections on international finance I found a bit of a struggle because of unfamiliar concepts,[3] but overall, if you can understand – say – William Keegan in the *Observer* or Larry Elliot in the *Guardian*, you will understand this.

The major elements in this story are the fall and rise of Russia; the rise

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1 He writes on his website 'my métier is narrative history' <https://adamtooze.com/books/>. This surprises me because it implies that he accepts the narrative/analytical distinction as meaningful in history writing, when almost all such writing is a mixture of both. As is his.

2 See <https://adamtooze.com/books/crashed-2018/>.

3 The book contains many acronyms. For example, on p. 60 MBS appears for the first time. I looked for a glossary and found none. On p. 204 FOMC appears. This is not in the index. Of course Google answered my questions (MBS = mortgage-backed securities; FOMC = Federal Reserve Open Market Committee) but a glossary would have helped.

of China; the attempts by the EU to move towards a more federal system; the growth of global banking and, in particular, the development of securitisation – the creation of financial 'products' largely based on US mortgages; and the growth of the American trade deficit and its funding by the creation of government debt, large amounts of which were bought by China. This last created a 'balance of financial terror' (p. 35) because China's dollar holdings were too big for the US economy to be allowed to fail.

Into this the banking crisis of 2007-10 erupted, unforeseen by those with 'the Davos mind-set' (p. 5): bankers, politicians, financial regulators – or economists. This was also a 'crisis of macroeconomics'.[4] (p. 15)

And as the cowboys on the fringes of the banking system in the US got to work selling houses to Americans who couldn't afford them, bankers bundled these new debts and existing mortgages into 'products' and sold them round the world. Securitisation, the creation of these new financial 'products', was thought to spread financial risk. It did indeed – but not in the sense of diminishing it. It just spread it, infecting much of the global banking system. This is one of Tooze's major points. Although initially European political leaders dismissed the failing US and UK banks as an 'Anglo-American problem', by 2008 one quarter of all securitised mortgages were owned abroad. (p. 73)

This is also a story of what happens when the banks are unregulated. Prior to 2008 the financial system was essentially left to its own devices. The childish nonsense of free market theories[5] was accepted by almost everyone who mattered, politicians included. Tooze notes that it was the social democrats in the US and the UK, the 'new' Democrats (Clinton) and New Labour (Brown and Blair), who took all this free market nonsense seriously and gave the money men their heads. 'It was, therefore, no coincidence that it was now Labour in Britain and the Democrats in the United States who were showing such energy in the struggle to fix the banking crisis. It was a monster they had helped to create.' (p. 192)

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[4] See also Eshe Nelson, 'The reinvention of economics after the crash' at <https://tinyurl.com/y72zju3z> or < https://qz.com/1486287/a-new-theory-of-economics-rises-from-the-ashes-of-the-global-financial-crisis/>.

> 'What went wrong for economics was that a key sector of the economy wasn't given the scrutiny it deserved: finance. The models used at the time by central bankers and other policymakers not only didn't foresee the crisis, they couldn't even conceive of such a shock emanating from the banking sector. The models didn't properly consider financial institutions as agents in the economy, with their own unique incentives and risks.'

[5] When I was an undergraduate in the early 1970s, in the economics subsid course I did, we were given examples of the free market theorists then associated with the Institute for Economic Affairs to kick around in tutorials. Even us dumb social science students could see they were nonsense.

Even after the initial crash, when efforts were made to create a global regulatory system:

> ‘The regulators were utterly subservient to the logic of the businesses they were supposed to be regulating. The draft text of what would become the Basel II regulations was prepared for the Basel Committee by the Institute of International Finance, the chief lobby group of the global banking industry.’ (pp. 86/7)

This global financial crisis became entangled with the on-going Eurozone problems. Was the EU a federation? Not really. There was still widespread opposition – on both left and right – to the EU’s federal ambitions. The Lisbon Treaty, another step towards a federal structure, was signed in 2007 and promptly rejected by the Irish in a referendum. Critically, while there was a European Central Bank (ECB), it had neither the legal nor financial power of the American Federal Reserve and could not serve as bank-of-last-resort for the Eurozone the way the Fed did in the US. So the Eurozone response to the crisis was patchy and ultimately inadequate. ‘Extend and pretend’ – extend the loans to the failing banks and/or bankrupt states and pretend all will be well eventually – became the initial strategy. In the end, through a variety of stratagems barely discussed in public, the US Federal Reserve became the bank-of-last-resort to many of the failing European banks. The Fed pumped *trillions* of dollars of loans to banks, ‘overwhelmingly in Europe’. (p. 13) If it began as an American crisis, the immediate solution was also largely American. This was the result of:

> ‘. . . a remarkable and bitterly ironic inversion. Whereas since the 1970s the incessant mantra of the spokespeople of the financial industry had been free markets and light touch regulation, what they were now demanding was the mobilization of all the resources of the state to save society’s financial infrastructure from a threat of systemic implosion, a threat they likened to a military emergency’. (p. 165)

A thread through all this is the rivalry between Russia and the USA. This is the one area in which the author doesn’t do justice to the events concerned. The US rejection of Russia’s desire to end the military rivalry is dismissed in a sentence (p. 131). The so-called ‘colour revolutions’ in the former Soviet satellites are presented as unproblematic with no hint of covert US influence conveyed. The political weight of the military-industrial-intelligence complex in US domestic politics is not mentioned. But these are relatively minor details in the broad sweep of his narrative.

In the end, after the trillions have been lent to the failing banks, most of the bankers still got their bonuses. And while 47 bankers in all were subsequently sentenced for crimes, only one was American and there was no-one from the City of London.[6]

The bill for all this got dumped on the ordinary citizens and the politics of 'austerity' was imposed a large chunk of the world. At the G20 meeting in Toronto in 2010:

> 'After the worst economic crisis since the 1930s, at a time when, according to the OECD, 47 million people were unemployed across the rich world, and the total figure for underemployed and discouraged workers was closer to 80 million, the members of the G20 committed themselves to simultaneously halving their deficits over the next three years. It was the householder fallacy expanded to the global scale. It was a recipe for an agonisingly protracted and incomplete recovery' (p. 354).

The 'householder fallacy' is the belief, common among economically ignorant politicians, that a nation's economy should be viewed in the same way as a householder's domestic budget.[7] Borrowed too much? Time to cut back spending. This ignores what 'Keynesian' macroeconomists call the reverse multiplier effect: government cuts mean less economic activity, less tax income and higher unemployment. At best, cuts slow the process of recovery down. Sometimes they make the situation worse.

In the EU the problem has been that a version of the 'householder fallacy' has been the economic policy of Germany since it recovered from the war. Having had the hyper-inflation of the 1920s, the German policy-making elites are acutely sensitive to the threat of inflation. Not only does Germany have the biggest and most successful manufacturing economy in the EU, they also have an industrial relations system (designed by a delegation from the British trade unions after WW2) which minimises industrial conflict. These two factors have enabled the German elites to produce enough economic growth to enable them to successfully pursue their 'householder' policy without the downsides which usually accompany it. And they have imposed it on the rest of the Euro zone, whether or not it actually works for other countries.

This is perfectly illustrated by the example of Greece. If you look at the Wikipedia entry for the Greek political party, Syriza, under 'Government formation' you will see this:

> 'See also Tenth austerity package (Greece), Eleventh austerity package

6 See <https://ig.ft.com/jailed-bankers/>.

7 See, for example, <https://tinyurl.com/yd9xa9ss> or <https://www.forbes.com/sites/francescoppola/2018/04/30/governments-are-nothing-like-households/#161bf93d54f8>.

(Greece), Twelfth austerity package (Greece), Thirteenth austerity package (Greece)'.[8]

Thirteen austerity packages, applying the same failed policies, repeatedly shrinking the Greek economy and forcing the emigration of about 10% of the population. The analogy with using leeches is apt. Patient not improving after application of leeches? Apply more leeches!

In the second last section of the book Tooze surveys the rise of nationalism as European citizens turned away from the EU in response to its austerity policies. Greece and Portugal half turned to the left and were swatted down. When he was Greek finance minister Yanis Varoufakis put his proposals to reduce Greece's debt payments to Dr. Wolfgang Schauble, German finance minister and president of the euro zone finance ministers, known as the Eurogroup.

> 'After I had recited our government's plea for a substantial renegotiation of the so-called "Greek economic programme", which had the troika's fingerprints all over it, Dr Schäuble astounded me with a reply that should send shivers up the spine of every democrat: "Elections cannot be allowed to change an economic programme of a member state!" he said categorically.' [9]

If there has to a be a villain in this tale, Mr Schauble would do.

> '[Schauble] has overseen a disastrous period in European history where its major step towards political and economic integration in the 1990s has delivered dysfunctional and divergent outcomes for the Member States. Some countries (Greece) has been ruined by the policies he championed while others are in serious trouble. Further, despite him claiming the monetary union has been successful, the fact is that the Eurozone is still together only because the ECB has been effectively violating the no bailout articles of the Treaty of Lisbon via its various quantitative easing programs since May 2010. Should it stayed within the "law" of the union, then several nations would have been forced into insolvency between 2010 and 2012.'[10]

But he was merely defending German interests as he saw them.

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[8] <https://en.wikipedia.org/wiki/Syriza#Government_formation>

[9] <https://tinyurl.com/yd4y3sks>
<https://www.theguardian.com/world/2016/apr/05/yanis-varoufakis-why-we-must-save-the-eu>

[10] <http://bilbo.economicoutlook.net/blog/?p=37106>

The UK gets a lot of attention in this section because of the role of the City of London whence much of the financial chaos originated. Tooze recounts in detail Prime Minister Cameron's attempts to persuade the EU to leave the City off-shore, outside the EU's regulatory remit. And Cameron got what he wanted, guarantees from the EU about not regulating the City. But three days before this was announced the UK referendum process had started and his triumph in Brussels was swept aside and forgotten.[11]

This is a great book to which I cannot do justice in a review. There is a particular pleasure to be had engaging with a really big brain and Tooze has one.

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11 See <https://tinyurl.com/ybo7fhxt> or <http://www.cityam.com/234994/eu-referendum-prime-minister-david-cameron-says-he-will-do-everything-he-can-while-energy-secretary-amber-rudd-says-a-reform-deal-is-out-of-reach>.

The relevant paragraph in the formal deal is in Section A paragraph 4 of the document at <http://www.consilium.europa.eu/en/meetings/european-council/2016/02/18-19/>.

Oddly, Tooze doesn't mention Cameron's success.