

2012

Warning! Read Instructions Before Operating the World's Financial Machinery: The Lords of Finance Guide to Handling Economic Crises

Kate Klausner

Follow this and additional works at: <http://scholarlycommons.law.hofstra.edu/jibl>

 Part of the [Law Commons](#)

Recommended Citation

Klausner, Kate (2012) "Warning! Read Instructions Before Operating the World's Financial Machinery: The Lords of Finance Guide to Handling Economic Crises," *Journal of International Business and Law*: Vol. 11: Iss. 1, Article 8.
Available at: <http://scholarlycommons.law.hofstra.edu/jibl/vol11/iss1/8>

This Book Review is brought to you for free and open access by Scholarly Commons at Hofstra Law. It has been accepted for inclusion in Journal of International Business and Law by an authorized administrator of Scholarly Commons at Hofstra Law. For more information, please contact lawcls@hofstra.edu.

WARNING! READ INSTRUCTIONS BEFORE OPERATING THE WORLD'S FINANCIAL MACHINERY: THE *LORDS OF FINANCE* GUIDE TO HANDLING ECONOMIC CRISES

*Kate Klausner**

Lords of Finance: The Bankers Who Broke the World. By *Liaquat Ahamed*. New York and London: Penguin Books. 2009.

INTRODUCTION

With a dark cloud of uncertainty looming over the global economy, interest in the Great Depression is piqued. Contemporaries frequently described the collapse of the world's financial system from 1929 to 1933 as an earthquake, blizzard, maelstrom, deluge; so it's no wonder people today are boarding up their windows and running for cover (p. 501). In his timely book, *Lords of Finance*, Liaquat Ahamed asks his reader to instead consider the possibility that the Great Depression was not some act of God or the result of deep-rooted contradictions of capitalism (p. 501). Ahamed convincingly argues that the economic cataclysm now reflected upon was the direct result of a series of misjudgments by economic policymakers—a dramatic sequence of collective blunders—that governments were *not* powerless to resist (p. 501).

The task of deconstructing the causes and consequences of the Great Depression is daunting, and yet Ahamed's historical, economic, and biographical analysis of this complex era has remarkable depth and clarity.¹ He chose to tell the story of the descent from the roaring boom of the twenties into the Great Depression by “looking over the shoulders” of the men in charge of the four principal central banks of the world—Montagu Norman of the Bank of England, Benjamin Strong of the Federal Reserve System, Emile Moreau of the Banque de France, and Hjalmar Schacht of the Reichsbank.² Ahamed effectively uses the careers and lives of his protagonists to guide the narrative, bringing a humanizing element to his depiction of a period plagued by failed attempts at peace, war debts, hyperinflation, and booms followed by busts.

* J.D. Candidate, 2012, Hofstra University School of Law. I would like to express my gratitude to the entire senior staff of the *Journal of International Business & Law* for giving me the opportunity to navigate uncharted waters, and to Matthew Amon for his vision. This book review is dedicated to my family: My brother, David, a true diplomat and scholar, without whom this would not have been possible. My wonderful sisters, Abby and Joey, who influence me more than they know and who make every day an adventure. Ben, my love, who best understands that life is all about learning how to dance. And finally, my parents, who have both given me the world and inspired me to learn about it; I am forever grateful.

¹ Ahamed uses easily discernable metaphors for complicated economic concepts. For example, he writes: “A simple analogy of the choice between deflation and devaluation might be that of the man who has put on weight and is having a hard time fitting into his clothes. He can either choose to lose the weight—that is, deflate—or alternatively accept that his larger waistline is now irreversible and have his clothes altered—that is, devalue,” p. 157.

² P. 7. Ahamed got the idea for his book when he read a 1999 Time Magazine cover story entitled “The Committee to Save the World,” about another dream team of financiers: then Federal Reserve Chairman, Alan Greenspan, President Clinton's Treasury Secretary, Robert Rubin, and Rubin's right hand man, Lawrence Summers, p. 506.

In the context of international business and law, *Lords'* central thesis is that domestic monetary and banking policies have tremendous international ramifications—a notion that bankers and politicians a century ago failed to realize. Wedded to the gold standard and unwilling to forget the post-war reparations that were “bleeding Germany white,” the central bankers dug a hole that swallowed up an entire economic order (p. 417). Their reluctance to see the interconnectedness of the global banking system, where failure in one country led to problems in other countries, proved fatal (p. 15).

Ahamed ultimately concludes that the Great Depression was caused “more than anything else, by a failure of intellectual will, a lack of understanding about how the economy operated” (p. 504). Although bankers in the 1920s and 1930s seemed greedy and incompetent, he concedes that none of the “bankers who broke the world,” as the book’s subtitle phrases it, had ever faced an international financial crisis before (p. 406). Central banks were a fairly new concept, currencies were still tied to gold, and international cooperation on markets was practically unheard of (pp. 11-13). Thus, they had to make things up as they went along (p. 406). Ahmed’s conclusion resonated from economic iconoclast Maynard Keynes who, in 1930, wrote of the world’s economy: “We have involved ourselves in a colossal muddle, having blundered in the control of a delicate machine, the workings of which we do not understand.”³

This Notice commends Ahmed’s portrait of times past and, in light of the current financial crisis, considers the unsettling question *Lords of Finance* poses about the present: Do today’s economic leaders really understand that delicate machinery any better than their predecessors? Or do they just think they do? Part I summarizes the book and explores its central thesis. Part II analyzes the flaws in monetary policies that caused the global economy to collapse. Part III attempts to make Ahmed’s portrayal of the Great Depression relevant to the current financial crisis, and takes account of other scholars’ contributions to this subject matter. A suggestion about consumer confidence and future economic growth concludes.

I. THE IMPORTANCE OF INTELLECTUAL WILL: AHAMED’S CONTRIBUTIONS TO HISTORY AND ECONOMIC SCHOLARSHIP

Ahamed places blame for the Great Depression on two culprits: politicians and bankers (p. 501). The politicians who presided over the Paris Peace Conference overburdened an already fragile world economy still trying to recover from the effects of war with a massive overhang of international debt (pp. 116, 501). Dealing with these claims “poisoned international relations” and “left massive fault lines in the world’s financial system, which cracked at first pressure” (p. 501). The central bankers who took on the challenge of restoring stability to the global economy refused to abandon economic orthodoxy and returned the world to the antique workings of the gold standard (pp. 7-8, 155). They had the power to reconstitute the financial landscape but instead chose to “crucify mankind upon a cross of gold” (p. 14). The implications of these fundamental errors are the heart of Ahmed’s book.

Lords' curtain opens on the dismal scene after the First World War; the world’s financial machinery lay in ruins (p. 7). Onerous and potentially destabilizing indebtedness

³ P. 374. Maynard Keynes, “the greatest economist of his generation,” was a shrewd observer in the years leading up to the Great Depression, p. 10. Ahmed uses Keynes perspective throughout his book as a useful counterpoint to the decision-makers of the day, p. 10.

OPERATING THE WORLD'S FINANCIAL MACHINERY

acted as a millstone around the necks of many countries' economies (pp. 7, 130). Intent on making Germany pay for the cost of the war, the victors, Britain and France in particular, sought punitive damages in the form of reparations.⁴ The mantle of "Banker to the World" had shifted from Britain to the United States, further upsetting the balance of economic power (pp. 135, 210). American money, however, "unused to the vagaries of international politics, flowed in fits and starts" (pp. 197, 210). All of these conditions would "haunt the financial landscape of Europe" for more than twenty years (p. 104).

Central bankers were compelling figures in the 1920s, "invested with unusual power and extraordinary prestige."⁵ The public had become infatuated with a quartet of bankers—Norman, Strong, Moreau, and Schacht—whom the newspapers had dubbed "the most exclusive club in the world" (p. 2). Ahamed's reader is instantly drawn to these men, not only because they faced the same economic issues as their present day successors, but also for the reason that Ahamed describes their personal lives with the zeal of a tabloid insider.⁶ These bankers were at the center of events in the interwar period and Ahamed opines, "each in his own way illuminates the national psyche of his time."⁷ The success of *Lords* can largely be attributed to the way Ahamed artfully conveys what made these men tick.

In the early 20th century, a majority of the world's economies were linked together by the gold standard, which was temporarily suspended during the First World War.⁸ Ahamed is adamant that the central bankers' first fatal flaw was making its restoration a priority (pp. 155-156). The perils of the gold standard were two-fold. First, built on a very narrow base, the system was incredibly fragile. Ahamed writes: "the totality of gold ever mined in the whole world since the dawn of time was barely enough to fill a modest two-story town house," and "new supplies were neither stable nor predictable" (p. 13). Second, there was insufficient gold in Europe to "grease the machinery of world trade" (p. 164). The bulk of the world's gold was concentrated in the United States after the war, while Europe suffered a chronic shortage (p. 164). Ahamed likens the conundrum to a "poker table at which one player has accumulated all the chips, and the game simply cannot get back into play" (p. 164).

⁴ PP. 6, 104. By 1921, the bill for German war reparations was fixed at \$12 billion, an impossible burden for Germany's critically wounded economy to meet, p. 118. A similar debt today would be \$2.4 trillion, p. 505.

⁵ P. 7. The immense power bestowed upon the central bankers was a direct result of the way central banks were structured in the 1920s and 1930s. See e.g. pp. 11-12, 77, 84, 88, 173-176.

⁶ Like today, bankers then faced "dramatic movements in stock markets, volatile currencies, and great tides of capital spilling from one financial center to another," p. 9. Ahamed details everything about the bankers' lives, from their upbringings to their health problems and marital woes, see e.g. 25-29, 39-41, 50, 63, 82, 93, 146, 150, 152, 224, 247-248, 285, 291.

⁷ P. 8. Norman, who rather idealistically relied on his faulty intuition, "embodied a Britain stuck in the past and not yet reconciled to its newly diminished standing in the world," *id.* Moreau's narrow-mindedness and xenophobia, reflected a France that had "turned inward to lick the terrible wounds of war," *id.* Strong was "a man of action"; while deeply overburdened, he "represented a new generation of America, actively engaged in bringing its financial muscle to bear in world affairs," *id.* Schacht's angry arrogance "seemed out of tune with the weak and defeated Germany," but Ahamed suggests "perhaps he was simply expressing the hidden truth about the nation's deeper mood," *id.*

⁸ PP. 11-14, 75. The gold standard involved pegging all major currencies against a specific quantity of gold, p. 11. Paper money was redeemable and, in theory, could be brought to the bank and exchanged for its gold equivalent, p. 12. Central banks were required by law to maintain a certain quantity of gold in its vaults as backing for its paper money, p. 12. In each country, the central bank controlled the flow of currency into the economy by varying interest rates, which was "like turning the dials up or down a notch on a giant money thermostat," p. 12.

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

Gold may have been a dangerous game, but Ahamed explains why the bankers played with fire. The war had brought Britain, France and Germany close to bankruptcy, their economies saddled with debt, their populations impoverished with rising prices (p. 7). The United States had become the world's leading international lender. Its fate, therefore, was inextricably linked to that of Europe (p.132). Before the war, the gold standard imposed order within the framework of economic expansion (pp. 13, 162). To central bankers, a return to gold represented a return to financial stability; thus, they clung tightly to it. For Ahamed, central bankers were like Sisyphus, the mythological character whom the gods had condemned to roll a large stone up a steep hill, only to watch it roll down again (p. 279). The bankers' belief in gold as the foundation for money was so embedded in their thinking that they couldn't imagine its failure (p. 155).

The period between 1929 and 1933 was a culmination of the bankers' and politicians' failure to see the world as connected by one integrated financial system. Ahamed describes the effect of their miscalculations as "a sequence of crises, ricocheting from one side of the Atlantic to the other, each one feeding off the ones before it."⁹ He illustrates how the problem was not just the gold standard, but also the way it was allowed to operate (p. 431). Although prices "rose and fell in great cycles under the gold standard due to ebbs and flows in the supply of precious metal," the larger concern was that the system was "incapable of preventing the type of financial booms and busts that were, and continue to be, such a feature of the economic landscape" (p. 14). Politics of the situation complicated the crises (p. 406), but the bankers' flawed monetary policies set in motion the cascade of events that caused the Great Depression (pp. 404, 504).

The book's climax is so provocative because, with an eye toward the present, Ahamed maintains that all financial crises have an "eerily similar cycle from greed to fear" (p. 14). A surge in optimism—reinforced by "cavalier attitudes to risk" among bankers—becomes overconfidence, and eventually panic (p. 14). Crisis has "a way of spreading, threatening to undermine the integrity of the whole system" (p. 15). A veteran hedge fund manager, Ahamed sees bubbles and crises as "deep-rooted in human nature" and "inherent to the capitalist system" (pp. 14, 506). But, while booms and busts may be unavoidable, the ability to prevent, counteract, and control meltdowns is very much within the reach of policymakers. *Lords* stands for the belief that when taking on a financial crisis, an appreciation for history is the strongest weapon; knowledge about the economy, the best defense. It is therefore worthwhile to consider Ahamed's contribution to scholarship a modern perspective on the Great Depression, from which there is much to be gained.

II. THE GREAT DEPRESSION: LESSONS TO BE LEARNED FROM THE LORDS OF FINANCE

Ahamed concedes that the "limping gold standard" and the "stresses and strains" of trying to keep it going may have made a "financial shakeout inevitable" (p. 502). He argues, however, that it was not necessary for the crisis to "metastasize into a world catastrophe" (p. 502). Before and after the crisis began, each country held fast to its own self-interested agenda and the resulting monetary policies proved self-defeating. But, as the world's economy tee-

⁹ P. 497. The crises included "the contraction in the German economy that began in 1928, the Great Crash on Wall Street in 1929, the serial bank panics that affected the United States from the end of 1930, and the unraveling of European finances in the summer of 1931," p. 498.

OPERATING THE WORLD'S FINANCIAL MACHINERY

tered on the brink of disaster, it was also the absence of policy in response that pushed it over the edge. This Part explores how the monetary policy errors that caused the Great Depression proved to be as much a consequence of omission as commission.

A. Faulty Monetary Policy

Currency competition contributed heavily to the disaster, as the uncoordinated return to the gold standard meant exchange rates were “grossly misaligned” (p. 502). Britain cautiously chose not to inflate its way out of debt or risk a currency collapse, and was rewarded with a weak and vulnerable economy and the highest unemployment rates in Europe (p. 159-161, 219). France lightened the burden of debt by devaluing its currency, and gained a profound competitive advantage (p. 219). Deliberately fixing the franc at an undervalued rate, France cheapened French goods and effectively disadvantaged Britain’s export industries (p. 219). France’s mistake, however, was to assume that the value of currency of a major economic power was a matter for that country alone (p. 268). Because exchange rates, by their nature, are a reflection of a multilateral system, France’s policy would eventually help undermine the stability of the very standard to which it had hitched its currency (p. 269).

Because of the dysfunctional gold standard, the central bankers were only able to keep the economy afloat using a system that “held the seeds of its own destruction” (p. 502). In keeping U.S. interest rates down to bolster international exchanges, the bankers “precipitated a bubble in the U.S. stock market” (pp. 276, 502.). Believing it could deflate the bubble gently, so as not to harm the economy, the Fed half-heartedly attempted to curb speculation (p. 321). Ahamed labels this an “absurd idea” because “monetary policy does not work like a scalpel, but more like a sledgehammer” (p. 320). In October 1929, the frenzied bubble burst, exposing the veneer of boomtown prosperity (pp. 354-358). The repercussions of the Fed’s faulty policy of easy credit were tremendous (pp. 320, 502). As the bubble grew, it caused a “squeeze in international credit” (p. 502) The sudden halt in flow of American capital to Europe “tipped Germany into recession” and sent deflationary forces throughout the world (pp. 498, 502). On its way down, the bubble shook the U.S. economy, sending it plunging into its own recession (p. 502).

A collapse in capital flows, spurred by trade protectionism and obsessive gold hoarding, was largely responsible for the fall in prices that magnified worries about fiscal sustainability around the world (p. 379). During the 1920s, the United States was “major haven for gold flows,” but after the stock market crashed U.S. foreign investment to Europe “dried to a trickle” (p. 375). Higher import tariffs imposed by the protectionist Smoot-Hawley Act also shrank U.S. demand for European goods (p. 375). Without a line of credit, Europe was forced to pay for its imports and service its debts in gold (p. 375). Gold also flooded into France because pegging the franc at low rate meant French goods remained attractively priced (p. 377). By 1930, the United States and France had accumulated more than half of the world’s gold stock (pp. 162, 376).

The already modest gold reserves in countries like Britain and Germany depleted rapidly (p. 375). Much of the reason why American capital remained “bottled up at home” was a result of the weakened U.S. economy (p. 375). France, in contrast, had the strongest economy in Europe, and yet insisted on stockpiling gold to the detriment of the wider system (pp. 378-379). In order to avoid inflating money supply, France sterilized much of its gold, effectively keeping in vaults and withdrawn from circulation (p. 378). While capital should

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

have been kept flowing across borders to wherever it was needed, France's policy of short-circuiting the gold standard, starved the world of much needed liquidity (p. 378).

B. Inadequate Policy Response

There were several voids in counter measures that aggravated the recession into a violent crisis. The first resulted from a lack of international collaboration and decisive action. Monetary-policy responses to deflationary shocks needed to be coordinated across countries, but deep-rooted feuds offset cooperation (pp. 378, 382, 502). In addition, the Fed did not act decisively or establish a clear policy in response to the crisis (pp. 322, 359). During the key months of 1929, the Fed appeared paralyzed to act (p. 322). It cut interest rates sharply after Wall Street crashed, but stopped easing much too soon in the summer of 1930 (pp. 365-366). Believing the economy would return to an even keel automatically, the Fed did almost nothing to counteract deflationary forces except wait them out (p. 503). While inappropriate tightening of policy was the root of the downturn, the subsequent failure to provide greater monetary stimulus turned the recession into a depression.

Another void was the failure to mitigate panics. Doubts about the safety of financial intermediaries caused a series of bank runs that spread across the United States from 1931-1933 (p. 499). Depositors hoarded currency and pulled their money from banks (p. 499). To counteract a crisis, a central bank "should lend freely, boldly, and so that the public may feel you mean to go on. . . [a] panic is a species of neuralgia, and according to the rules of science you must not starve it" (p. 387). Instead of fulfilling its role as the lender of last resort, the Fed stood passively aside while thousands of banks failed and credit contracted forty percent (pp. 499, 503). A similar lack of intervention caused the evaporation of confidence in European banks and currencies. The European financial crisis of 1931 pushed much of Central Europe to impose capital controls and default on their debts (p. 500). The resulting "contagion of fear" led to an unraveling of the entire gold-based system (p. 500).

There is a lesson to be gained from the stock market bubble itself, which resulted when speculation caused stocks to "completely lose touch with economic reality" (p. 498). Aside from the Fed's policy of easy credit, greedy corporate insiders and a "rouge's gallery of Wall Streeters," oft blamed for encouraging the market for personal gain, pushed the bubble upward (pp. 315, 498). But, while it may be possible to predict the factors that cause any given stock to rise or fall, the overall market is driven by fluctuations in confidence, "a force so intangible and elusive that it [is] not readily discernable to most people" (p. 307). The "speculative orgy" was thus fueled by the herd mentality of everyday investors; gamblers, old timers, novices—their memory lapses, superstitions, and gullibility working against them—had become obsessed with trading stock (p. 311). Regulation aimed at curtailing excessive risk taking may have reduced the possibility of crisis, but none existed. The problems caused by the absence of this type of policy were only compounded by a general weakness in government regulation over the banking system and a void in crisis-management measures to reduce the impact of panics.

III. THE GREAT RECESSION: WILL HISTORY BE REPEATED?

It is clear that wiping dust from long forgotten pages of history was not Ahamed's only goal when sitting down to write this commanding piece of literature. For Ahamed, economic crises are not some "historical curiosity" (p. 15). As he wrote his book in October

OPERATING THE WORLD'S FINANCIAL MACHINERY

2008, credit markets were frozen, stock markets were crumbling, financial institutions were hoarding cash, while news stories about banks around the world going under or being taken over had become a weekly occurrence (p. 15). He reflected: "Nothing brings home the fragility of the banking system or the potency of a financial crisis more vividly than writing about these issues from the eye of the storm" (p. 15). A lot more has happened, however, since *Lords* was published in 2009. This Part assesses whether the remedial actions taken by current authorities have staved off catastrophe, and considers the perspectives of other scholars on the future of finance and economics.

A. Policymakers' Response to the Current Economic Crisis

While bankers and politicians have, over the past two decades, seemed as blind to the unintended consequences of their decision-making as their 1920s contemporaries, the fate of the financial system does not seem as grim as it did eighty years ago. Economic scholar Dennis Keegan contends that the massive intervention of the world's central banks is a strong indicator another depression has been avoided.¹⁰ The Fed responded aggressively to the subprime mortgage crisis, for example, dropping official interest rates and creating numerous programs to offset the credit collapse.¹¹ As the recession spread internationally, European banks followed suit, taking measures to rescue financial companies and ease market conditions.¹² Unlike in the past, the United States pursued innovative policies that allowed more dollars to be available globally.¹³ Governments have injected massive amounts of liquidity into the system, and provided capital to banks at unprecedented levels.¹⁴

International cooperation has been productive, but questions linger about whether further calamity may still be possible. Greece, for instance, has received several bailouts from European members States and the IMF, and will continue to receive more help in the future.¹⁵ "[T]he purpose of the funding is to help Greece avoid default on its loans, which would cause further disruptions to the European financial sector and Wall Street."¹⁶ Many experts, however, suggest default is inevitable because Greece owes more than it can realistically pay back.¹⁷ Additionally, smaller countries, like Slovakia, have voted against recent bailouts because their economies cannot afford to expense the counter-measures put in place by larger economic powers.¹⁸ Related funding pressures have also pushed large-scale lenders like Franco-Belgian Dexia Group to the brink of collapse, and analysts warn that the European banking system is vulnerable to more failures.¹⁹

¹⁰ Dennis Keegan, *At the Intersection of Global Economics and Politics*, 8 J. INT'L BUS. & L. 1, 2 (2009).

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ *Id.*; See also, American Recovery and Reinvestment Act (ARRA), 26 U.S.C. § 1 (2009).

¹⁵ Aaron Smith, *Greece: One Step Closer to More Bailout Funds*, CNN, Oct. 11, 2011, available at http://money.cnn.com/2011/10/11/news/international/greece_bailout/index.htm.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Slovakia Votes Down Eurozone Bailout Expansion Plan*, BBC News, Oct. 11, 2011, available at <http://www.bbc.co.uk/news/world-europe-15265987>.

¹⁹ Ben Rooney, *European Bank Rescue Talk Intensifies*, CNN, Oct. 5, 2011, available at http://money.cnn.com/2011/10/05/news/international/europe_bank_recapitalization/index.htm.

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

In 2011, as part of a measure to address high rates of unemployment, U.S. President Barack Obama proposed a bill aimed at reforming taxes to fund the creation of jobs.²⁰ The President has acknowledge that the “problems Europe is having could have a very real effect on our economy at a time when it’s already fragile. But this jobs bill can help guard against another downturn if the situation in Europe gets worse. It’ll boost economic growth, it’ll put people back to work.”²¹ Obama’s words indicate a greater understanding of the interconnectedness of the world’s financial system—an area where his depression era counterparts fell short. However, the Senate did not pass his bill, “reflecting a cavernous ideological divide over economic growth strategies.”²² If the economy’s negative momentum is not countered in other ways, unemployment rates may remain high for the foreseeable future.²³

B. Scholars’ Suggestions About the Future Financial Landscape

Shifts in the balance of economic power, similar to those that occurred after the First World War, are currently transforming the existing financial framework. Some scholars have argued that as the world’s economy evolves, a change in perspective is warranted. One area of change involves currency valuation and the U.S. dollar.²⁴ Since 2001, the U.S. dollar has lost more than forty percent of its value against the Euro, thirty percent against the British Pound, and about twenty percent against the Japanese Yen.²⁵ Currency strategist Dr. Michael J. Woolfolk suggests that as the U.S. descends further into a several trillion-dollar debt, and U.S. growth and interest rates lag behind those in other major economies, the value of the U.S. dollar is expected to decline even more and remain weak for some time.²⁶ Available evidence also indicates that growth in foreign exchange reserves has been accompanied by a notable push to diversify away from U.S. dollars in to Euros.²⁷

Sovereign risk is another area of change that is challenging the status quo. Ramon Maronilla and Kevin D. Anderson, experts on fixed income, argue that profound structural shifts in the economic landscape are giving investors reason to revisit previously held beliefs about global sovereign risk.²⁸ Conventional wisdom dictated the debt of large advanced economies like the U.S. should be seen as carrying very low risk, and debt issued by Asian borrowers was considered volatile and risky.²⁹ In analyzing the creditworthiness of many country’s sovereign debt, however, they found that these assumptions may no longer hold true.³⁰

²⁰ Alan Silverleib, *Obama Jobs Bill Faces Likely Senate Defeat*, CNN, Oct. 10, 2011, available at http://www.news8000.com/news/politics/Obama-jobs-bill-faces-likely-Senate-defeat/-/1032/2853176/-/format/rsss_2.0/view/print/-/6lcejv/-/index.html.

²¹ *Id.*

²² *Id.*

²³ See Keegan, *supra* note 12, at 5.

²⁴ Dr. Michael J. Woolfolk, *Global Markets: Currency Valuation and the Outlook for the U.S. Dollar*, 7 J. INT’L BUS. & L. 1 (2008).

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.* at 8.

²⁸ Ramon Maronilla & Kevin D. Anderson, *The Changing Landscape of Global Sovereign Risk*, 10 J. INT’L BUS. & L. 99 (2011).

²⁹ *Id.*

³⁰ *Id.* To analyze the credit quality of each country’s sovereign debt, Maronilla and Anderson weighed qualitative factors—stability of the country’s political system, the perceived effectiveness of its central bank

OPERATING THE WORLD'S FINANCIAL MACHINERY

The global financial crisis caused the G-7 countries to register negative growth rates for 2009 and these economies are expected to post only modest growth rates as they move toward fiscal sustainability.³¹ In contrast, developing Asian countries posted positive growth rates in 2009 and future growth is projected to be robust.³² Data indicates that investors consider select European government debt riskier than even lower rated, Asian debt.³³ Although emerging Asian economies are still subject to risks associated with emerging markets, Asian governments have taken measures to mitigate risk and build credible track records.³⁴ Maronilla and Anderson conclude that because of the explosion of debt among many advanced economies, coupled with the risk of significant slowdown in growth, the search for diversification across developed and emerging bond portfolios has intensified.³⁵

Law professor Dan Danielson believes the current economic crisis has “demonstrated a need to assess the countless legal rules and institutions that affect global economic life from the perspective of their impact on global welfare as a whole.”³⁶ While economic globalization has increased prosperity for people in the developing world, financial interdependence has increased vulnerability to the volatility of the world economy.³⁷ Danielson concludes that, despite their accomplishments, law and economic scholars are using methods that limit their ability to fully capture the complexity and diversity of the international legal order.³⁸ He proposes expanding upon existing analytic methods in order to achieve more comprehensive results.³⁹ Danielson and the other scholars discussed above agree that the current financial crisis has caused a rapid and drastic restructuring of the world's economy, the consequences of which can best be met with innovative solutions, forward thinking strategies, and open-mindedness to change.

CONCLUSION

In the early 1930s, in addition to keeping their hands on the levers of the gold standard, central bankers took on the task of forestalling bank panics and other crises (p. 15). Ahamed believes, however, that “ultimately the goal of a central bank in a financial crisis is both very simple and very elusive—to reestablish trust in banks” (p. 15). Today, a continued lack of trust in the banking system is perhaps the greatest hurdle not yet mounted. This concern is exemplified, for example, by the massive protest known as Occupy Wall Street that has left hundreds of demonstrators eating, sleeping and rallying in downtown Manhattan,

and the country's ability to adapt to shifts in the global economy—against quantitative factors—the size and growth rate of a country's GDP, total debt as a percentage of GDP and the current fiscal deficit as a percentage of GDP. *Id.*

³¹ *Id.* at 100. G-7 is an economic and political group of seven developed, industrialized nations with large economies, including France, Germany, Italy, Japan, United Kingdom, United States, and Canada. *Id.*

³² *Id.*

³³ *Id.* at 102; The Philippines and Indonesia, for example, have the same credit rating as Greece, yet investors are more worried about the creditworthiness of Greece because of its high deficit-to-GDP ratio. *Id.*

³⁴ Risks associated with emerging markets include government, political and social instability, regulatory risks, lack of transparency, and others. *Id.*

³⁵ *Id.* at 103.

³⁶ Dan Danielson, *Economic Approaches to Global Regulation: Expanding the International Law and Economics Paradigm*, 10 J. INT'L BUS. & L. 23 (2011).

³⁷ *Id.*

³⁸ *Id.* at 85.

³⁹ *Id.* at 86

THE JOURNAL OF INTERNATIONAL BUSINESS & LAW

showing no signs of going home.⁴⁰ In September 2011, NPR reported that protesters have said they are “tired of struggling to make a living while the big banks get help from the government.”⁴¹ Some argue that the political system is “being gamed by corporations and the wealthy.”⁴²

New York’s Mayor Michael Bloomberg expressed disdain for those who play the blame game: “Our problem today is we keep going and vilifying the banks. They’re not going to make any loans. If they don’t make any loans, companies don’t expand. If companies don’t expand, people don’t have jobs.”⁴³ Investment banks, however, are no longer private partnerships, but publically held companies. In addition to reducing accountability, “going public allowed the former Investment Bank Partnerships to become more powerful, with much deeper equity cushions, giving them the gravitas to actively influence regulatory change to support their agendas.”⁴⁴ In 2004, for example, investment bank CEOs convinced the Securities and Exchange Commission to change its rules, allowing investment banks to increase the amount of debt they could take on in their books.⁴⁵ The end result was that “shareholders suffered, but employees and executives didn’t.”⁴⁶

It would seem, therefore, that the public has every right to question the methods and practices of investment banks.⁴⁷ Scholars argue that if investment banks do not want the public “digging into their businesses,” they should shrink their balance sheets, stop relying on the Federal Reserve for funding, replace government-subsidized debt with market-rate debt, and “get out of index funds that bet against our domestic economy.”⁴⁸ In addition, a lot is riding on the policy responses of economic leaders and regulatory authorities. Consumer spending, and in turn consumer confidence, drives approximately 70% of economic growth.⁴⁹ If consumers are uncertain about the economy, they will buy less and the economy will slow further.

Ahamed admits that there is no “magic bullet” or formula for dealing with financial panics; however, “it is the skill that [policymakers] display in navigating these storms through uncharted waters that ultimately makes or breaks their reputation” (p. 16). *Lords of Finance* is a lesson in economics and history, as well as the story of four men whose formulas failed and

⁴⁰ Arun Venugopal, *Wall Street Protest Continues This Week*, NPR, Sept. 27, 2011, available at <http://www.npr.org/2011/09/27/140854961/wall-street-protest-continues-this-week>

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ Dennis McDermott, *Some Thoughts on Occupy Wall Street*, Oct. 27, 2011, available at <http://walrus51.wordpress.com/2011/10/27/occupy-wall-street>.

⁴⁵ *Id.* “Before Lehman crashed, it had amassed more than \$600 billion in debt. No partnership or private corporation could have achieved that milestone.” *Id.*

⁴⁶ *Id.* “When Lehman failed, \$45 Billion in shareholder value disappeared forever. Bear Stearns was rescued from a similar fate when JPMorgan bought it at what some have claimed was a fire-sale price with the help of the Federal Reserve. Morgan Stanley and Goldman managed to remain independent and solvent, apparently because huge subsidies were made available to them.” *Id.*

⁴⁷ *Id.*

⁴⁸ *Id.*

⁴⁹ Hale Stewart, *Consumer Spending and the Economy*, N.Y. TIMES, Sep. 19, 2010, available at <http://fivethirtyeight.blogs.nytimes.com/2010/09/19/consumer-spending-and-the-economy/>; See generally, The Conference Board, <http://www.conference-board.org/data/consumerdata.cfm>.

OPERATING THE WORLD'S FINANCIAL MACHINERY

who faded from memory as a result (p. 8). While politicians and bankers have done a great deal to prevent a catastrophe, they still need to do a lot more to restore stability to the world's financial system; they need to read this book.

