Learning to deal with financial crises in England

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Introduction

Financial crises were frequent in England in the nineteenth century and then they reappeared in the twentieth century. The Bank of England and the banking system gradually learned how to deal with and then prevent financial crises and a long period of stability followed. But lessons on all sides get forgotten and crises reappeared.

What constitutes a financial crisis? Some working definition is useful and one to work with is that a crisis is the result of a disturbance that threatens the payments system. In the words of a great authority: 'A financial crisis is fuelled by fears that the means of payment will be unobtainable at any price and, in a fractional reserve banking system leads to a scramble for high-powered money. It is precipitated by actions of the public that suddenly squeeze the reserves of the banking system…. The essence of a financial crisis is that it is short-lived, ending with a slackening of the public's demand for additional currency.' (Schwartz, 1986)

It is not the failure of an institution or of a municipality or anything else like that. There will always be such failures and so long as they do not threaten to impinge on the payments system they can be ignored for these purposes. Movements in asset prices might be indicators of what might follow and therefore useful to watch, but no more than that. A collapse in asset prices is not a financial crisis on its own. Only when it impinges on the banking sector does it threaten to become one.

What happens in a crisis

The pattern of events in crises is well known. Many authors have set it out and Kindleberger has a good summary of what typically happened in

a financial crisis. Something happens to begin with that shocks the system however mildly, what Irving Fisher called displacement; that exogenous event then opens up profitable opportunities. That could be something such as the discovery of a new technique or the discovery of a new resource. New investors are then attracted in to the activity. After that interest turns to other assets. The next stage is borrowing to buy. The boom is well underway by this stage and feeds on itself. A state of euphoria is reached. Bit by bit credit then becomes over-extended and there will invariably be fraud and other kinds of skulduggery along the way. Some keener participants or insiders will decide it is time to take their profits and get out and the writing is then on the wall. The monetary authorities often take fright and tighten conditions at this stage. The monetary authorities often take fright and tighten conditions at this stage. Collapse follows. (Kindleberger) Historically, banks have played a central part in the process since it was bank credit that financed the boom; and then banks failed in the collapse.

Nineteenth century financial crises in England

One further comment should be made. It is difficult to see how a banking crisis (which is really at the heart of this) gets underway before there has developed a banking multiplier of some significance. If banks are simply cloakrooms, as they were close to being in their earliest days, then it is hard to see how they fail or at least bring wider problems. So it is only after financial intermediation has progressed a reasonable distance that we get a multiplier of sufficient size to take seriously.

In England it is not until the beginning of the nineteenth century that that point is reached. In the eighteenth century there was definitely movement towards it but by the end of that century the multiplier is no more than 1.3. Typically, developing countries with nascent banking

systems have multipliers between 1.2 and 1.5. There was undoubtedly a growth of banking in England but regulation constrained that growth. (see Capie in Prados) (By the mid-nineteenth century the multiplier is close to 4. see Capie and Webber.)

From the 1820s onwards there is a long series of financial crises that run through much of the nineteenth century: 1825; 1836-7; 1847; 1857; and 1866. There are some other episodes after that to which I will return, episodes that do not qualify as financial crises but are often thought of as such: 1878; 1891; 1914; and 1931. But from 1866 onwards there was essentially 100 years of financial stability without any financial crises. Then they reappeared albeit in milder form in: 1973/4; 1982-3; and 1991-2.

I will describe these genuine nineteenth century crises briefly simply to bring out the important similarities between them, and comment more briefly on those in the twentieth century.

In the few years before the 1825 crisis there was what would come to be recognised as a distinguishing feature of most crises, easy money. On this occasion it was 'improvident finance on the part of the country banks' (King). They were guilty of over-issuing bank notes. But the Bank of England joined in, reducing its discount rate to 4% and extending the life of bills from 65 days to 95 days. There was abundant credit and there broke out speculative activity across a range of commodities. There were also several development schemes for the newly established South American Republics. In the three years 1822 to 1825 there were twenty loans for a total of £40m (when British national income – GDP - was about £300m). In early 1825 the Bank suddenly refused to discount bills and alarm spread quickly. According to one report the country was, 'within twenty-four hours of barter'. Remarkably, in recent times the

same thing was in effect being said – the banking system was within twenty-four hours of complete collapse. Then the Bank was slow to act but did so eventually, quelling the panic. As a director of the Bank (and a former Governor) Jeremiah Harman put it at the time: ‘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 made advances on 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, p.52) Bagehot added, ‘After a day or two of this treatment, the entire panic subsided, and the ‘City’ was quite calm.’ (Bagehot, p.52)

In the 1830s there were some similarities at least in terms of easy money. In 1830 the Bank had sanctioned the opening of discount accounts for bill brokers in what was agreed was an improvement to the functioning of the money market. Then in 1834 the Bank had especially large deposits from the East India Company and went out of its way to find employment for the funds. But in addition there was a reckless use of the new facilities for discounting. Yet again according to King the Bank should take responsibility for the crisis because it not only permitted but fostered the easy money which encouraged the growth of paper of doubtful quality. The unprecedented ease in the money market was the Bank’s responsibility. As ever there was an increasingly adventurous spirit abroad in the commercial world and a host of new joint stock flotations. As an anonymous pamphlet of the time said these were, ‘losing sight of caution and common rules’. There followed excessive discounting of

poor quality paper – today's toxic assets. In the mid-1830s many of these related to the Anglo-American trade. The same pattern followed with the Bank first refusing to discount the paper of the Anglo-American houses, then deciding it could not let them fail so came to their assistance to allow for an orderly liquidation. In 1836/7 and 1839 European bank promotion added problems and the crisis ebbed and flowed.

In the mid-1840s it was the railways that were the new thing and they were growing rapidly. But they were not growing as rapidly as the prospectuses for new projects. In the middle of this the Bank launched an aggressive lending policy apparently encouraged by the passing of the 1844 Act. After the Act the Bank believed it had an obligation to discount competitively and immediately cut its discount rate to 2.5% and offered temporary advances with a wider definition of acceptable collateral 'until further notice'. In 1845 the Bankers Magazine warned: 'if this line of conduct continues a monetary crisis will be inevitable'. But the easy money continued and the railway mania really took off. There were many new projects though many were entirely fictitious. The share prices of some companies rose by as much as tenfold in as many months. Even after the boom in railway shares collapsed the feverish activity spread to other ventures. In the middle of this the Bank kept its rate at 2.5% and its security portfolio grew apace and the Bank could not see any problem. Then in 1847 fears of poor harvests spread fear further afield and the Bank realized late the threat to its reserve, raised the discount rate and imposed increasingly onerous terms until it was impossible to discount bills or to raise money on first-class securities. A paralysis of trade followed. Attribution of blame changes little over the years too. The defenders of the 1844 legislation put all the blame for the crisis on the

‘commercial world for the reckless overtrading, its foolish speculations and its irrational exuberance’. (King 1936 p.149)

In the 1850s the feverish speculation that developed had its origins in the gold discoveries of the decade. In 1853 the Bank’s discount rate went up to 3.5% but the speculation continued unabated. It was also fuelled by developments in California and in what was said to be gross over investment in land, railways, and mining such that by 1854 all the ingredients of a financial crisis were present. But instead of a crisis breaking at that point it was fed for another three years by the gold inflows from Australia. As the market rates fell the Bank imprudently followed the rates down. Then as usual the bank decided enough was enough and tightened. When bad news filtered through from the American west, and particularly the failure of Ohio Life and Trust Co. at the end of August with liabilities of $7 million, it was followed by wholesale bank failures. Panic spread to Glasgow and Liverpool -- the most exposed cities. Again, Bank of England reserves fell, Bank Rate was raised, and panic followed. In fact the Bank had vacillated over a couple of years before finally breaking the boom.

In 1866 there were some differences. The crisis became focussed on a major firm, Overend Gurney. Overend Gurney’s origins were Quaker; and they were highly respected in the financial sector from at least as early as the late seventeenth century. Few, it was said, were as wise in the ways of the City or more judicious than Samuel Gurney.

The decade of the 1860s was the high point of the mid-Victorian boom. In early 1866 the Chancellor of the Exchequer, Gladstone, was decidedly upbeat about the economy. In May Bank of England reserves

were in good shape. But on 10 May Overend Gurney & Co failed. Overend's had become a giant financial institution dominating the discount market. But it got involved in bad asset management and became grossly over-committed to risky enterprises. Many of the booming firms of the 1860s failed and after Overend's failure panic set in immediately. It was the worst panic since 1825: 'this ruin of its (the Bank's) most famous neighbour and sometime rival, 'the Corner House', the greatest private firm in England'.(Clapham p.261)

Overend's 'losses were made in a manner so reckless and so foolish that one would think a child who had lent money in the City of London would have lent it better.' (Bagehot, p. 19) Samuel Gurney's old sound business called for 'great care with every bill, great knowledge of the "standing of parties", and considered use of that knowledge. The younger men now in charge held bills of doubtful subordinate. Portfolios were filled with all sorts of flimsy paper, including the so-called "finance securities"'- toxic assets again. (Clapham, p. 261) These latter were 'issued in advance by company promoters, perhaps before the public had even subscribed, to contracting firms, and by them discounted'. And Overend had gone far beyond dealings in bills, good or bad. They were mixed up in all sorts of financing, were 'partners in almost every kind of speculative and lock-up business'. (Clapham, p. 262)

On 11 May 1866 there was an unprecedented fall in Bank of England reserves. Bank Rate went to 10 per cent and stayed there for 3 months; and more banks failed. Bagehot criticised the Bank for lending 'hesitatingly, reluctantly, and with misgiving. In fact to make large advances in this faltering way is to incur the evil of making them without obtaining the advantage'. (Bagehot, pp. 64,65)

Resolution and prevention

How was it that these crises occurred at regular intervals and then stopped? My argument is that there were two parts to the solution. First, the banks learned how to behave and found their own way to prudence. Secondly, the Bank of England learned how to perform its role as lender of last resort.

The commercial banks

At the beginning of the nineteenth century banks were generally small and without branches. Any shock to the system that cast doubts over the security of deposits could result in a run and the nature of a bank's balance sheet meant even well-behaved banks could fail.

So they had to find their own way to the most suitable capital/asset ratio, cash/deposit ratio and liquid/asset ratio that was consistent with acceptable profitability. The ratios as might be expected all started out fairly high and gradually came down as banks found what could work consistent with an acceptable level of profitability.

Caution was learned and by mid-century was essentially the bye-word. In fact a major contribution to this was made by, not surprisingly, a Scot – a people known the world over for their caution (well they were before the last fifteen years or so). But within Scotland there are those who are noted for their extreme caution. They are from Aberdeen. They give nothing away. George Rae was from Aberdeen. He learned his trade as a banker there and in the 1830s decided he needed to test himself in England. He joined a Liverpool bank, the North and South Wales Bank, and did well before he was embarrassed in the crisis of the 1840s. Amid the various difficulties the bank experienced, in October 1847 a London newspaper carried a story that the bank had failed, a story that was false. But not surprisingly panic followed and the bank was forced to suspend

payment. Other difficulties followed that set Rae pondering further on the nature of banking.

Rae then went on to write the handbook for bankers which was still being used in the twentieth century, The country banker (1885), and indeed editions of which were produced in 1930 and again in 1976. It had gone through many editions. Rae covered every aspect of banking but central to his instruction was caution. He wrote: 'There is … a possibility of being over cautious; but in banking that is one of the cardinal virtues, compared with the opposite evil and mischief of being over credulous.' (Rae, p. 3) Bagehot agreed: 'Adventure is the life of commerce, but caution, I had almost said timidity, is the life of banking'.

Nevertheless, even the best behaved banks could still be embarrassed when a shock hit the system and there was a second part to the solution that was needed, the lender of last resort.

The Bank of England

At the end of the eighteenth century and the beginning of the nineteenth there were many contributors to a developing literature in the changing financial and monetary environment. And many of these addressed the question of the role of a lender of last resort. Francis Baring was probably the first to use the phrase and describe what was meant. But Henry Thornton gave a fuller, even comprehensive, treatment. Others such as Thomas Joplin contributed before Bagehot writing in the 1840s brought greater clarity following the crisis of 1847. But the Bank of England learned its role as lender of last resort slowly. It resisted for a long time the advocacy of theorists.

The lender is the ultimate source of cash and is therefore usually the central bank. The lender should provide liquidity to the market as a whole, and not bail-out individual firms (banks). It can provide liquidity

without limit, but should do so at an increasing price. It is the knowledge in the markets that the supply cannot run out that serves to assure the market and allay the panic. In its ideal form it should do this anonymously. There should be no commercial rivalry that might deflect the bank from its task. If it is known in advance that this is how the bank will behave (pre-commitment) then the picture is complete.

Any commercial bank may, from time to time, extend loans to customers who are illiquid or even insolvent. They may do so even when the present expected return from the new loan itself is zero or negative; if the wider effects on their own reputation for commitment, or the knock-on effects of the failure of the first customer on others, warrant it. By the same token, a nascent central bank - an institution still some way short of maturity as a central bank - may `rescue' some client or correspondent bank, just as the commercial bank may support its business customer. But we would not want to describe such ad hoc exercises as involving a conscious assumption of a systematic lender of last resort function. Nor would we want to see a mature central bank endeavouring to rescue individual banks. There is simply too much moral hazard involved. No central bank would want to pre-commit itself to giving special support to *any* individual bank that was running into liquidity problems. A bank liquidity problem that is not caused by some technical problem is likely itself to be a reflection of some deeper suspicions about solvency. Consequently, an unqualified pre-commitment to provide assistance to an individual firm would involve too much moral hazard.

Besides, it is worth pausing to consider what could reasonably be meant by 'bail-out'. Central banks in general do not have the capital resources to salvage single-handedly an institution of any significant size - significant in the sense that it could have damaging consequences for the rest of the system. If the central bank discounted at face value the inferior

assets of an individual institution in difficulty then if these assets were subsequently marked to market their values would appear much lower on the bank's balance sheet. Thus the central bank would be seen to be damaging its own balance sheet since it has parted with cash and exchanged that for lower value assets. If this in turn required government assistance in raising of more capital, the central bank would in effect have taken a fiscal decision. Thus, in the case of an individual institution, all the central bank can really do is oversee or organise a rescue operation, perhaps putting pressure on others to subscribe new capital.

How can the ideal operation of lender of last resort be achieved? The lender of last resort supplies funds to the market in times of need; it does not supply individual institutions. In its proper form it should not engage in bailing out firms of any kind, be they banks or non-banks. Therefore, if the operation could be carried out where the identity of those seeking funds was not known to the Bank that would be ideal. Institutions holding good quality assets will have no difficulty in getting hold of the funds they need. Institutions with poor quality assets are likely to suffer. In times of panic the interest rate would rise.

By something of a happy accident this was in effect the system that developed in England. At the beginning of the nineteenth century the Bank's monopoly offended the rest of the banks. Such was the antipathy that the new joint stock banks preferred to keep a distance. Discount brokers emerged who conveniently transacted business between the commercial banks and the Bank of England. These discount brokers gradually acquired the capital base to finance their own portfolios and by the third quarter of the nineteenth century had developed their modern form of the discount house.

When the commercial banks were under pressure in a liquidity squeeze their first line of defence was to call in their loans to the discount

houses; this in turn sent the discount houses off to the Bank of England. If the commercial banks had to cash in bills they would do this at the discount houses and the latter would in turn take them to the Bank. In this way the central bank never needed to know from whence the great bulk of the demand was coming. The precise source of the demand is largely an irrelevance. Good bills get discounted.

Some confusion in the discussion over the nature of the lender of last resort function may have arisen from too cavalier a treatment of this model. Central banking was more advanced in Britain than in other countries, and the British model of central banking was often adopted elsewhere. But the actual mechanism did not always exist elsewhere. Thus a key feature of the British system, its in-built protective device for anonymity, was ignored. This meant that in most other countries the institutions themselves went to the central bank, losing their anonymity by so doing. Difficulties were exacerbated when the government's bank and the commercial banks were in competition for commercial business. This seems to have been ignored in most of the literature, and it may be this that accounts for the way in which bailing out has been treated.

Prior to the latter part of the nineteenth century, central banks were generally expected to carry out a commercial banking function. In some cases, when they were first established, they offered the only source of commercial banking services and they were often the most important and largest commercial bank in their country. Consequently, the early relationship between central banks and commercial banks was often one of business rivalry and competition. This adversarial relationship was resolved around the beginning of the twentieth century in most cases by a largely uncodified concordat, whereby, in return for the central bank's withdrawal from commercial banking, the commercial banks voluntarily accepted the central bank's leadership. (see Capie, Goodhart, and Schnadt) A central

bank assumes the function of lender of last resort when it accepts responsibility for the banking system as a whole that overrides any residual concern with its own profitability. It is the appreciation of how they should behave in a crisis, rather than any individual act of rescue, that signals acceptance of the role.

It is worth pausing here to consider the 'too-big-to-fail doctrine' as it might have applied to Overend Gurney. Overend had become banker to the London and country banks and on the day it failed *The Times* said it 'could rightly claim to be the greatest instrument of credit in the Kingdom'. (11/9/1866) Its balance sheet was roughly ten times the size of the Midland Bank and the Westminster Bank – two of the biggest banks in the country; and while they operated with capital/asset ratios of about 9-11 per cent, Overend's was 2 per cent. (Discount houses do have lower ratios, but Overend was conducting banking business). Overend's appeal to the Bank for help was refused: 'The Governor took the view that the Bank could not assist one concern unless it was prepared to assist the many others which were known to be in a similar plight'. (King, p. 242) There was considerable animosity between the two institutions. Nevertheless, the refusal to help Overend can clearly be seen as a further step on the road by which the Bank came to see its function as coming to the aid of the market as a whole rather than bailing out imprudent and insolvent institutions. The panic of 1866 was huge. But in spite of Overend's size and apparent centrality to the system, the panic passed and the system went on to become strong and stable. The Bank's refusal, then, can be regarded as a signal that was an important step on the road towards a sound policy towards financial crises in the Schwartz sense of the term.

The Bank of England learned how to do all this over a long period beginning with the crisis of 1825 and continuing until the crisis of 1866, and then putting it in to action if ever the need appeared to be arising. (Ogden, and Capie, 2002) There followed over 100 years of financial stability; banks failed as they should indeed be allowed to, but there were no financial crises. And that was across a long period of alternating fortunes of growth and recession, and of war and different exchange-rate regimes and so on.

Regulatory environment

The striking thing about all this to a modern eye is that it was all done in a period of laissez-faire and banking followed that course. The preceding period that ran through the eighteenth century was that of mercantilism – the supremacy of the state. And in that century banking in England was severely circumscribed. But the reaction to the inefficiency and corruption in government that mercantilism produced, was to seek small government, free trade, and sound money. And so in the new climate of laissez faire, after each financial crisis they deregulated.

The first stage in this process came with relaxation of the Usury laws, at least for the Bank of England. The laws had been in force for centuries. In 1825 when the crisis blew up the Bank did what it could to lend but it could not lend at a rate above 5% which in the context of the times was hardly a penalty rate. After the crisis the usury laws were relaxed and at the next crisis the bank raised its rate above 5%.

At the same time the restrictions on banks being limited to partnerships of no more than six was also abandoned and joint stock banks were allowed to form. Initially, they could only operate away from London - outside a

radius of 65 miles. But a few years later they were also allowed to operate within London.

The gold standard had been more strictly defined in the 1844 Act but it proved too restrictive and when the 1847 crisis developed it was clear that the Bank could not hold to the law and do what was required for financial stability. The Chancellor then wrote to the governor and relieved him temporarily of the need to stick to the requirements of the Act and so the limitless lending (at a penalty rate) could take place.

There was a growing discussion on the merits and demerits of limited liability in the second quarter of the nineteenth century and after the 1857 crisis the laws were relaxed and limited liability was available for those who chose to avail themselves. Not all did but it was an option.

After that banking was extremely lightly regulated and everything was then in place that would allow the Bank to act as a lender of last resort. Generally speaking it did so though on occasions it might have blurred the issue.

Some non-crises

There are, as mentioned at the outset, some other episodes which have sometimes been portrayed as financial crises but are better described otherwise. They were the events of: 1878, 1890, 1914, and 1931.

In 1878 the large and heavily-branched bank, The City of Glasgow Bank, failed. The bank was of unlimited liability and its failure caused considerable distress. But the bank was corruptly run. It was not the system that was at fault or at risk. The failure did of course have an effect

on other firms and even on some other banks. But there was no financial crisis; there was no threat to the payments system. There was no need for action by the Bank or the Chancellor's. There was no need for action of any kind.

In 1890 Barings bank failed. Barings was an old and a distinguished British name. But it was a merchant (investment) bank and not directly involved in the payments system. Of course its demise might still have impinged on the payments system had it been taken as a sign of more general difficulties and fears then spread elsewhere. But it quickly became clear that Barings' problems derived from difficulties in Argentina. The rest of the system was sound. The Bank did take action and organised a 'lifeboat' rescue, an action that is better described as crisis manager.

In 1914 there was a major problem in the financial system on the outbreak of war. There were though none of the common features of the build-up to a crisis. There was no boom and no downturn. There were simply the seriously disruptive problems produced by the failure of remittance from continental Europe. The solution, however, was similar in many respects to that for normal crises. An injection of liquidity was required and was provided. But there were also some guarantees given to the accepting houses and the discount houses on their bills. The liquidity injection happened to coincide with the abandonment of the gold standard for reasons of war and thereafter there were failures in not retracting the liquidity. But 1914 is not a good guide to a typical crisis.

There was no great depression in Britain between the wars. Neither was the 1920s a depressed decade. There was a recession between 1929 and

1932 with a fall in output of 5.6 per cent. The financial system remained robust throughout the whole period and British growth in the 1930s was faster than it had ever been. There were serious financial problems in most of the rest of the world and great depression too. But financial stability remained in Britain. What happened in 1931 was an exchange-rate crisis. The return to gold in 1925 had taken place at an over-valued rate, one that could not be held to, and was abandoned in mid-1931. But there were few financial ramifications. The payments system was essentially undisturbed. Bank profitability was hardly dented.

So, following the crisis of 1866 while there were many bank failures and there were episodes when other kinds of problems blew up, there were no financial crises. The system was stable for over 100 years.

The end of the intermission in mercantilism

By the Second World War that financial stability was taken for granted and continued for another 25 years. But then, as is frequently the case, after a period of increased, and deliberately encouraged, competition in 1971-73, and of expansionary monetary policy, there was a huge growth of the fringe (shadow) banking sector. This sector lay outside the banks which were subject to credit controls (in many ways was a consequence of avoiding the controls) and its business model was to borrow in the short-term money markets – the inter-bank market – and lend on property. A great property boom developed. When the monetary authorities then tightened policy in the face of spiralling inflation the market turned down, the euphoria turned to gloom, property companies failed and then too the fringe banks were in danger. There were also the usual accompanying dodgy practices that are expected.

There were then fears that the difficulties might spread to other parts of the banking system and the Bank launched a rescue operation that came to be called the lifeboat. This should properly be called crisis management of the kind that was organised for Barings in 1891. The question that arises is: why not rely on that former stabiliser, the lender of last resort, if indeed it were needed? Any bank in difficulty that held good assets could have got the necessary liquidity by the traditional means. If they did not hold the appropriate assets then that might be considered poor management and they could be left to fail. If they were thought of as sufficiently good risks then a clearing bank might well have thought it worth while rescuing them.

Instead of which the Bank became involved in a long process (lasting over many years in some cases) of propping up or winding down a large number of institutions at considerable cost in terms of the resources devoted to the exercise; and in some cases in substantial financial losses. And that does seem to have been the Bank's approach thereafter, quietly to bail out or otherwise arrange the affairs of banks in trouble no matter how small and insignificant they were. In the mini-crises of the early 1980s and 1990s and from year to year across last third of the century that was the practice. (Jackson) How much moral hazard was being stoked up is hard to say.

Lessons can be learned from history

There are many similarities between the current financial turmoil and financial crises of the past. But there are always differences. No two crises are ever identical. But if the present crisis were characterised as deriving from a period of easy money stimulating an asset price boom (in this case housing) and then turning down as monetary policy tightened there would be the essentials of many, or even most, previous crises. The

tightening led to the credit crunch which in turn affected the real economy.

There are few, if any, simple lessons that can be drawn from historical experience; there is no manual to which one can refer. History is better used when the patterns or the rhythms of the past are understood and absorbed. (As Mark Twain put it, history does not repeat itself; it rhymes.) Nevertheless, lessons do appear to have been learned in the course of the nineteenth century for how else do we explain the long period of stability in England that followed the long period of recurrent crises, particularly so when the crises continued to appear in other countries around the world. The banks had to learn what shape their balance sheet should have. They did and stuck to it. They did suffer abuse for the next 100 years for being too conservative. Perhaps the main lesson from English experience (though I believe it extends elsewhere) is that periods of monetary expansion produce booms that then collapse. But it is still monetary expansion that is required to then restore confidence and stimulate the economy. A second lesson was that it needed to be clear in advance that liquidity would be available. The Bank had to accept this as a primary function, and it did and its role as lender of last resort was understood by the market. (There is a danger that a lesson might be over-learned. A fear of lack of liquidity should not be sufficient to call forth ever increasing injections of liquidity.) Perhaps a third general lesson is that when something goes wrong it is not necessarily a good thing to identify the problem (past) and disallow it in the future. Regulation is not necessarily the solution; it is just as likely to be the problem.

There are some other smaller points. These might seem too obvious to mention, and I hesitate to do so, and yet they do keep re-appearing. If some activity is growing extremely rapidly it should probably be looked at closely. If high returns are being offered on some investment then it too

should be examined closely.

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