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Anxieties about the true value of their assets caused three money market funds run by BNP Paribas to suspend withdrawals on 9 August 2007. That announcement has become accepted as the start of the Great Financial Crisis, now almost a decade ago. Turmoil in the financial system was followed by the Great Recession of late 2008 and early 2009, in which many countries experiencing the worst downturns in demand, output and employment since the Great Depression of the early 1930s.

Although key events are narrated easily enough, no consensus has yet emerged on causation. Most commentators have claimed that bankers were to blame in some way, implying that a "tidying-up of bank balance sheets" was the correct answer. This line of thought was certainly the underlying basis for the policy response in Britain in the 18 months from August 2007.

For several years before the crisis Britain's banks had been growing their loans more rapidly than their retail deposits. They covered the gap by heavy inter-bank borrowing, mostly from banks in other countries. In August 2007 the global inter-bank market closed, cutting off this vital source of funding. Many banks expected the Bank of England to respond as it had done in earlier episodes of inter-bank stringency by making available large credit facilities to them.

But the governor of the Bank of England, Mervyn King, had other ideas. The institutions that were most vulnerable to the closure of the inter-bank market included a handful of former building societies, such as Northern Rock. By mid-August its funding problem had become critical. A possible solution was for a well-funded bank to buy it and absorb its operations. Lloyd's was the obvious "safe harbour", as it had been cautiously managed in the credit boom and did indeed want to acquire Northern Rock.

But even Lloyd's was worried about its future balance-sheet strength. It asked for a back-up loan facility from the Bank of England to facilitate a possible transaction. King was opposed, saying that it was not the central bank's job to help bank mergers. Lloyd's pulled the deal and Northern Rock was forced to seek an emergency cash loan from the Bank of England. The issue of a press release on Northern Rock's plight on 13 September was bungled, provoking the first large-scale retail run on a British bank since the nineteenth century.

The Bank of England's – or at any rate Mervyn King's – aversion to extending loans to cash-strapped banks persisted throughout the crisis. In King's view, any cash support for a UK financial institution which lasted longer than six months ought to come from either the private sector or the government, not from the Bank of England. On 22 February 2008, exactly six months after the government had guaranteed its deposits to stop the run, Northern Rock was nationalized without compensation.

In the autumn of 2008 even the big clearing banks (apart from HSBC, helped by its extensive retail network in Asia) faced the same predicament as Northern Rock. The government and the Bank of England presented them with an ultimatum. The Bank of England would provide them with loans to meet their funding needs, but only if they agreed to capital injections from the state. These injections amounted to partial nationalization and would allow the state to meddle in management decisions. But, if the banks refused the offer, they could find themselves in the same mess as Northern Rock and might also be nationalized without compensation.

RBS, HBOS and Lloyd's complied with the government's demands, but Barclays declined. It instead was able to raise the money required by the regulators from Qatar, the small Gulf kingdom which had sums sitting idle in American and European banks because of huge gas exports. Was Barclays right to go to Qatar? Even today its decision is controversial. The banks' executives have been charged with fraud by the Serious Fraud Office, which alleges that key individuals in the Qatar authorities were bribed.

One view is that the Bank of England was responsible for the fiasco, because it failed to make last-resort loans efficiently and promptly. Indeed, Walter Bagehot in his 1873 classic work on *Lombard Street* warned that, unless the central bank acknowledged that such loans were essential to counter a run, "our liability to crises and our terror at crises will always be greater than they otherwise would be". A counter-argument is that the capital from Qatar was more expensive than that from the British government and that Barclays' management were needlessly hostile to state involvement. Their more outspoken critics would say that they were overpaid, greedy and incompetent, and did not deserve a bail-out at all.

Since then the pressure on all international banks to have ever-higher levels of capital has been intense and unremitting. Again, the results have been controversial. Some experts believe that the recapitalization drive has made banks more resilient than before the GFC. An alternative and much more critical view is argued by some papers in a recently-published book on *Money in the Great Recession*, of which I am the editor.*

In the traumatic conditions of late 2008 the banks could not easily raise new equity capital. In my chapters I contend that the increase in banks' capital/asset ratios was therefore certain to lead to shrinkage in their assets, particularly their loans to the private sector. When somebody repays a loan by drawing on a deposit, the deposit disappears from the economy. It needs to be remembered that bank deposits are the main form of money nowadays. So banks' asset shrinkage leads to the destruction of money balances.

Logically, the sequel to the official demands for higher capital/asset ratios was a plunge in the rate of growth of the quantity of money in late 2008 and 2009. An argument can be made that this collapse in money growth – which was particularly marked in the USA and the Eurozone – was the main cause of the Great Recession. If so, the pattern of causation in the Great Recession has definite similarities to that in the USA's Great Depression in the early 1930s. In their famous work on *A Monetary History of the United States 1867 – 1960* Milton Friedman and Anna Schwartz proposed that a 40 per cent fall in the quantity of money was responsible for the severe setback in demand and output that ran from late 1929 to early 1933, and for subsequent mass unemployment.

Happily, on its tenth anniversary it is clear that the Great Financial Crisis has not had – and will not have – such a gruesome outcome. From spring 2009 vigorous and appropriate

measures were adopted, by means of so-called “quantitative easing”, to expand the quantity of money. But the Great Recession was man-made, not an Act of God. If the Bank of England had been more flexible in the early stages of the crisis, and if officialdom had taken action in autumn 2008 to boost the quantity of money rather than focussing so obsessively on bank capital, the worst of the UK’s Great Recession could have been avoided. In their determination to punish the bankers for their actual or alleged sins, top central bankers and regulators forgot the importance of the quantity of money to macroeconomic conditions.

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* Tim Congdon (ed.) *Money in the Great Recession*, published by Edward Elgar Publishing.