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Why Financial Crises Give Birth to Legends

Nathan MARCUS

In our haste to explain away the 2008 crisis, we have tended to put all the blame on bankers and regulators. This simplification, while soothing, might be just as misguided as Germans' or Austrians' tendency in the 1920s and 1930s to put the blame on France and Britain for their economic difficulties, or later for World War Two. Crises are the stuff of legend, but we should find other ways to cope with them.

Each week, the popular U.S. series *Mad Men*, which has been flickering over our TV screens for several years now, begins with the shadow of the show's main character falling endlessly down the glitzy façade of a 1960s office building on New York's Madison Avenue. The meme of men in suits falling through the air against the backdrop of New York's skyscrapers is etched into our visual memories since the tragic pictures broadcast all over the world on 11 September 2001. But the makers of *Mad Men* are certainly not drawing any anachronistic connection between the advertising world of the 1960s and modern-day terrorism. Rather, the falling shadow of the show's protagonist conveys the consequences of his moral failures by drawing an analogy to the score of bankers who, having gambled away their own and other people's savings before the 1929 Wall Street crisis, committed suicide by jumping out of a window.

The truth is, however, that just one such suicide actually occurred, followed by the similar jump to death of a cleaning lady. The erroneous but widely held belief that bankers jumped to their deaths goes back to the sketch of a stand-up comedian, who joked following the crash of the New York Stock Exchange in 1929 that bankers were lining up to get to the window. Even though there was no mass suicide and no jumpy bankers, the makers of *Mad*

Men show us that the joke has become a widely recognized contemporary legend. And it is by far not the only example of a financial crisis giving birth to legends that become ingrained in popular consciousness. In Germany, for example, people strongly believe that at the height of hyperinflation in 1923, workers returned home with their daily salary piled up in wheelbarrows, which were worth more than their pay-check. But apart from a staged picture of a well-dressed man presenting a pile of banknotes in a wheel-barrow, there is no proof or testimony of this ever happening.

Convenient Explanations

The reason for the longevity of such contemporary legends is their ability to explain the world we live in. Thereby they help create solidarity and social cohesion, and provide legitimacy to social institutions and practices. A famous example is the legend that sprang up following the French Revolution (amidst another financial crisis), according to which Marie-Antoinette commended the hungry masses to eat cake. No record exists of her heartless advice and historians are convinced it was never uttered, but the legend endures because it helps express and reify the antagonism that existed between the common people and French aristocracy. Marie-Antoinette's lack of empathy towards her subjects helped justify the beheading of her family and gave sense to the brutal means by which the monarchical order was overthrown in France. Much research has gone into explaining the origins of the French Revolution, but for most people it still boils down to the understandable action of hungry masses fed-up with an indifferent aristocracy that lived in luxury. Similarly, the German hyperinflation of 1923 or the crash on Wall Street in 1929 had multiple and unrelated causes, but to many it made sense to believe that the fault simply lay with irresponsible bankers.

Because financial crises are by their very nature esoteric, but have a very real and direct impact on the life of almost everyone, they are prone to generate multiple explanatory accounts. Trying to make sense of what is happening around them, people are less interested in discovering the truth, and more interested in finding an explanation that will give legitimacy to their own personal views and choices. Good examples of this are the incoherent explanations for a series of financial crises that hit Austria in the 1920s. It was in Austria that hyperinflation struck first. This country was also the first to undergo a prolonged period of economic reconstruction through austerity, and then the first European country to experience a financial crisis in 1931. Hit hard by hyperinflation, austerity and the 1931 collapse, Austria's citizens sought explanations to make sense of what was happening. Often, the

explanation that stuck was wrong, but it helped legitimize political, social and economic practices in the eyes of those experiencing the crises.

The Austrian Case

Austrian hyperinflation, which helped eliminate the country's war-debt, destroyed much of the middle class' savings. It resulted from an enormous budget deficit and the printing of new notes. What determined the rate of inflation were public expectations, which in the early 1920s were dominated by uncertainty about the future. It is commonly believed that hyperinflation ended in August 1922 when Austrian Chancellor Ignaz Seipel left for a whirlwind tour of European capitals, threatening to unite helpless Austria with the bigger Germany. Allegedly, this threat frightened the French into action and Austria was placed on the agenda at the League of Nations, changing public expectations and putting an end to the rising prices. The truth is, however, that the risk of hyperinflation lingered on until December, pending the League's introduction of a new regime of austerity and reforms. Still, the legend went that Seipel's wily tour saved Austria from collapse stuck and he was soon called the savior of his country, because in the eyes of many Austrians, this was preferable to giving the credit to an international body dominated by their former enemies.

The Austrian reconstruction period that followed engendered its own legends, too. Initial euphoria and a massive inflow of capital fueled a bubble on the Vienna Stock Exchange, which burst in 1924. It left in its wake a series of bankruptcies and shaky financial institutions and destroyed foreign confidence in Austria's economic future. This translated into the lack of long term capital available to Austria from abroad, and Austrian banks and industries had to rely on expensive short-term funding to finance their businesses. Disagreement over monetary policy between the Austrian National Bank and the Bank of England gave rise to the claim that the British were to blame for the lack of long-term capital, by issuing a credit-embargo on Austria. This allegation was widely reported in the Viennese press and England blamed for much of the country's economic woes—a counterfactual explanation still to be found in many a history book unto this day. But the truth is that, while the Bank of England tried to minimize foreign loans in preparation of Sterling's return to gold in 1924, there never was an embargo on private lending to Austrian banks.

Similarly, the collapse of the Viennese Credit-Anstalt bank in May 1931, probably the most infamous of Austrian financial crises during the interwar, created another legend—this

one of global proportions. Since no foreign help was available, the bank had to be bailed out, which emptied the public coffers. When in July banks began failing in Germany and then Britain faced a run on Sterling in August, the Austrian authorities had no funds to prop up the Austrian currency to preserve gold convertibility, leaving them no choice but to introduce capital controls. The chronological sequence of events, from the Credit-Anstalt collapse in May to the end of the gold-exchange standard in September, gave rise to the legend that the Austrian crisis had triggered the Great Depression in Europe. Although the truth of the matter is that the Credit-Anstalt crisis was successfully contained and far too small to cause a global crisis, the collapse of Austria's largest bank is still widely believed to have set off the economic calamity of the 1930s.[1]

The spillover from popular lore into historiography is only possible because these legends were considered true by contemporaries, who plotted them down all over diaries, memoirs, diplomatic correspondence and the press. Rigorous historical research may prove them wrong, but the legends will live on because they are not merely historiographical mishaps, but in fact support a narrative everyone wanted and continues to want to believe in. The modern-day misconception of the Austrian interwar reiterates contemporaries' fixation on France and Britain as the powerful victors. Thus hyperinflation was only terminated by provoking France into action, the Bank of England suffocated the Austrian economy through its credit-embargo, and the Credit-Anstalt collapse triggered the Great Depression because France and Britain would offer no help. At the same time, the narrative conserves Austria's position of importance on the stage of world-affairs, despite having been reduced to a tiny republic. Dissected to its core, the narrative blames the victors for ignoring Austria's global importance and provoking not only the Great Depression but also World War II.

Bankers: Still the Focus of Public Attention

Of course, it is still too early to predict what contemporary legends our current crisis will stir up, but it might help to look at the most common explanations being put forward today. A recent academic paper by Andrew W. Lo reviewed more than twenty books published on the crisis, giving us an idea of how economists and journalists are making sense of it.[2] There seems to be very little consensus, but three major strands of explanation can be

[1] A thesis most prominently defended by Charles P. Kindleberger, in *A Financial History of Western Europe* Francis & Taylor, 2006 or Barry Eichengreen, in *Golden Fetters*, Oxford University Press, 1992.
[2] Andrew W. Lo, "Reading About the Financial Crisis: A 21-Book Review."

identified. First, that investors placed too much trust in the efficiency or honesty of financial markets. Second, that the annual bonuses earned by professionals on Wall Street created short-term incentives to choose quick profits over prudent investing, a problem that was exacerbated by a lack of regulation, regulatory capture and greed.[3] Third, that global imbalances, lax regulations and massive international capital flows caused large banks to increase their leverage to a level at which they could no longer cope with financial crises, often under the belief that they would be bailed out should crisis strike.

What all three strands have in common is that they place the blame on bankers for acting erroneously, be it due to ignorance, greed or simply because they needed to survive. Through their focus on bankers, the various explanations match the more popular accounts about the crisis, such as Matt Taibbi's reports published by *Rolling Stone*, which particularly blamed Goldman-Sachs.[4] According to Taibbi, Goldman-Sachs generated the housing crisis for its own profit, ripping of customers and tax-payers alike. In the process, Goldman shortened the very products it sold to hedge-funds, a fact Taibbi equates with financial fraud. Finally, the vast network of Goldmanites in government and regulatory bodies helps the bank escape punishment and manipulate regulation. As Megan McArdle argues in *The Atlantic*, such simplifications are not necessarily wrong, they are just not complex enough to capture the complicated nature of the truth. Taibbi's accounts create the stuff of future legends because they are easy enough to understand and because they convey the sorts of truths people want to believe in, even if they remain incoherent and conspiratorial.

Taibbi and others are putting the blame on bankers much the way Austrians blamed the British and the French—exporting the crux of the problem outside their own domain. Of course, blaming foreigners is not the same as blaming bankers, but the difference here is instructive. Austrians put the blame on the French and British, because the latter had won the war and gained from it in territory and power. Similarly, we blame bankers, who appear to be the only ones to profit from the crisis and come out of it unscathed. In both cases, there is more than just a bit of jealousy. In Europe, it is quite common to simply put the entire blame on the U.S. and its unrestrained form of capitalism, but given the effect of the crisis on society at large, should we not be questioning the system instead of looking for scapegoats?

[3] On the thorny question of exeecutives' salaries, see Claire Célérier, "How Should Executives Be Paid?,"*Books and Ideas*, 13 March 2012.
[4] Matt Taibbi, "The People vs. Goldman Sachs," *Rolling Stone*, 11 May 2011.

Our focus on bankers and regulators is just as misguided as the enduring legend of jumpy bankers, which allowed Americans to cope with the harsh consequences of the Great Depression. Reducing the problem to the actions of greedy bankers helps preserve social cohesion and allows the capitalist system we live in to endure. It exonerates us from our own responsibility to act and allows us to continue living in peace within our present economic framework. But perhaps we ought to ask how come financial markets, banks and regulators possess such destructive power over each and every one of us in the first place. Instead, our failure to do so guarantees that incoherent explanations will continue to find their way into the future historiography of our current crisis, much akin to the joke about a banker, who paid with his life for the crisis of 1929 by jumping out of a window on Wall Street.

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