To some, the term “economic historian” conjures up images of an academic whose only interests lie deep in the past; an armchair scholar who holds forth on days long ago but has no insights about the present. Barry Eichengreen provides a useful corrective to that stereotype. For, as much as Eichengreen has studied episodes in economic history, he seems more attuned to connecting the past to the present. At the same time, he is mindful that “lessons” have a way of taking on lives of their own. What’s taken as given among economic historians today may be wholly rejected in the future.

Barry Eichengreen is the George C. Pardee and Helen N. Pardee Professor of Economics and Political Science at the University of California, Berkeley, his hometown. He is known as an expert on monetary systems and global finance. He has authored more than a dozen books and many more academic papers on topics from the Great Depression to the recent financial crisis.

Eichengreen was a keynote speaker at the Federal Reserve Bank of Cleveland’s research conference Current Policy Under the Lens of Economic History in December 2012. Mark Sniderman, the Cleveland Fed’s executive vice president and chief policy officer, interviewed Eichengreen during his visit. An edited transcript follows.
Sniderman: It’s an honor to talk with you. You’re here at this conference to discuss the uses and misuses of economic history. Can you give us an example of how people inaccurately apply lessons from the past to the recent financial crisis?

Eichengreen: The honor is mine. Whenever I say “lessons,” please understand the word to be surrounded by quotation marks. My point is that “lessons,” when drawn mechanically, have considerable capacity to mislead. For example, one “lesson” from the literature on the Great Depression was how disruptive serious banking crises can be. That, in a nutshell, is why the Fed and its fellow regulators paid such close attention to the banking system in the run-up to the recent crisis. But that “lesson” of history was, in part, what allowed them to overlook what was happening in the shadow banking system, as our system of lightly regulated near-banks is known.

How did they miss it? One answer is that there was effectively no shadow banking system to speak of in the 1930s. We learned to pay close attention to what was going on in the banking system, narrowly defined. That bias may have been part of what led policymakers to miss what was going on in other parts of the financial system.

Another example, this one from Europe, is the “lesson” that there is necessarily such a thing as expansionary fiscal consolidation. Europeans, when arguing that such a thing exists, look to the experience of the Netherlands and Ireland in the 1980s, when those countries cut their budget deficits without experiencing extended recessions. Both countries were able to consolidate but continue to grow, leading contemporary observers to argue that the same should be true in Europe today. But reasoning from that historical case to today misleads because the circumstances at both the country and global level were very different. Ireland and the Netherlands were small. They were consolidating in a period when the world economy was growing. These facts allowed them to substitute external demand for domestic demand. In addition, unlike European countries today, they had their own monetary policies, allowing them to step down the exchange rate, enhance the competitiveness of their exports at one fell swoop, and avoid extended recessions. But it does not follow from their experience that the same is necessarily possible today. Everyone in Europe is consolidating simultaneously. Most nations lack their own independent exchange rate and monetary policies. And the world economy is not growing robustly.

A third “lesson” of history capable equally of informing and misinforming policy would be the belief in Germany that hyperinflation is always and everywhere just around the corner. Whenever the European Central Bank does something unconventional, like its program of Outright Monetary Transactions, there are warnings in the German press that this is about to unleash the hounds of inflation. This presumption reflects the “lesson” of history, taught in German schools, that there is no such thing as a little inflation. It reflects the searing impact of the hyperinflation of the 1920s, in other words. From a distance, it’s interesting and more than a little peculiar that those textbooks fail to mention the high unemployment rate in the 1930s and how that also had highly damaging political and social consequences.

The larger question is whether it is productive to think in terms of “history lessons.” Economic theory has no lessons; instead, it simply offers a way of systematically structuring how we think about the world. The same is true of history.

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Sniderman: Let’s pick up on a couple of your comments about the Great Depression and hyperinflation in Germany. Today, some people in the United States have the same concerns. They look at the expansion of the monetary base and worry about inflation. Do you find it surprising that people are still fighting about whether big inflation is just around the corner because of US monetary policy, and is it appropriate to think about that in the context of the unemployment situation as well?

Eichengreen: I don’t find it surprising that the conduct of monetary policy is contested. Debate and disagreement are healthy. Fiat money is a complicated concept; not everyone trusts it. But while it’s important to think about inflation risks, it’s also important to worry about the permanent damage to potential output that might result from an extended period of subpar growth. To be sure, reasonable people can question whether the Fed possesses tools suitable for addressing this problem. But it’s important to have that conversation.

Sniderman: Maybe just one more question in this direction because so much of your research has centered on the Great Depression. Surely you’ve been thinking about some of the similarities and differences between that period and this one. Have you come to any conclusions about that?

Eichengreen: My work on the Depression highlighted its international dimension. It emphasized the role of the gold standard and other international linkages in the onset of the Depression, and it emphasized the role that abandoning the gold standard and changing the international monetary regime played in bringing it to an end.
As a student, I was struck by the tendency in much of the literature on the Depression to treat the US essentially as a closed economy. Not surprisingly, perhaps, I was then struck by the tendency in 2007 to think about what was happening then as a US subprime crisis. Eventually, we came to realize that we were facing not just a US crisis but a global crisis. But there was an extended period during when many observers, in Europe in particular, thought that their economies were immune. They viewed what was happening as an exclusively American problem. They didn’t realize that what happened in the United States doesn’t stay in the United States. They didn’t realize that European banks, which rely heavily on dollar funding, were tightly linked to US economic and financial conditions. One of the first bits of research I did when comparing the Great Depression with the global credit crisis, together with Kevin O’Rourke, was to construct indicators of GDP, industrial production, trade, and stock market valuations worldwide and to show that, when viewed globally, the current crisis was every bit as severe as that of the 1930s.

Selected Publications


Whether things will play out as anticipated is, as always, an open question. We now know that the move to monetary union was premature. Monetary union requires at least limited banking union. Banking union requires at least limited fiscal union. And fiscal union requires at least limited political union. The members of the euro zone are now moving as fast as they can, which admittedly is not all that fast, to retrofit their monetary union to include a banking union, a fiscal union, and some form of political union. Time will tell whether or not they succeed.

But even if hindsight tells us that moving to a monetary union in 1999 was premature, it is important to understand that history doesn’t always run in reverse. The Europeans now will have to make their monetary union work. If they don’t, they’ll pay a high price.

**Sniderman: Let me pose a very speculative question. Would you say that if the Europeans had understood from the beginning what might be required to make all this work, they might not have embarked on the experiment; but because they did it as they did, there’s a greater likelihood that they’ll do what’s necessary to make the euro system endure? Is that how you’re conjecturing things will play out?**

**Eichengreen:** If I may, allow me to refer back to the early literature on the euro. In 1992, in adopting the Maastricht Treaty, the members of the European Union committed to forming a monetary union. That elicited a flurry of scholarship. An article I wrote about that time with Tamim Bayoumi looked at whether a large euro area or a small euro area was better. We concluded that a small euro area centered on France, Germany, and the Benelux countries made more sense. So one mistake the Europeans made, which was predictable perhaps on political grounds, though no more excusable, was to opt for a large euro area.

I had another article in the *Journal of Economic Literature* in which I devoted several pages to the need for a banking union; on the importance, if you’re going to have a single currency, single financial market, and integrated banking system, of also having common bank supervision, regulation, and resolution. European leaders, in their wisdom, thought that they could force the pace. They thought that by moving to monetary union they could force their members to agree to banking union more quickly. More quickly didn’t necessarily mean overnight; they thought that they would have a couple of decades to complete the process. Unfortunately, they were sideswiped by the 2007–08 crisis. What they thought would be a few decades turned out to be one, and they’re now grappling with the consequences.

**Sniderman:** You’ve written about the dollar’s role as a global currency and a reserve currency, and you have some thoughts on where that’s all headed. Maybe you could elaborate on that.

**Eichengreen:** A first point, frequently overlooked, is that there has regularly been more than one consequential international currency. In the late nineteenth century, there was not only the pound sterling but also the French franc and the German mark. In the 1920s, there was both the dollar and the pound sterling. The second half of the twentieth century is the historical anomaly, the one period when there was only one global currency because there was only one large country with liquid financial markets open to the rest of the world—the United States. The dollar dominated in this period simply because there were no alternatives.

**I didn’t anticipate the severity and interactability of the euro crisis. All I can say in my defense is that no one did.**

But this cannot remain the case forever. The US will not be able to provide safe and liquid assets in the quantity required by the rest of the world for an indefinite period. Emerging markets will continue to emerge. Other countries will continue to catch up to the technological leader, which is still, happily, the United States. The US currently accounts for about 25 percent of the global economy. Ten years from now, that fraction might be 20 percent, and 20 years from now it is apt to be less. The US Treasury’s ability to stand behind a stock of Treasury bonds, which currently constitute the single largest share of foreign central banks’ reserves and international liquidity generally, will grow more limited relative to the scale of the world economy. There will have to be alternatives.

In the book I wrote on this subject a couple of years ago, *Exorbitant Privilege: The Rise and Fall of the Dollar and the Future of the International Monetary System*, I pointed to the euro and the Chinese renminbi as the plausible alternatives. I argued that both could conceivably be significant rivals to the dollar by 2020. The dollar might well remain number one as invoicing currency and currency for trade settlements, and as a vehicle for private investment in central bank reserves, but the euro and renminbi could be nipping at its heels.
In the fullness of time I’ve grown more pessimistic about the prospects of those rivals. Back in 2010, when my book went off to the publisher, I didn’t anticipate the severity and intractability of the euro crisis. All I can say in my defense is that no one did. And I underestimated how much work the Chinese will have to do in order to successfully internationalize their currency. They are still moving in that direction; they’ve taken steps to encourage firms to use the renminbi for trade invoicing and settlements, and now they are liberalizing access to their financial markets, if gradually. But they have a deeper problem. Every reserve currency in history has been the currency of a political democracy or a republic of one sort or another. Admittedly, the United States and Britain are only two observations, which doesn’t exactly leave many degrees of freedom for testing this hypothesis. But if you go back before the dollar and sterling, the leading international currencies were those of the Dutch Republic, the Republic of Venice, and the Republic of Genoa. These cases are similarly consistent with the hypothesis.

The question is why. The answer is that international investors, including central banks, are willing to hold the assets only of governments that are subject to checks and balances that limit the likelihood of their acting opportunistically. Political democracy and republican forms of governance are two obvious sources of such checks and balances. In other words, China will have to demonstrate that its central government is subject to limits on arbitrary action—that political decentralization, the greater power of nongovernmental organizations, or some other mechanism that places limits on arbitrary action—before foreign investors, both official and private, are fully comfortable about holding its currency.

I therefore worry not so much about these rivals dethroning the dollar as I do about the US losing the capacity to provide safe, liquid assets on the requisite scale before adequate alternatives emerge. Switzerland is not big enough to provide safe and liquid assets on the requisite scale; neither is Norway, nor Canada, nor Australia. Currently we may be swimming in a world awash with liquidity, but we shouldn’t lose sight of the danger that, say, 10 years from now there won’t be enough international liquidity to grease the wheels of twenty-first-century globalization.

Sniderman: It sounds to me as though you’re also trying to say that the United States should actually become comfortable with, perhaps even welcome, this development, because its absence creates some risks for us.

Eichengreen: I am. The United States benefits from the existence of a robust, integrated global economy. But globalization, in turn, requires liquidity. And the US, by itself, can’t satisfy the global economy’s international liquidity needs. So the shift toward a multipolar global monetary and financial system is something that we should welcome. It will be good for us, and it will be good for the global economy. To the extent that we have to pay a couple more basis points when we sell Treasury debt because we don’t have a captive market in the form of foreign central banks, that’s not a prohibitive cost.

Sniderman: And how has the financial crisis itself affected the timetable and the movement? It sounds like in some sense it’s retarding it.

Eichengreen: The crisis is clearly slowing the shift away from dollar dominance. When the subprime crisis broke, a lot of people thought the dollar would fall dramatically and that the People’s Bank of China might liquidate its dollar security holdings. What we discovered is that, in a crisis, there’s nothing that individuals, governments, and central banks value more than liquidity. And the single most liquid market in the world is the market for US Treasury bonds. When Lehman Brothers failed, as a result of US policy, everybody rushed toward the dollar rather than away. When Congress had its peculiar debate in August 2011 over raising the debt ceiling, everybody rushed toward the dollar rather than away. That fact may be ironic, but it’s true.

And a second effect of the crisis was to retard the emergence of the euro on the global stage. That too supports the continuing dominance of the dollar.

Sniderman: Economists and policymakers have always missed things. Are there ways in which economic historians can help current policymakers not to be satisfied with the “lessons” of history and get them to think more generally about these issues?

Eichengreen: It’s important to make the distinction between two questions—Could we have done better at anticipating the crisis? and, Could we have done better at responding to it? On the first question, I would insist that it’s too much to expect economists or economic historians to accurately forecast complex contingent events like financial crises. In the 1990s, I did some work on currency crises, instances when exchange rates collapse, with Charles Wyplosz and Andrew Rose. We found that what works on historical data, in other words, what works in sample doesn’t also work out of sample. We were out-of-consensus skeptics about the usefulness of leading indicators of currency crises, and I think subsequent experience has borne out our view. Paul Samuelson made the comment that economists have predicted 13 out of the last seven crises. In other words, there’s type 1 error as well as type 2 error [the problem of false positives as well as false negatives].
Coming to the recent crisis, it’s apparent with hindsight that many economists — and here I do not mean to exonerate economic historians — were too quick to buy into the idea that there was such a thing as the Great Moderation. That was the idea that through better regulation, improved monetary policy, and the development of automatic fiscal stabilizers, we had learned to limit the volatility of the business cycle. If we had paid more attention to history, we would have recalled an earlier period when people made the same argument: They attributed the financial crises of the nineteenth century to the volatility of credit markets, they believed that the founding of the Fed had eliminated that problem and that the business cycle had been tamed. They concluded that the higher level of asset prices observed in the late 1920s was fully justified by the advent of a more stable economy. They may have called it the New Age rather than the Great Moderation, but the underlying idea, not to say the underlying fallacy, was the same.

A further observation relevant to understanding the role of the discipline in the recent crisis is that we have not done a great job as a profession of integrating macroeconomics and finance. There have been heroic efforts to do so over the years, starting with the pioneering work of Franco Modigliani and James Tobin. But neither scholarly work nor the models used by the Federal Reserve System adequately capture, even today, how financial developments and the real economy interact. When things started to go wrong financially in 2007–08, the consequences were not fully anticipated by policymakers and those who advised them — to put an understated gloss on the point. I can think of at least two prominent policymakers, who I will resist the temptation to name, who famously asserted in 2007 that the impact of declining home prices would be “contained.” It turned out that we didn’t understand how declining housing prices were linked to the financial system through collateralized debt obligations and other financial derivatives, or how those instruments were, in turn, linked to important financial institutions. So much for containment.

Sniderman: I suppose one of the challenges that the use of economic history presents is the selectivity of adoption. And here I have in mind things like going back to the Great Depression to learn “lessons.” It’s often been said, based on some of the scholarship of the Great Depression and the role of the Fed, that the “lesson” the Fed should learn is to act aggressively, to act early, and not to withdraw accommodation prematurely. And that is the framework the Fed has chosen to adopt. At the same time, others draw “lessons” from other parts of US economic history and say, “You can’t imagine that this amount of liquidity creation, balance sheet expansion, etc. would not lead to a great inflation.” If people of different viewpoints choose places in history where they say, “History teaches us X,” and use them to buttress their view of the appropriate response, I suppose there’s no way around that other than trying, as you said earlier, to point out whether these comparisons are truly apt or not.

Eichengreen: A considerable literature in political science and foreign policy addresses this question. Famous examples would be President Truman and Korea on the one hand, and President Kennedy and the Cuban Missile Crisis on the other. Ernest May, the Harvard political scientist, argued that Truman thought only in terms of Munich, Munich having been the searing political event of his generation. Given the perspective this created, Truman was predisposed to see the North Koreans and Chinese as crossing a red line and to react aggressively. Kennedy, on the other hand, was less preoccupied by Munich. He had historians like Arthur Schlesinger advising him. Those advisors encouraged him to develop and consider a portfolio of analogies and test their aptness — in other words, their “fitness” to the circumstances. One should look not only at Munich, Schlesinger and others suggested, but also at Sarajevo. It is important to look at a variety of other precedents for current circumstances, to think which conforms best to the current situation, and to take that fit into account when you’re using history to frame a response.

I think there was a tendency, when things were falling down around our ears in 2008, to refer instinctively to the Great Depression. What Munich was for Truman, the Great Depression is for monetary economists. It’s at least possible that the tendency to compare the two events and to frame the response to the current crisis in terms of the need “to avoid another Great Depression” was conducive to overreaction. In fairness, economic historians did point to other analogies. There was the 1907 financial crisis. There was the 1873 crisis. It would have been better, in any case, to have developed a fuller and more rounded portfolio of precedents and analogies and to have used it to inform the policy response. Of course, that would have required policymakers to have some training in economic history.
Sniderman: This probably brings us back full circle. We started with the uses and misuses of economic history and we've been talking about economic history throughout the conversation. I think it might be helpful to hear your perspective on what economic history and economic historians are. Why not just an economist who works in history or a historian who works on topics of economics? What does the term “economic history” mean, and what does the professional discipline of economic historian connotate to you?

Eichengreen: As the name suggests, one is neither fish nor fowl; neither economist nor historian. This makes the economic historian a trespasser in other people’s disciplines, to invoke the phrase coined by the late Albert Hirschman. Historians reason by induction while economists are deductive. Economists reason from theory while historians reason from a mass of facts. Economic historians do both. Economists are in the business of simplifying; their strategic instrument is the simplifying assumption. The role of the economic historian is to say “Not so fast, there’s context here. Your model leaves out important aspects of the problem, not only economic but social, political, and institutional aspects — creating the danger of providing a misleading guide to policy.”

Sniderman: Do you think that, in training PhD economists, there’s a missed opportunity to stress the value and usefulness of economic history? Over the years, economics has become increasingly quantitative and math-focused. From the nature of the discussion we’ve had, it is clear that you don’t approach economic history as sort of a side interest of “Let’s study the history of things,” but rather a disciplined way of integrating economic theory into the context of historical episodes. Is that way of thinking about economic history appreciated as much as it could be?

Eichengreen: I should emphasize that the opportunity is not entirely missed. Some top PhD programs require an economic history course of their PhD students, the University of California, Berkeley, being one. The best way of demonstrating the value of economic history to an economist, I would argue, is by doing economic history. So when we teach economic history to PhD students in economics in Berkeley, we don’t spend much time talking about the value of history. Instead, we teach articles and address problems, and leave it to the students, as it were, to figure how this style of work might be applied to their own research. For every self-identifying economic historian we produce, we have several PhD students who have a historical chapter, or a historical essay, or a historical aspect to their dissertations. That’s a measure of success.

Sniderman: Well, thank you very much. I’ve enjoyed it.

Eichengreen: Thank you. So have I.