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## Good question, Ma'am

By Alan Beattie

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Dear Ma'am

So the news has filtered through to Buckingham Palace that there's a **financial crisis** on. (Sorry to break this to you, but we lost the Empire as well.) This, at least, is what we gather from reports that you put Luis Garicano of the London School of Economics on the spot with the question: "If these things were so large, how come everyone missed them?"

It's a reasonable question – and one to which you evidently haven't had a satisfactory answer during your weekly visits from that man who comes to tell you what is going on. Not the nice smooth one – he went some time ago. Now it's the grumpy Scottish one who addresses you as though you were a public meeting.

All in all, that's not surprising. The grumpy one has desperately been trying to give the impression that the crisis suddenly and inexplicably pitched up in Europe from New York, like a confused migrant trying to buck the historical trend.

If I were you, Ma'am, I'd raise a regal eyebrow in polite scepticism at that one. The truth is that lots of people in lots of different countries simultaneously made the same mistake. The explanation you got from the man from the LSE was a pretty good summary. "At every stage," Prof Garicano apparently replied, "someone was relying on somebody else and everyone thought they were doing the right thing."

That is at least half right. House buyers took the view that as long as someone was prepared to lend them money, things would be OK. The mortgage lenders reckoned that as long as they could package up the mortgages as newfangled financial derivatives (it's a long story, Ma'am) and sell them on, that would be fine. The financial institutions surmised that as long as the credit ratings agencies were giving the derivatives their seal of approval, everything would be dandy. The credit ratings agencies thought – actually, it is pretty hard to work out what in God's name the credit ratings agencies were thinking, except that as long as their rivals were giving these assets the thumbs-up, they had better do so as well. As for the regulators, Ma'am, the point is that they didn't really know and too many didn't want to. Warren Buffett, a somewhat well-known investor from one of your revolted colonies, called these exotic derivatives "weapons of mass destruction".

(Speaking of WMD devastating large parts of Docklands and the City of London, some of my more venerable colleagues vaguely recall your mother touring the area in an earlier era to sympathise with battered locals. But I'm not sure about a repeat performance: back then the destruction was easier to spot, the villain simpler to identify, and "shell-shocked" wasn't a metaphor.)

Actually, the comparison is apter than even Mr Buffett might have thought. The main thing about these derivatives is no one knew how big the stockpiles were, who had them, or what exact form they took.

Nor did people know enough about how much they were really worth. To extend the Iraq war analogy, the smarter economists treated this as a known unknown. They knew that they didn't know, and they knew that they wanted to know. But the politicians and regulators whose job it was to know, it appears, didn't want to know, or didn't want to know badly enough. They are now pretending it was an unknown unknown. Don't believe them.

How did they get away with it? Partly because there were always some tame economists on hand to say that everything was fine. Economists are supposed to be scientists, albeit of the social variety. It gets dangerous when you start treating them as court necromancers, selectively listening only to the ones whose views you find congenial. And at each point, it wasn't in the politicians' interests to poke around too much. Look at it from the perspective of your own dear government. They came to power after 18 years in the windswept wastes of opposition being continually caricatured as profit-loathing Luddites. The last time they had been in office, investors had gone on strike and forced them to borrow from the International Monetary Fund.

This time round, when you asked that nice smooth man to form a government for you and he politely obliged, the economy was growing merrily. House prices were rising. People were feeling richer and taking out more loans. (God might save, our gracious Queen, but your subjects are better at borrowing.) Banks were creating lots of jobs. The golden eggs, both economic and electoral, kept tumbling into your government's lap. It would have taken a brave minister to go anywhere near the goose, particularly when it was being fiercely guarded by a dour Scotsman with a giant clunking fist and a truly divine talent for hand-to-hand infighting. As for the banks themselves, they were supposed in essence to take out proper insurance against everything going wrong. But they didn't, and the taxpayer ended up footing the bill. (Does this ring a bell, Your Majesty? Something about Windsor Castle and fires?)

So there you have it. Why didn't people see it coming? Some did, Ma'am. Some did. But it doesn't mean they were listened to. And there is a long history of people in authority running up vast debts without public accountability and eventually losing their heads. Let's just try and get through this one without a civil war, shall we?

Yours sincerely,  
Alan Beattie

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