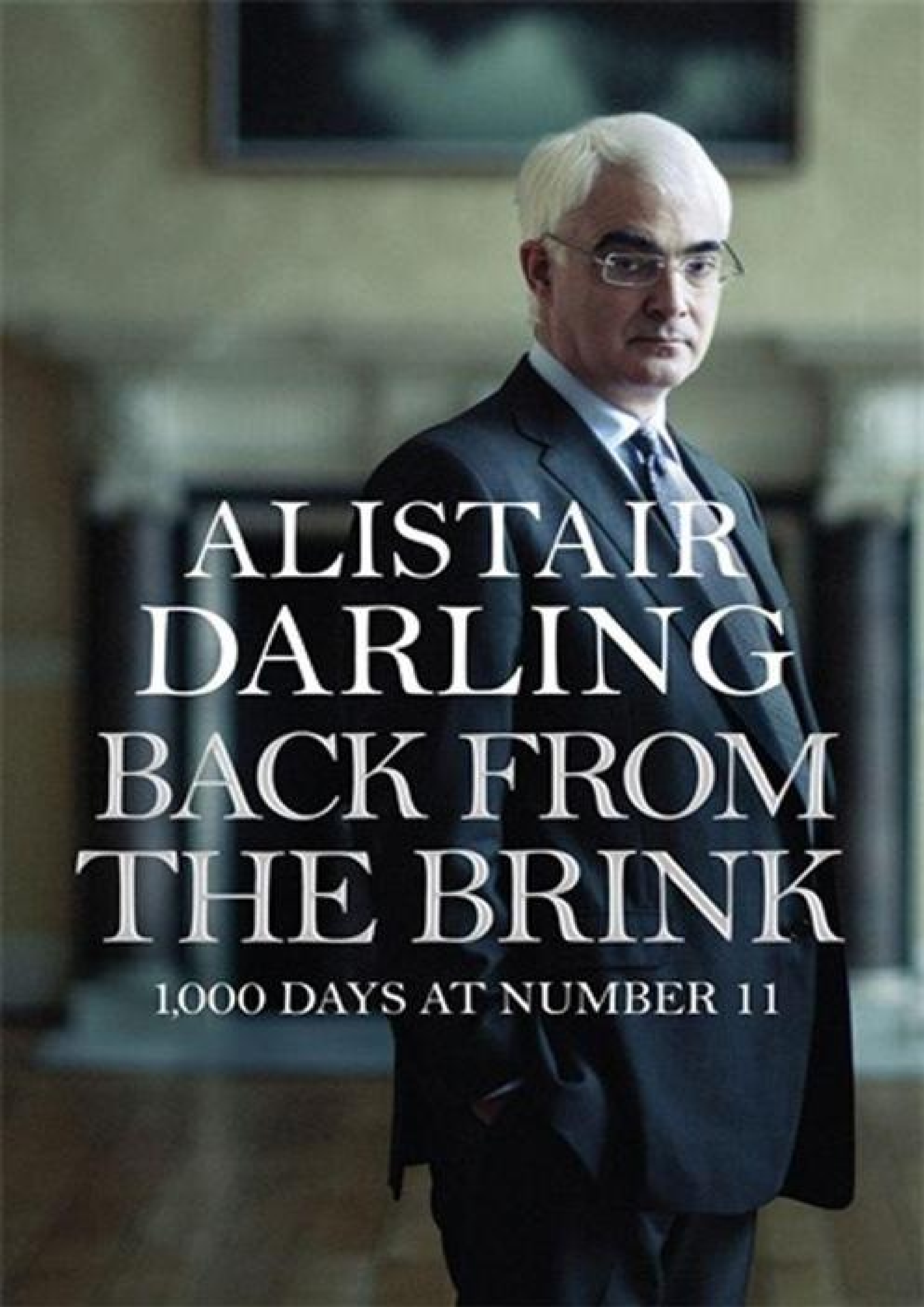
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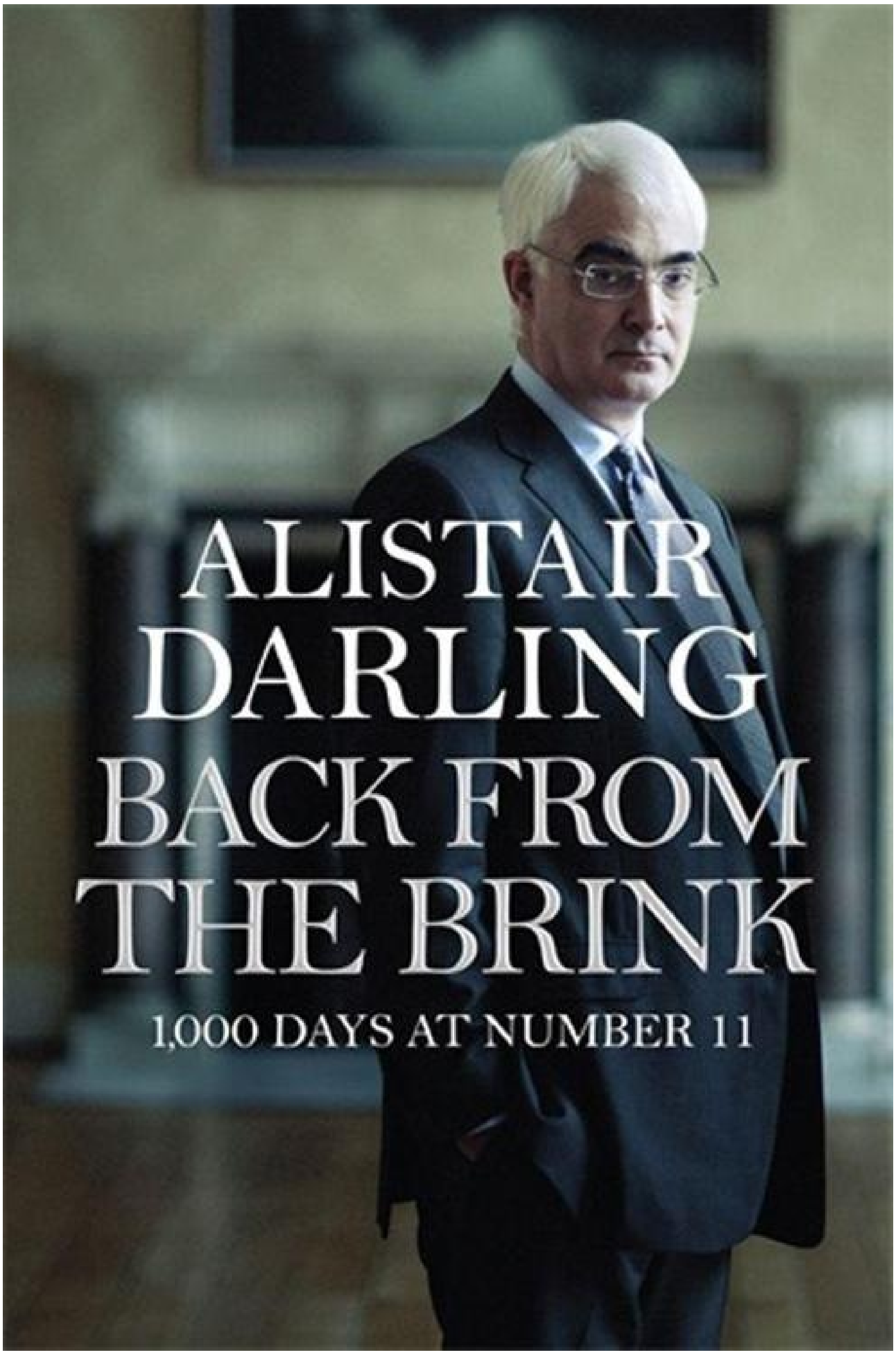
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Back from the Brink

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Alistair Darling

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For Calum and Anna

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Edinburgh, July 2011

Prologue

I don't believe in panicking before it's absolutely necessary but I came close to considering it on the morning of 7 October 2008. I left Downing Street in the dark at a quarter to five on a cold, wet morning, for a routine meeting of finance ministers in Luxembourg. It was going to be a bad day, I knew that. The night before, I had met with Britain's top bankers in the Treasury. They had brought with them into the room an air of desperation. An account of that meeting, only partly true, had been leaked to the BBC and the *Financial Times*. It was reported that Britain's largest banks desperately needed money to stay afloat. Some of them needed capital which they could no longer raise from their shareholders. Crucially, it was reported, that the banks were desperate. The bankers' briefing had the whiff of panic. The result was that bank shares plummeted.

We took off from RAF Northolt on a small chartered jet. A sunrise never felt so bleak. I knew the London markets were about to open and that they would react badly to the leaked news, however wrong it was. Iceland and its banking system were close to collapse and one of its banks would probably fail that day. In Ireland the day before they had, without warning, underwritten all the savings in their banks, causing disarray for everyone else in Europe. Three weeks earlier, in the United States, the collapse of Lehman Brothers, one of the country's oldest banks, had pushed the rest of Wall Street to the edge. We were looking over the precipice. It would not take much to tip the world's banking system and its economies over the edge. The fate of Royal Bank of Scotland – or RBS, as it preferred to be known – one of the world's largest banks, was critical.

By the time I landed in Luxembourg, RBS was worth 40 per cent less than before take-off. Dealings in its shares had been suspended twice on the London Stock Exchange. My private secretary Dan Rosenfield and my special adviser Geoffrey Spence called me out of the meeting with fellow finance ministers to say that Sir Tom McKillop, the RBS chairman, needed to speak to me urgently. We cleared a room so that I could take the call. When I put down the phone, Geoffrey asked, what did he say?

'He told me that his bank is going to go bust this afternoon. And he asked me what we were going to do.'

For more than a year a firestorm had been gathering over the financial system in the United States and Europe. We had been singed by the warning flames a year previously, but that was a minor conflagration compared to this.

I gave my first interview as Chancellor of the Exchequer to a newspaper editor about a week after I was appointed in June 2007. His opening remark was to note that I usually was sent to departments that were in trouble in the hope that I could keep them out of the news. ‘This must be the first department you’ve turned up in that’s actually not a mess,’ he said.

I replied that the same thought had struck me. ‘This is the complete opposite. It’s in good nick, both the department and also the economy, which is strong and stable after ten years’ growth.’ What complacency! I tempted fate by adding: ‘Of course, there will be challenges to come.’ This, at least, proved to be an accurate forecast. Looking back on that interview, neither I nor the editor mentioned banks, or anything approaching the subject. Yet just over two months later, savers would be queuing up outside Northern Rock, desperate to withdraw their money – the first obvious signs in the UK of a global crisis that would bring the world banking system, and our economies, to the brink of collapse.

We were not alone in our complacency. The collapse of banks across the globe was not on people’s minds. There were those – some academics, a few economists – who worried about some of the stresses and strains building up within the financial system, much as people worry about earthquakes or tsunamis, but it is fair to say that no one foresaw the crisis that lay just ahead.

Since then many people have claimed to have predicted what was to happen. Most of them failed to mention it at the time. This book covers what happened from the summer of 2007, when I became Chancellor of the Exchequer, through to what proved to be the end of the Labour government which had first been elected ten years before. It was a period of almost one thousand days, none of them easy. There have been, and will be, many accounts written about these momentous events. This is mine.

The story is in the main about the banking crisis: how close we came to the collapse of one of the world’s largest banks, a collapse that would have brought down the global banking system within hours. This is not simply a story about banks and bankers, however. The banking crisis precipitated an economic crisis, the worst for more than a hundred years, and one that, even three years later, is far from resolved. These events also took place at a crucial point in history, at a time when the world is still coming to terms with the rapid globalization of our economies. We are witnessing a power shift – certainly economic, and increasingly political – that will not be reversed and which we in the developed economies have yet fully to appreciate, or even fully understand.

Politics above all is about people and relationships. I cannot tell this story without dealing with the often fraught and increasingly difficult relationship with the prime minister, Gordon Brown. The three years I served as Chancellor were also, sadly, a period of decline in the political fortunes of the Labour Party, which I believe could have been avoided had we played our hand differently. As the cliché has it, in every crisis there is an opportunity: in this case, to show that we could deal with the financial meltdown, come through it, and chart a way forward. I believe that we did deal with the crisis and guided the economy through the storm, but we failed to navigate a political course for the future that would convince the public.

For me, this period also marks something of a transformation in my public profile. As that newspaper editor observed, my political reputation had been built on my ability to ‘troubleshoot’. The epithet ‘a safe pair of hands’ will no doubt feature in my obituary. My ability to get trouble out of the headlines and put things back on the right track served me well in my various ministerial roles. Along with Gordon Brown and

Jack Straw, I sat in the Cabinet for thirteen years. We were to be the only survivors of the long march of the Labour Party from its resurrection as New Labour, through its triumph at the polls in 1997, to its defeat in May 2010.

After that victory in 1997, I was appointed as the Chancellor's number two, Chief Secretary to the Treasury. Those were heady days. Labour had won a spectacular victory at the general election. The country wanted change and it seemed we could do no wrong. The day after the election I flew with my wife Margaret and my children, Calum and Anna, from our home in Edinburgh to London. They were there, in the crowd outside the gates, to watch me take part in the British ritual of walking up Downing Street in front of the world's press to enter the door of No. 10, to be asked formally to serve by the new Prime Minister, Tony Blair.

On the flight down, the pilot, seeing that I and my colleague, George Robertson, about to be made Defence Secretary, were on board, told our fellow passengers we were on our way to Downing Street. There was a resounding cheer – something rarely heard again. We made the most of it.

I knew I was going to be Chief Secretary because Gordon had asked me a couple of days before the election if I would serve in the job. It was no great surprise, then, when Tony repeated the offer in the Cabinet Room. I felt a bit overawed walking into that room for the first time. I was about to take a chair when Tony said: 'There's no need to sit. You know where you're going.' Just to make sure I did, I said: 'The Treasury, I presume.'

From No. 10, ministers go in their shiny new cars to their departments. As I left the Cabinet Room, I was handed a folder by the Cabinet Secretary. It was empty. He told me that ministers cannot be seen to leave Downing Street empty-handed. I accepted the prop.

I was keen to get to work. Gordon had been at his desk since his appointment as Chancellor the evening before. Ten minutes later I walked into the Treasury. I had never seen inside the building. In those days it was a gloomy place, a cross between a cathedral and a Victorian asylum, with endlessly looping long corridors. The civil servants worked enclosed in cell-like rooms with their own internal corridors. It struck me that while the building was grim, its civil servants were bright, young and enthusiastic. Until a few days before, they had served a Conservative government. For eighteen years the Treasury had been a creature of the Tories. Now, here they were, advising us on how to implement our plan to make the Bank of England independent. Of course, they will tell you why any decision is difficult, or whether there might be a better way; but once it was clear we were determined on our course of action, they worked flat out over the weekend to make it happen on Monday morning.

I remember, a week or two after arriving, one of my Cabinet colleagues, David Blunkett, who is blind, came to see me in a vain attempt to get more money for his department. As I walked him out, halfway along one of those corridors, he stopped and said: 'Tell me, is this a gloomy place?'

I told him it was, in every sense – and not just because he was getting no more money. I spent fifteen months working in that dreary building, in an office next to the room from which Winston Churchill walked out on to the balcony to lead the cheers at the end of the Second World War. Gloomy it might be, but there was a palpable sense of history, as there is in so much of Whitehall. You are conscious of passing through the pages of history, sometimes influencing it, sometimes not. I enjoyed my time as Chief Secretary. From the vantage point of the Treasury, you get to know about every government department.

By the time I returned as Chancellor a decade later, on 27 June 2007, the Treasury had been reincarnated and completely refurnished. It had moved from the front of the building to facing on to Whitehall to the rear. Now it was above the old Cabinet war rooms, overlooking St James's Park, airy and open-plan. The endless loop of corridors remained but the fusty atmosphere was gone. Strangely, there was none of the excitement or anticipation I had felt when I was appointed to previous Cabinet jobs. This was one of the most important roles in government. It was a job I had long wanted, and I knew I could do it. I should have felt elated, but I didn't. There was a sense of foreboding. I was worried about my relationship with the new Prime Minister, Gordon Brown.

My arrival at the Treasury was delayed by a small demonstration outside the building by a group of half-dressed women – protesting about what, we never learned. My colleagues arrived at their departments to stand on the steps and set out a bold vision for the future. I couldn't do that. Perhaps, in retrospect, that's just as well. I eventually got there, to be greeted by Nick Macpherson, the engaging, and somewhat idiosyncratic, Permanent Secretary. As we walked through the doors, Nick said that most of the people working in the building were young and most had never worked for any Chancellor but Gordon. What's more, he observed in his droll style, there were only about three who had ever experienced a recession. That was soon put right.

My arrival as Chancellor heralded something of a culture change in the Treasury, especially for the senior officials. During his ten-year tenure, Gordon had tended to deal with them through his special advisers, principally Ed Balls and Ed Miliband. He worked on the strategy; his advisers made sure the detail fitted that strategy. Unlike other departments I'd worked in, where officials were used to working with the Secretary of State directly, many senior Treasury officials had never actually sat down with the Chancellor himself.

It took me some time to convince them that, although I was intent on, and perfectly capable of, making up my own mind, I did value their advice. There was another consequence, too, of this *modus operandi* – for my relations with Gordon, now that he was Prime Minister. He was persuaded that the Treasury – the majority of whom had in fact taken pride in working for him – had now turned against him. Also, as I began increasingly to take a different view from him, he would accuse me of having been taken prisoner by his erstwhile civil servants. At first it was exasperating, but in time it became a source of anger. Worse still, it eventually led to dysfunction at the top of the government.

On that first day as Chancellor, as I sat down in Gordon's old room, which must have been the most uncomfortable in the Treasury with its battered chairs and floral prints on the walls, there was no hint of what was to come. The landscape seemed extraordinarily tranquil. Britain had seen more than ten years of continuous economic growth, something that had not been experienced for more than two centuries. While other countries had experienced recessions, particularly after the Asian crisis of the late 1990s and the collapse of the dot.com bubble, we had not. Our debt levels had fallen from being the second highest of the world's seven largest economies to the second lowest, behind Canada.

Reading through the briefing papers prepared for the new Chancellor, I remarked to Nick Macpherson, almost in passing, that we seemed very dependent on taxes coming in from the financial services industry. About 25 per cent of our corporate taxes came from that sector. I wish I could claim knowledge of what was to come, but that wasn't the case. And the much-criticized bankers' bonuses and sometimes inflated salaries made a big contribution to income tax receipts.

Living standards were rising for most people, but not for all. People on middle to low incomes, especially those with no children or whose children had left home, were beginning to feel the squeeze well before the crash of 2007. The 'squeezed middle' is neither a new or peculiarly British political problem. It has been a growing feature of most developed countries for more than two decades. But generally, most people felt better off. In addition to the annual holiday, there would be a second break, weekends away. Low-cost airlines thrived as more and more people acquired the means to take breaks abroad. A lot of this was fuelled by increased borrowing and the running up of credit-card bills. People did this on the back of the security that comes when you see the value of your home increase each year and you do not fear losing your job.

On the broader front, China, finding itself with huge savings to invest, was happy to place them in the West, particularly the United States, fuelling even more borrowing and spending. In the eurozone, abnormally low interest rates – appropriate, perhaps, for Germany, but not for countries such as Ireland, where the interest rate brakes should have been applied – caused property prices to soar in what was to prove an unsustainable boom. Icelandic banks, eager to get into the global banking scene, came to London and expanded in a way that would not have been possible had they confined their activities to the streets of Reykjavik. Foreign banks happily lent into Britain, against property in particular.

It is true that rising private debt and the huge imbalance between some Asian economies and the developed world were subjects of concern in some quarters, but it was muted. There were also very few worries expressed about the stability of the world's banking systems, which not only lent a great deal of this money but increasingly found more and more imaginative ways of investing it – without, it would appear, pausing to ask the essential question: what happens if this all goes wrong?

Britain was no exception, and none of us, particularly those responsible for making policy, can remain blameless. London has always been a major financial centre, but from the 1980s onwards, encouraged first by the Conservatives and then by our own government, it seemingly went from strength to strength. It employed ever more people and paid considerable – on occasion, fantastic – rewards for ever greater risk-taking. This success, and the rewards for the country, blinded us to the defects. Naturally, there were two things corporate entities within the financial sector did not like: paying taxes; and what was seen as the heavy hand of government interference, in the shape of regulation. Indeed, for ten years the cry from the City and from politicians of every party was for less rather than more regulation. If ever the claim that we were all in this together were true, it was here. Why, even Vince Cable, in his 2006 address to a luncheon of the Association of Foreign Banks, in which he praised the City's achievements, warned of the dangers of 'the current clamour for regulation of financial products'. On City regulation, like everyone else he favoured a 'light touch'. The problem was that this concept of 'light-touch' regulation came to influence the whole climate in which these institutions operated. If there was money to be made, they did not hold back. There was a general assumption that the global economic boom would continue, that the good times would continue to roll.

Nick Macpherson, in his informal, laconic way, did voice concerns that we were very dependent on tax receipts from the financial sector continuing to flow forever. Nick, unstuffy – about as unlike someone out of C. P. Snow's *Corridors of Power* as could be imagined – is intellectually self-confident. He always had an opinion which I valued but he was intensely relaxed when I didn't follow his advice, as came to happen. Treasury officials expressed no concern about the banking system in the course of the early briefings I was given as a new minister. I don't blame the Treasury for this view. It was widely shared. Subsequently I discovered that, deep within the Treasury and in the Financial Services Authority (the FSA), the UK's financial regulator, questions had arisen about what might happen were a bank to fail. There had been an exercise carried out in 2006 in which they had asked themselves the question *what if?* A lack of adequate legislation was identified at the beginning of 2007, partly as a result of this experiment. But, at that time, putting legislation in place that would allow government to seize control of a failing bank would have been impossible to justify and might well have caused panic in the markets.

This *laissez-faire* approach to regulation was not unique to the UK. There was not a regulatory system, central bank or, indeed, government that saw what lay ahead and how exposed the global economy had become to systemic failure. So the industry was feted for its success, the razzle of new and shiny buildings seen as evidence of riches achieved. The dazzle was blinding and few questions were asked.

That the know-how to deal with a firestorm was not there in the Treasury was both a tribute to the relative economic tranquillity of the previous decade and a sign of a collective failure to ask *what if*? The Treasury did rise to the occasion when the Northern Rock crisis hit. And when, in the autumn of 2008, we were faced with the imminent collapse of the banking system, the experience gained in dealing with Northern Rock meant we were able to act decisively because we knew what would happen if we didn't.

Although it did not seem like it at the time, Northern Rock, it turned out, was to be a well-disguised blessing, the canary down the mine-shaft. Without that experience we would have struggled to deal with the far bigger crisis to come. By the time the big crash did threaten, we had learned that we had to act both quickly and boldly.

In the summer of 2007, my first as Chancellor, there was no reason to suppose that our government was about to enter its last three years. The Conservative opposition had yet to find its feet. Gordon had enjoyed a bounce in the polls when he took over. I don't believe that it is axiomatic that if a government enters an economic downturn, or is faced by a catastrophic banking crisis, then it will fall. After all, governments show their real mettle at times of crisis. Throughout those three years there were occasions when our support grew, when our ability to deal with the crisis – by nationalizing Northern Rock, for example – won us approval.

Ultimately, I believe that we failed to win the 2010 election because the public did not think we had dealt with the resultant economic crisis as well as we should have done. The reason is that we were too often divided among ourselves as to what our response should be. In the end, the debate within government, such as it was, came down to a single question: cuts versus no cuts. The tragedy was that the breakdown of our relationships and the lack of collective discussion in private led to a very public falling-out. The result was that we opened the door for the return of a Tory government. But even then, they failed to get a majority when they should have romped home.

It is simplistic to say that Gordon Brown's leadership cost Labour the election. The truth is that we had lost our way some time before he moved into No. 10. We were elected in 1997 with a landslide, and much of the credit for that victory goes to Tony Blair. Here was a leader who captured the mood of the times, a mood of change, optimism and hope. Very few politicians impact on the public in a big way. He did. He was able to get into people's sitting rooms when they saw him on television and they felt at ease with him. It was to change, of course, especially over Iraq. I often wonder how our government would have fared if Tony had not become so absorbed in foreign conflicts, Iraq especially. He became distracted from domestic affairs at just the time when we still had a mandate to carry through the reforms needed to improve public services. By the time he returned to address domestic issues, following a historic third election victory in 2005, it was too late. Everyone in government knew that he was going, and the political centre of gravity swung towards Gordon. In the two years between the election and Tony standing down in June 2007, the business of government was paralysed as the clamour grew for him to go sooner rather than later. Yet when Gordon took over, despite years of anticipation, he was unable to convince the public that he could reinvigorate the government and create something new and fresh.

There is a paradox for me at the heart of this story. Were it not for the banking crisis and its economic and political fallout, I would, most likely, have ended my career as a footnote in political history. The irony is that the pinnacle of my time in government coincided with the end of our time in power. That was the hand I was dealt and I learned, often the hard way, to be bold in playing it. In 2007 we agonized over spending £6 billion to sort out the political crisis caused by the abolition of the 10p tax band. A year later I was signing off a £50 billion rescue package for the UK banks.

I hope that in this book I give a fair account of what happened during those three turbulent years. I had to change from a supporting character to being one of the main actors on the political stage, something I was never really comfortable with. We had to make some enormous decisions. Had we got them wrong, which could easily have happened, the results would have been catastrophic.

The biggest decision of them all would have to be made on a wet Tuesday morning, on 11 October 2008, when I took a call from Sir Tom McKillop, chairman of RBS, whose headquarters is in the city in which I live. He told me his bank would collapse within hours. What was I going to do about it?

1 The Wreck of Northern Rock

The prelude to that chilling call from Sir Tom McKillop had been played out thirteen months before when we were caught out with a run on a small British bank, Northern Rock. That day, 14 September 2007, is seared in my memory. I had been Chancellor of the Exchequer for seventy-nine days. The echoing venue, then, was a grand Moorish hall in the Palacio da Bolso in Porto where European finance ministers and central bank governors had gathered for a meeting of the European Union's economic and financial affairs council, Ecofin. The palatial surroundings made rather less of an impression on me than the scene displayed on a giant TV screen in the hall. What it showed was long, snaking queues of people waiting to make the first run on a British bank in more than a century.

As we gazed at this horrifying spectacle playing out in the Friday sunshine half a continent away, my companion leant over: 'They're behaving perfectly rationally, you know.' It was not what I wanted to hear, even if it was Mervyn King, the Governor of the Bank of England, who was telling me. I watched an elderly lady emerge from a branch of Northern Rock with her savings. She was, she said, off to deposit them down the road at the Halifax. Not such a good idea, I thought.

A banking calamity that had begun with losses on risky loans to US home buyers now threatened catastrophe in Britain. The talks that day in Portugal were intended to find ways to improve crisis management and to guarantee financial stability within the European Union. A management consultant was trying to explain to the assembled ministers and governors how to work more efficiently – useful advice perhaps, but the irony was not lost on me. I left them to it and set off back to London.

What I had witnessed on television that day was potentially disastrous for Northern Rock, for other banks, and for the economy. As the pictures flashed around the world, the damage to our reputation would be immense. Politically, it was potentially fatal. People may have been panicking in a very British way – there was no shouting or hammering on windows – but they wanted their money out. No matter how much the bank staff tried to reassure them that there was no problem, that they could get every last penny, they wanted their savings and they wanted them now. It was going to take a Herculean effort to turn things around.

Safe as the Bank of England? We were all brought up to believe it. Yet, far from reassuring people, the announcement that the Bank was effectively standing behind every last penny simply caused a stampede to the doors of Northern Rock. I had flown out to Porto that morning, despite the fact that the run had started. I knew full well that if I did not turn up for the meeting it would simply reinforce the sense of crisis. But now I had to get home. We had chartered a small jet to allow us to make a fast escape. Jammed together in the back seats, Mervyn King and I had time to get to know each other better. There was ample time, too, for me to reflect on how we had got to where we were.

I had known Mervyn King for some years. We met first when I was a Treasury minister in the early days of the Labour government. He was one of the first people I spoke to after becoming Chancellor. Softly spoken, bookish and an academic economist, I liked his quietly considered, slightly impish style. He could also be incredibly stubborn. There are times when this is an ideal quality for a Governor of the Bank of England, but equally it could be exasperating. He and I were to work closely together over the coming three years. We had our disagreements, but, at the height of the crisis a year later, when it was clear that drastic action was needed to recapitalize the banks, he did what was needed.

In the back of the plane, the Governor and I talked about the unfolding crisis, interspersed with his explanation of how he had come to be an avid Aston Villa supporter when he was growing up in the West Midlands. As we descended through the clouds, the thought came to me: I was damned if our reputation was going to be destroyed over the failure of a small, reckless bank. We had to stop this run and regain control of events, no matter what it took.

When I arrived at the Treasury as Chancellor in June 2007, I was reminded of a perfectly calm sea on a summer morning – not a cloud in the sky, hardly a ripple on the water. On days like that, on my small boat in the Outer Hebrides, you look out for subtle changes in wind and wave: they are the harbingers. They were there in the Treasury too, not too far below the surface. Beneath the calm there was concern about what was happening in the US housing market, although it was thought to be containable. It had barely touched the public or political consciousness. Cheap mortgages had been sold to people on low incomes for properties that would be difficult, if not impossible, to sell when the economic waters turned choppy. Worse, these loans had been parcelled up by banks and sold on to other banks and financial institutions, in an attempt to spread the risks of people defaulting on loans they could not afford. They were certified by the credit-rating agencies as being top-quality, but they came to be known, notoriously, as ‘sub-prime’ loans.

Normally, if you make a loan to someone it makes sense to insure yourself against the risk of the borrower defaulting. But what happened in many cases was that one part of a bank sold off the loans and, unwittingly, another part of the same bank bought them back. In other words, the risk was simply wheeled down the corridor. Yet despite these indicators of turbulence, it was still thought on both sides of the Atlantic that this was little more than a temporary squeeze and, even at the beginning of August 2007, the Treasury believed there were no serious implications for UK banks. The view was that this was an American problem which could be contained. Many of the loans, however, had been insured by big companies like AIG – best known in the UK at the time as sponsors of Manchester United Football Club – and that British banks, RBS among them, were very exposed to these insurers. If the insurance companies collapsed, British banks would be badly hit.

There was an additional problem. The Treasury and the regulators tended to focus on the financial health of each individual bank, rather than on how much the banks depended on each other and the extent to which, if something were to go wrong with