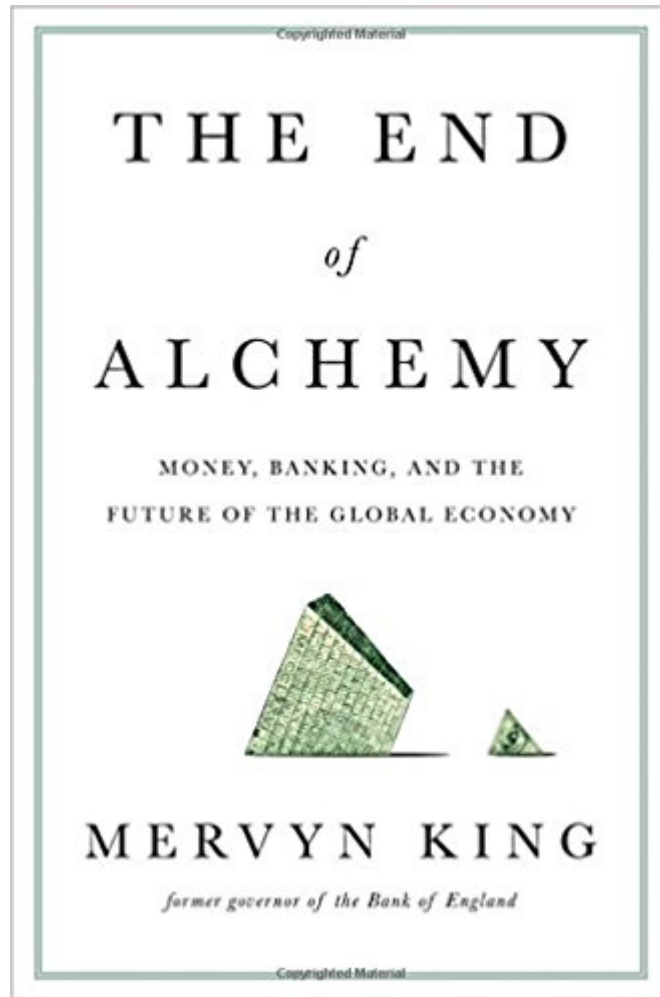


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The End Of Alchemy: Money, Banking, And The Future Of The Global Economy



Synopsis

“Mervyn King may well have written the most important book to come out of the financial crisis. Agree or disagree, King’s visionary ideas deserve the attention of everyone from economics students to heads of state.” —Lawrence H. Summers

Something is wrong with our banking system. We all sense that, but Mervyn King knows it firsthand; his ten years at the helm of the Bank of England, including at the height of the financial crisis, revealed profound truths about the mechanisms of our capitalist society. In *The End of Alchemy* he offers us an essential work about the history and future of money and banking, the keys to modern finance. The Industrial Revolution built the foundation of our modern capitalist age. Yet the flowering of technological innovations during that dynamic period relied on the widespread adoption of two much older ideas: the creation of paper money and the invention of banks that issued credit. We take these systems for granted today, yet at their core both ideas were revolutionary and almost magical. Common paper became as precious as gold, and risky long-term loans were transformed into safe short-term bank deposits. As King argues, this is financial alchemy—the creation of extraordinary financial powers that defy reality and common sense. Faith in these powers has led to huge benefits; the liquidity they create has fueled economic growth for two centuries now. However, they have also produced an unending string of economic disasters, from hyperinflations to banking collapses to the recent global recession and current stagnation. How do we reconcile the potent strengths of these ideas with their inherent weaknesses? King draws on his unique experience to present fresh interpretations of these economic forces and to point the way forward for the global economy. His bold solutions cut through current overstuffed and needlessly complex legislation to provide a clear path to durable prosperity and the end of overreliance on the alchemy of our financial ancestors.

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Customer Reviews

Stop what you're doing, drop everything, buy and read this book. Twice. I'll start my second reading as soon as I'm done writing down my thoughts. I'd gladly swap all ten books I've read about the crisis (at ten) for this modest and mischievous masterpiece. Mervyn King does not go looking for villains or victims here. You will not find the words 'greed' or 'fear' in this text, nor do you get any history recounted, unless it is to illustrate a point. What you get is an informal, comprehensive, passionate and witty treatise on the origins, purpose and future of money, banking and monetary policy. And yes, you do also find out what he thinks about the crisis. As a former central banker and protagonist in the crisis, he not only accepts blame for wrongheaded policy at the BOE, he also proposes changes to the banking system that address the problems he identifies with the status quo and will hopefully enhance the system's stability in the future. That is, indeed, the bit of the book that gives it its name: the 'End of Alchemy' is a proposal to move from a 'lender of last resort' model to a 'pawnbroker' model of central banking; endorsements of the book by Summers, Volcker and Greenspan testify to its validity. The main idea is all bank assets at all times should be pre-assessed for central bank haircut while nerves are calm and heads are cool; second, banks should only ever have current liabilities equal to the 'pawned,' post-haircut amounts that could be pre-positioned to raise cash in a crisis. Neat, if insufficient at current levels of liabilities. Single events (dunno, the failure to bail out Lehman for example) do not merit mention in this narrative.

This latest memoir/collection of economic oriented thoughts from a central banker differs primarily from those written by Dr. Ben Bernanke and Alan Greenspan in that, unlike those books, it is not an autobiography. The author and former head of the Central Bank of Britain, Dr. Mervyn King, instead concentrates on discussing what he believes are the problems with current money and banking systems in the developed world along with what he considers to be solutions. The book is not geared towards specialists in the field or graduate students but for those he defines as the 'interested' public. On pp.6-7 the author writes: 'It [this book] is written in plain English | Although I would like my fellow economists to read the book in the hope that they will take forward some of the ideas presented here, it is aimed at the reader with no formal training in economics but an interest in the issues'. Despite this, this reviewer still recommends that the reader should have

the equivalent of an undergraduate degree in economics to really appreciate what is put forth. One of the wonderful things about the book is that it is filled with novel and/or very reasonable economic ideas, primarily in the policy realm. For example, the author like many professional economists, believes that central banks should set rules to follow but that these rules need to be flexible due to radical uncertainty and the changing policies required as a result over time. It is not so much rules, fixed or not, that are important as transparency in central banking. The book also points out the main weakness of modern banking systems and proposes a solution. That is inadequate capitalization combined with radical uncertainty which, in turn, leads to runs on banking systems during crises of confidence.

The End of Alchemy gives an insider's view on the role and evolution of central banking in the last 20 years. The author outlines in plain language how central banks operate, the economic theories that frame those operations and how those theories and the practice of monetary policy have changed as the conditions have changed. The author outlines how the role of lender of last resort is of a totally different nature today compared to Bagehot's time and how often the nature of economic uncertainty is not appropriately considered when thinking about the calculation of risks. In this book one gets a clear description of today's economic challenges and some policy prescriptions that will be partial solutions to some of the moral hazard and prisoner dilemma challenges we face. Much of The End of Alchemy gives the reader a background in some of the economic theory that goes into the central bank's role in the economy. The author discusses the money supply, fractional reserve banking and the only recent progression to independent central banking that has taken place. The author also discusses the nature of uncertainty that we actually face in our daily lives. This boils down to considering the concept of Knightian uncertainty where the distribution of outcomes is not known and so there is no objective way to optimize decisions. The author builds out this idea and discusses how modern market clearing mechanisms can't coordinate investment activity under this kind of uncertainty and uses long dated oil demand as an example. The author also spends time discussing the role of banks in maturity transformation of lending to long run risky projects by borrowing short term deposits. This process the author describes as the alchemy of finance.

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