

Men, Money and Morality: How can trust in banking be restored?

Transcript of the Q&A section of the talk.

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Giles Fraser (Canon Chancellor of St Paul's Cathedral): I'm going to start with a question of my own. I wonder if you could try and help us see what has changed since Siegmund Warburg's day and our own – what is the big moral change that has happened in that time?

Niall Ferguson: Well, in Siegmund Warburg's day nobody would have left halfway through the event.

[Audience Laughter]

The best answer I can give to that is not the obvious one. The obvious one is to say we changed the system. We removed all those regulations. We unleashed greed. Gordon Gecko became the iconic figure and not Siegmund Warburg - you'll remember Gordon Gecko, the caricature, in the film *Wall Street* who has made a recent reappearance. But I don't think that's the right answer. I actually think the right answer is that memory has faded. That the generation that I've been talking about, which Siegmund Warburg exemplified, acted the way it acted because of what it had been through. They had seared into their memories the consequences of reckless, speculative, transaction banking. Because that, in their view - and certainly in Siegmund Warburg's view - had caused the Great Depression. It's fascinating to find Warburg talking about the difference between transaction banking and relationship banking, and regarding transaction banking as a thing of the bad old past – as a phenomenon of the 1920s.

So, I think the best answer is that the generation that had lived through the Great Depression – lived through the great upheavals of the mid-20th century – passed from the stage and their place was taken by the Baby Boomers, to whom no bad thing had ever happened. When something bad threatened to happen, as, for example, in 1987 just five years after Siegmund Warburg's death, the magical power of the Federal Reserve bailed the markets out. The birth of the Greenspan Put, the implicit promise that the Fed would put a bottom – a floor – underneath the market. That was really what changed, I think. And because there was no financial historic education, the generation that entered financial life whose careers began in, say, 1982 - and it's interesting to notice, that the average age of the Chief Executives of the major banks of the United States in 2007, the average career duration when the crisis began, was 25 years. They'd come into the business the year Warburg died, with no knowledge – complete ignorance in fact – of what had caused the last Great

Depression. It's an old cliché, but it's true. Those who don't learn from history, repeat its mistakes; and we are living through a huge and terrible repetition of the mistakes of the 1920s today.

Giles Fraser: Thank you. Question here from Simon White: in your opinion, does the comprehensive knowledge of financial history resolve the current debate of whether governments should continue to run budget deficits in order to support the recovery; or should austerity measures be instituted now as George Osborne has tried to achieve with his recent budget?

Niall Ferguson: This is a very good question. Because it illustrates the limits of historical knowledge. The sample size of Great Depressions is rather small, at most there have been three events in modern history that qualify as depressions. The one we all know about, that began in 1929; the earlier one that began in 1873; and the one we're in right now. But in only *one* of these have we attempted to avoid collapse through massive fiscal and monetary stimulus. Don't believe those who claim to know with total certainty that we can carry on running huge, trillion dollar, deficits year after year and get away with it. They cannot that certainty, they do not have evidence to support their position. Nor should we pin our trust on the economic models taught in universities on both sides of the Atlantic; which after-all, so flagrantly failed to anticipate the crisis. We have to acknowledge that we are in uncertain territory here; and I'd like to suggest this evening that we beware of a false dichotomy. It is, I think, a false dichotomy to claim that governments have a choice between Keynesianism without limit; and austerity until the pips squeak. That is not the choice. There is only now one, perhaps two, countries in the world – in the Western world – that have the option of continuing to run deficits in the order of 10% of GDP for another year or two. One is the United States, which will. The other is Germany, which won't. Every other country, including this one, does *not* have that option. It was not an option open to George Osborne to continue running deficits on the scale that his predecessor had notched up; because the day of reckoning was fast approaching for the United Kingdom. A day of reckoning of the sort that the Greeks have experienced at first-hand.

No, the real choice for all European countries – indeed ultimately for all *Western* countries, including in the end, finally, also the United States – is between fiscal stabilisation that depresses economic activity, and self destructs in the process; and fiscal stabilisation that revives business confidence and allows us to grow our way out of this hole. When I visited Greece just a few weeks ago, I was deeply dispirited to see that they had opted for the former. A kind of masochistic austerity; raising taxes on business; failing to grapple, in fact, with their out of control public pension scheme. We are, I hope and trust, going down a better route. In which the object of the exercise is to shift the balance of economic power from the public sector, to the private sector where it properly belongs.

The real choice, in other words, is between a masochistic austerity that ultimately fails; and prosperity, that comes from reviving business confidence. It remains to be seen whether George Osborne's budget will achieve that revival of confidence. But at least the right kind of things are being done. The reduction of corporation tax as a part of the budget strategy struck me as a brilliant and inspired step. But there's much, much more that still has to be done to persuade the small to medium sized businesses – at the core of any economy - that good times are coming. Only when those small to medium sized businesses feel that it is wise for them to take on new staff, to invest in new equipment, will we see growth; will we see jobs. In that process, finance has a crucial role to play. Because small to medium sized businesses right now feel cut off from credit. That's especially true in the United States, which is in fact in the grip of a credit contraction right now as serious as any we've seen since the 1930s.

So, I would say it's the wrong question. We don't have to choose between Keynes forever and austerity. The Keynes forever option has gone. The real choice is between austerity and prosperity driven by the private sector.

[Pause]

I thought that would make you clap.

[Laughter and Applause]

We're not used to clapping in church, I know. It's okay.

[Laughter]

Giles Fraser: Okay, let's see if they boo. Is there such a thing as earning too much money? A lot of people have asked.

Niall Ferguson: Yes. I think there is. The thing that most puzzled me, for years, when I was working on Siegmund Warburg's life – and I spent a dozen years trying to figure this guy out – was why he almost never referred, in his letters, in his diaries, in his memoranda, to money. I thought: I've made a terrible mistake. I'm writing a biography of a banker who doesn't talk about money. Who isn't interested in his bonus. Who hardly ever thinks about his salary, and delegated his investment – with a complete lack of curiosity – to one of his fellow employees. For Warburg, money was not the point. It was a by-product of successful, *ideal* business. Siegmund's philosophy, which I am fascinated by, was that if you focused on doing your job as well as you possibly could; to the highest standards ethically, and aesthetically, as he put it; the bottom line would take care of itself. The interesting thing is that it *did*. Because S.G. Warburg consistently outperformed his competitors, even in the absolutely ugly years of the 1970s which devastated the balance-sheets of

most of the other merchant banks – Warburg soldiered on. So my sense is that those who focus on compensation, and say this is the proof of my financial virility - the fact that *my* compensation package is bigger than *his* – those are the people who will lead us down, once again, the Primrose Path to perdition.

Ask yourself: which of the financial CEOs had the biggest compensation package? It wasn't Lloyd Blankfein. It was the guy running Country Wide, which was one of the banks that came closest to totally destroying the U.S. financial system. So, yes you can earn too much money. Think also of the English soccer team, if you want further proof of the proposition.

[Laughter and Applause]

Giles Fraser: I have a question from Hannah Hillcott, which neatly follows on from your talk of virility. Why is your lecture gender specific in its title? Why men and not women? The question from that is: is there a sort of gendered aspect to all of this?

Niall Ferguson: I chose the title of the lecture very deliberately. Not just for reasons of alliteration; but also to make an important point. It was men. It was men, not women, who made the financial crisis. You will look in vain for key decision makers in the City of London; or on the other side of the Atlantic, on Wall Street; or for that matter in the hedge-funds of Greenwich, Connecticut; who were female. Read any of the umpteen books being published on the subject of the financial crisis. Take the best, in many ways, Andrew Ross Sorkin's book *Too Big to Fail* which is a masterpiece in journalism; in the sense that, uncannily, Sorkin appears to know exactly what all the key players were saying at every stage of the crisis. Incidentally, I've checked and he didn't make it up. Hardly a single name in the index of that book is female. So, I called this lecture *Men, Money and Morality* because it is about men; and you'll have noticed – and this is why I'm so glad this question has been asked – that the hero of the lecture is not a man. The hero of the lecture is Siegmund Warburg's mother. She's actually the critical figure in this story. Aren't you haunted by that? I am. That exaltation: think of the mistakes you made – think of the omissions – and if you can't think of any, at the end of every day, you're slacking. What a fantastic way to bring someone up. I really must try it on my own kids.

[Laughter]

Giles Fraser: Why have the credit rating agencies escaped unscathed from the banking crisis?

Niall Ferguson: This is a profoundly interesting question; or perhaps a rather technical one. For those of you who are not obsessive readers of the Financial Times, as I of course am, the credit rating agencies are people like Standard & Poor's; Moodys and Fitch whose role it is to do the thinking for investors. To save investors from having to figure out whether a particular security is a

safe investment, or a risky one. They've been in this business for a surprisingly long time, it dates right back to the inter-war years where they really began to grow in significance. Rating securities, shares and bonds – and it might possibly have come to your attention that these agencies played a somewhat malign role in the crisis that exploded in 2007.

In 2007, on the eve of the financial crisis, there were 12 corporations in the world with a AAA credit rating – that's the best you can get. There were 64,000 structured financial products with a AAA rating, including that things that 'Fab' was selling to the Belgian widows and orphans. I remain puzzled as to why the credit rating agencies have got off more or less scot-free from the legislation that has emerged from congress. I've even asked Larry Somers – my former boss at Harvard and now, of course, President Obama's closest economic advisor: 'Larry, what about the agencies?' Now, I think Larry Somers is a very clever man, let me make that quite clear; but the answer that he gave to my question was about the worst I've ever heard from him. It raises the suspicion, and it's an important suspicion that we should discuss, that certain institutions have the power to protect themselves through political lobbying. Through the influence that they can exert not on Wall Street, not on the markets; but in Washington, in the legislative process. This applies not just to the credit rating agencies, it applies across the board. Simon Johnson, of MIT, has posed the question - and I think it is the right question to pose – has the political economy of the United States become corrupt at its core. That's a question that we need to confront; because if there is an improper nexus between financial institutions and political institutions, then the legitimacy of capitalism itself will inevitably be called into question. Call it, if you want to, a kind of Latin-American syndrome – although increasingly that looks a little hard on Latin America. So I think this is a very puzzling and troubling phenomena. One of the things we must watch, like hawks, is that we avoid such a dangerous symbiosis between finance and politics here.

You know, one of the most enjoyable chapters of the book for me to write was the chapter that details Siegmund Warburg's relationship with Harold Wilson. I owe a debt of gratitude to my former student, fellow researcher Glenn O'Hara – really one of the outstanding authorities on the politics of the 1960s – because he helped me figure out what it was that was going on. Think of it. Harold Wilson, who denounced the Gnomes of Zurich, who blamed finance for the devaluation of the pound in 1967, turned out to have had – as his more or less secret financial advisor – Siegmund Warburg. The chapter is a fascinating study in the nature of the relationship between business and politics. What strikes me, at no point in that relationship – which began in WWII and continued all the way through into the 1980s – did Warburg ever seek any preferential treatment whatsoever for SG Warburg. His role was purely that of an advisor on issues of policy. That is the appropriate role for banks to play. We don't want to exclude financial expertise from our system, there has to be a clear understanding that conflicts of interest are real and dangerous. Those who say, and I've heard

it said, that we should embrace the conflicts of interest. Those are the people of whom we should be most suspicious.

Giles Fraser: We've got time for one more question, I think, and if I just collate a number and perhaps try and get you to raise your gaze from the US and the UK to a more global one. I've got one here that says what can we learn from Islamic banking? I've got another question about China and capitalism, morality. A number of questions of that order, I wonder if you could perhaps set what you've been saying in a more global context in...you've got two and a half minutes.

[Laughter]

Niall Ferguson: And I spent last night on a plane! Let me say it very briefly: Islamic finance is a marketing ploy. It's a very ingenious marketing ploy to try and attract Muslim clients to financial institutions that do not fundamentally behave differently from other financial institutions. It's a very successful one, and it is proving more and more successful in countries like – for example – Malaysia or Indonesia where Islamism as a political force is growing in its strength. This is the financial side of that growth – not just of Islam, but of Islamism – which I regard as one of the great threats to Western civilisation; to freedom; and to democracy.

As to China, I've just returned from China. I spent two weeks there travelling around, making a television series that will come out next year on civilisation. A sort of narrow topic. The subtitle of the series will be 'the West and the Rest'. I want to conclude by offering you this thought. If you are consoling yourself that China is about to collapse - that it must be some kind of elaborate Ponzi scheme that they're running in Beijing – dismiss those illusions. The Chinese economic miracle looks, at least to my eyes, unstoppable and it means that, within our lifetimes, perhaps even as early as 2027, China's will be the largest economy in the world. Mark my words, the way the Chinese regulate banks; the way *they* manage their financial system, is very very very different indeed to the way that we have managed ours. What I heard most frequently from the Chinese officials and the businessmen that I spoke to was this: you can no longer lecture us about the superiority of your system. We used to have to listen to all that stuff about the Washington consensus – well you blew it; now we know, our way is best.

The price of financial error, of mismanagement and of fraud, the price of losing morality and ethics in our financial system is more than just a loss of money; more than just a loss of jobs. Ladies and gentlemen, we have risked losing the legitimacy of our Western way – and that seems to be the most alarming consequence of all.

[Cathedral bells ring] [Laughter and Applause]

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