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THE GLOBAL FINANCIAL CRISIS:
LESSONS FROM HISTORY

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Discussion:

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P R O C E E D I N G S

MR. WESSEL: Good morning. I'm David Wessel, director of the Hutchins Center on Fiscal and Monetary Policy here at Brookings. Thank you all for braving what, by Washington standards, is a blizzard and actually making it here this morning. (Laughter)

I'm very pleased today to be able to host Barry Eichengreen, who is the George and Helen Pardee Professor of Economics and Political Science at Berkeley. I don't think you can say that without taking a breath.

Our mission here at the Hutchins Center is to improve the quality of fiscal and monetary policy and public understanding of it. But one of the things I learned from a good friend of mine, an economic historian at Harvard, Claudia Goldin, is you don't know where you're going unless you know where you've been. And Barry Eichengreen's book, *Hall of Mirrors*, which is on sale outside the room, is an attempt to help us learn from history.

And I think it's a fundamentally optimistic book because he thinks we can learn something from the mistakes, so future generations, we're not doomed to repeat them. And for those of you who have read the book or the incredibly impressive reviews, Barry's point is basically we did remember enough to avoid turning the crisis into a Great Depression, but we didn't remember enough to avoid it in the first place, and we could have, and we certainly didn't remember enough about what to do after a crisis to assure a stronger recovery than the one we've had.

Barry's written about a wide variety of subjects and mostly on international economics. He's really the author of the definitive work on the role that the gold standard played in the Great Depression. And in addition to this book, *Hall of Mirrors*, he's the co-editor of a new Brookings Press book called *RMB Internationalization*, which isn't out yet, but if you can't wait, we're selling copies even though it's not out yet outside the room.

Barry's going to give a little presentation on the book and then I'm going to be joined by two discussants, and I'll introduce them later. So, Barry. (Applause)

MR. EICHENGREEN: If I do a good job, can I get a copy of that *Renminbi Internationalization* book? (Laughter)

It is, indeed, a pleasure to be speaking at Brookings this morning. If not for Brookings, I wouldn't be speaking anywhere this morning. In 1974, I arrived here with a freshly minted bachelor of arts, not knowing anything about economics, not knowing whether I wanted to do economics. And the rest, as they say, is history, bringing me to the history that's recounted in the book.

I argue there that history is the lens through which we -- by which I mean both elected and appointed officials and the public -- view current problems. And the logic of historical analogy is compelling in general, but never more compelling than in crises since crises are when there is no time for careful analytical reason. Foreign policy specialists point to the powerful influence of the Munich analogy in President Truman's decision to intervene in Korea; or think of the analogy, right or wrong, between 9-11 and Pearl Harbor. I went online the other day and there are 100,000 distinct Google hits referring to that analogy.

So it was with the Great Recession of 2008/2009 and the Great Depression of 1929-1933, the two great financial crises of the last century. There is no doubt that conventional wisdom about the earlier episode, what are referred to colloquially as the lessons of the Great Depression, powerfully shaped the response to the crisis of 2008/2009. In particular, the decisions of policymakers were powerfully informed by received wisdom about the mistakes of their predecessors.

In the 1930s, when the crisis hit, those predecessors had succumbed to the protectionist temptation. They had cut public spending at the worst possible time.

They had failed to stabilize the money supply, neglecting their responsibility for financial stability. They had failed to provide emergency liquidity to the banking system. The result was collapsing banks, collapsing prices, collapsing trade, and collapsing activity; in a phrase, the great macroeconomic catastrophe of modern times.

This economic crisis-reflected disastrous but avoidable policy failures became conventional wisdom courtesy of influential accounts like Milton Friedman and Anna Schwartz' *Monetary History of the United States*. So in 2008, heeding the lessons of that earlier episode, policymakers vowed to do better. If the failure of their predecessors to provide emergency liquidity had produced a cataclysmic banking and financial crisis, then this time they would flood the markets with liquidity and otherwise provide assistance to the banks. If failure to stabilize the money supply had resulted in destructive deflation, then this time they would cut interest rates and expand Central Bank balance sheets. If efforts to balance budgets had worsened the earlier slump, then this time they would apply fiscal stimulus.

And as a result of their very different response, unemployment in the U.S. peaked in 2010 at only 10 percent. This was still painfully high, but it was far below the catastrophic 25 percent that unemployment reached in the U.S. in the Great Depression.

Failed banks this time numbered in the hundreds, not the thousands. Financial dislocations were widespread, but the complete and utter collapse of financial markets, like that in the 1930s, was successfully averted, if barely.

And what was true of the United States was true, also, of other countries. Every unhappy country, I write, is unhappy in its own way. And there were varying degrees of economic unhappiness starting in 2008, but a few unfortunate European countries notwithstanding, that unhappiness did not rise to 1930s levels. And because policy was better, the decline in output and employment, the social dislocations, and the pain and suffering were less, full stop.

Unfortunately, this happy narrative is too easy. For one thing, it's hard to square with the failure to anticipate the risks. Queen Elizabeth II famously posed the question on a visit to the London School of Economics in 2008, why did no one see it coming? A few economists claimed later that they had seen it coming, but I think if you look at what they actually said you will see that they were warning of crises that did not occur, like a collapse of the dollar, or that they issues only vague warnings that did not point to specific risks. That even specialists on financial crises did not sound louder warnings -- there's my own mea culpa -- suggests adopting a somewhat less critical posture toward officials in the 1920s for failing to head off the risks that resulted in the Great Depression.

Our failure reflects what psychologists refer to as continuity bias, the tendency to believe that the future will resemble the relatively recent past. It reflects peer pressure and the costs of being ostracized if, for example, you criticized Alan Greenspan's financial stewardship at Jackson Hole in 2005. It reflects the power of a dominant ideology. In this case, the ideology of market efficiency and financial liberalization. And it reflects the influence of big financial institutions in shaping the policy debate.

Ultimately, though, I would argue that the roots of this failure to see the recent crisis coming lay in the same progressive narrative of the Great Depression I described a moment ago. Entirely correctable flaws of collective decision-making, that narrative explained, had been responsible for the inability of contemporaries to appreciate the risks to stability in the 1920 and then for their failure to deal adequately with consequences.

Modern-day policymakers have learned from the mistakes of their predecessors. Scientific central banking informed by a rigorous framework of inflation targeting now reduced economic and financial volatility and prevented serious imbalances. Advances in supervision and regulation limited financial excesses. Deposit insurance put in place in response to the problems of the 1930s had eliminated bank runs and financial panics. Conventional wisdom about the Great Depression, that it was caused by avoidable policy failures, was itself conducive to the belief that those failures could be, and indeed had been, corrected. It followed that no comparable crisis was possible.

Now, all this we now know was dreadfully wrong. Part of the problem I think is that we -- meaning economic historians -- had always done a better job of explaining the course of the Great Depression and why, once it was underway, it became so great than we had in explaining its onset. We had failed to highlight how rapid financial innovation in the 1920s you can substitute in the early 2000s for everything that follows. We had failed to highlight how rapid financial innovation had combined with inadequate regulation and lax monetary policy to create dangerous financial fragilities. We had failed to explain how capital flows to one half of Europe from the other half of Europe. And the rest of the world had set that continent up for a fall.

We had failed to explain how the naïve belief that advances in scientific central banking had rendered crises a thing of the past, the Fed having been created -- recall in 1914 -- shortly before the problems of the 1920s, how those advances in scientific central banking had rendered crises a thing of the past. We failed to explain how a long period of stability in the 1920s they called the New Era rather than, as recently, the Great Moderation encouraged excessive risk-taking and empowered those who argued against stricter regulation.

Recent experience suggests that we now need to write that 1920s history more carefully. Had we done so earlier, maybe we would have been more clearly how the same factors were at work in the early 21st century.

There was also the failure to anticipate how disruptive the events of September 2008 and the collapse of Lehman Brothers. Here, too, I would blame the lessons of the great Depression for informing the decision to let Lehman go under in what proved to be a disorderly way. The convention narrative about the Great Depression focuses on the disruptive impact of bank failures and on runs by retail depositors. Lehman as not a deposit-taking bank. I've been reminded recently it owned a couple of small, deposit-taking banks. But no matter, Lehman didn't have retail depositors of consequence. It followed that its failure would post a serious problem.

This view informed by the so-called lessons of the Great Depression was why the Basel Accord setting capital standards for financial institutions focused on commercial banks. Deposit insurance focused on commercial banks. Regulation generally focused on commercial banks. That focus neglected the shadow banking system of investment banks, hedge funds, money market funds, and commercial paper issuers. It ignored Lehman's derivatives positions. It ignored the fact that wholesale creditors could effectively run on the bank. So, in my view, the result was the decision to allow the uncontrolled failure of Lehman, with benefit of hindsight, the single most serious mistake of the financial crisis.

So it was at this point, after Lehman, that policymakers realized that they had a situation on their hands, that we were on the verge of another Great Depression. The leaders of the advanced industrial countries issued a joint statement that no systemically significance financial institution would be allowed to fail. A reluctant U.S. Congress, on the second try, passed the Troubled Asset Relief Program. One after another, governments took steps to provide capital and liquidity to distressed financial institutions. Central banks flooded financial markets with liquidity. Policymakers congratulated themselves that they had successfully avoided another Great Depression.

And yet, the results of these policy initiatives were decidedly less than triumphal. Post-crisis recovery in the United States was lethargic. As everyone in this room knows, two-quarters of good growth in the middle of last year notwithstanding to the contrary, recovery proceeded at less than half the pace of a normal recovery.

Europe did even worse than the U.S., experiencing a double dip, maybe now a triple dip recession and full-blown crisis starting in 2010. This was not the successful stabilization. This was not the vigorous recovery promised by those who had learned the lessons of history.

Why is no mystery? Starting in 2010, the U.S. and Europe took a hard right turn toward austerity. You will recall that spending under the Obama stimulus peaked in Fiscal Year 2010, and then headed steadily downward. You will recall that in the summer of 2011, the administration and the Congress agreed to $1.2 trillion worth of spending cuts to be implemented over 10 years. In 2013 came the expiration of the Bush tax cuts. The end of the reduction in employee contributions to Social Security and the sequester, all of which took a big bite out of spending and economic growth.

In Europe, this turn was even more dramatic. In Greece, clearly, where spending was out of control, a dose of austerity was required, but the adjustment program on which the country embarked starting in 2010 was unprecedented in history. It required the Greek government to reduce spending and raise taxes by an extraordinary 11 percent of GDP over 3 years, in effect to eliminate a 10th of all spending in the Greek economy in a relatively short period.

The euro area as a whole cut budget deficits modestly in 2011 and then sharply in 2012, despite the fact that the euro area was back in recession and other forms, private spending, was stagnant. Even the UK, which had the flexibility afforded by a national currency and a national central bank embarked on an ambitious program of fiscal consolidation, cutting government spending and raising taxes by a cumulative 5 percent of GDP.

So what lessons, historical or otherwise, informed what I think with hindsight was an extraordinary turn of events. For central banks, there was, as always, deeply engrained fear of inflation. That fear was nowhere deeper than in Germany, given memories of the hyper inflation of 1923. And German fear, as we know, has translated into European policy, given the Bundesbank-like structure of the ECB and the desire of its French president, at the time Jean-Claude Trichet, to demonstrate that he was a Teutonic and an inflation-fighter as any German.

The United States had not experienced hyperinflation in the 1920s or at any other time, for that matter, but this did not prevent overwrought commentators from warning that Weimar was right around the corner. The lessons of the 1930s, that when an economy is in depression-like conditions with interest rates at zero, the central bank can expand its balance sheet without igniting inflation. Those lessons were lost from view. The more hysterical the commentary, the more loudly the Congress accused the Fed of debasing the currency and the more Fed governors then feared for their independence, something that I think at least subconsciously rendered them anxious to start shrinking the Fed's balance sheet toward normal levels before we had anything resembling a normal economy.

In the case of fiscal policy, the case for continued stimulus was weakened by its failure to deliver everything promised, whether because politicians tend to over-promise or because the shock to the economy was greater than we knew at the time in late 2008 and early 2009. I'm reminded similarly to be a little more sympathetic to policymakers in the second half of 1929 when they similarly did not know how rapidly the economy was contracting.

There was the failure to distinguish how bad conditions were from how much worse they would have been without the policy. There was the failure to distinguish the need for medium-term consolidation for the need for spending in short-term. There was the failure to distinguish the case for fiscal consolidation in countries that needed it, like Greece, from the situation in countries with space to do more, like Germany. Thus, a range of factors came together. The one thing they had in common was failure.

Inevitably, failures like these have multiple causes; including the dominance of ideology in politics over what we like to think is sensible economics. There was the inability of economists to make the case for better policies. There was the tendency of economists to forget as many lessons of the 1930s as they remembered.

But I think, to conclude, the most powerful factor in this premature decision to abandon policies that would have done more to support the economy when it needed it was surely that policymakers had prevented the worst. They had avoided another Great Depression. They could declare the emergency over. They could, therefore, heed the call for an early return to normal policies. The irony then is that their very success in preventing a 1930s-like economic collapse led to their failure to do more to support a more vigorous recovery and do more in terms of far-reaching financial reform.

Thank you very much. (Applause)

MR. WESSEL: Thank you very much for that, Barry. I'm joined up here by, at my immediate left, Chris Brummer, who is a law professor at Georgetown, who conveniently also has a Ph.D. in Germanic studies, so I can't think of anybody better to join us today. He's written a lot about international financial regulation and has a book out called *Minilateralism*, which is basically about how small strategic alliances, informal agreements, financial engineering increasingly characterize a new generation of economic state craft as power becomes more diffuse and we're no longer able to have the central bankers of France, Germany, the UK, and the U.S. decide everything, as they did in the period that Barry talked about in the '20s.

And to his left is David Lipton, who's first deputy managing director of the IMF, a veteran of the Obama White House, the Clinton Treasury, Citibank, Moore Capital. Basically Lipton thrives on crises. Lipton was there when Jeff Sachs fixed Russia, Poland, and Slovenia. And his arrival at the IMF was am indication to all the people who cover the IMF that we were going to have some crises because, otherwise, why would David Lipton be there? And he's delivered on that. So from the journalists of Washington, we thank you.

Barry, I wonder if you could expand just briefly on your last sentence because I want Chris to respond to it. In addition to criticizing the fiscal and monetary policy immediately after the crisis, you say that the opportunity to do far-reaching financial reform, which was the case in the '30s, was missed this time. Could you just expand on that a little bit so I can get Chris' reaction?

MR. EICHENGREEN: In the 1930s, the banking and financial system collapsed. The prevailing system was widely discredited and, as a result of that, we got far-reaching financial reform in the form of the Glass-Steagall Act, the creation of the Securities and Exchange Commission to actually oversee the operation of securities markets, and a host of other new regulation. I think Dodd-Frank includes some meaningful reform, but its weak soup compared to what was done in the 1930s.

This time we prevented the collapse of the system. The banks were able to regroup, in a way. Those who argued in defense of the existing system and continue to argue today in defense of a light-touch regulation and the existing system, were better able to make their case. So I'm tempted to say a crisis is a terrible thing to waste and because we didn't do more in 2010, we wasted it.

However, now we are blessed with a whole host of new financial scandals -- the LIBOR rigging scandal, the foreign exchange market rigging scandal, evasion of U.S. money laundering regulations, various settlements having to do with insider trading and IPOs -- that are keeping alive the idea that self-regulation by financial markets and banks is something of a contradiction in terms.

Bill Dudley has addressed the bad apple defense of financial markets, that it's only a few Bernie Madoff types responsible for these problems. I think we're being reminded now that there is -- self-regulation is problematic. There is a culture problem and maybe that will continue to invigorate financial reform. We'll see.

MR. WESSEL: Chris?

MR. BRUMMER: Well, I'm a bit surprised because it turns out that I will be slightly more optimistic than the optimistic view introduced, in part -- and I think this is a real challenge. Many of us are lawyers in the room and I teach international financial regulation, and I always begin my first class by saying, kids, what you're going to learn in this class if that the very nature of international financial law, international financial regulation, is very, very different from the kinds of international legal standards, international treaties that you may be aware of and understand in the context of international trade and even in traditionally international monetary standards.

And it's important to understand both as a lawyer and also as a practitioner of economic state craft, in part because the transmission or the channels by which you now transmit monetary policy are increasingly regulatory in nature and, also, the way in which financial market supervisors respond to how they regulate their markets is, in part, a response to monetary decisions, but it's also a response to the fact that you have a much more free-flowing world of capital than at the time of the -- or excuse me, in the wake of the both 1930s, the creation of the Bretton Woods standards, and the imposition at times of capital controls.

Let me just start by very briefly saying, you know, when you look at sort of the remarkable regulatory progress that was made in the 1930s, when you think about those New Deal agencies, like the Securities and Exchange Commission. The creation of those agencies was a first step and really the regulatory reform embodied in our current New Deal regulatory apparatus took almost 20 years to create. It really wasn't until the 1960s, where you started to end up with a world of securities regulations, flawed or perfect, whichever way you want to look at it, that we have today. And that international regulatory reform, you should expect, would take even more time. It's going to take more time for a variety of reasons.

Number one, even when you compare international financial regulation to other areas of international economics involves much more rapidly evolving issue areas. So when you think traditionally at least about trade, you think about tariff barriers and then obviously we get into the wackier world of non-tariff barriers. But you had relatively stable areas of regulation that provided a certain space for not only substantive reform, but also the maturation of institutional reforms that culminated obviously in, say, the WTO.

When you're talking about a world of financial markets where financial market innovation doesn't proceed along a continuum of years or weeks or seconds or milliseconds, but picoseconds where you need not a Ph.D. in dramatic studies, but a Ph.D. in physics to fully understand, you start to realize that the very nature of financial market regulation is very different. And then you superimpose certain kinds of challenges, like varying political and economic interests and varying kinds of economic and political cycles, financial regulatory supervision and regulation globally takes on a very different qualitative character.

And I think that when you look at what's been done both in the reformation of -- we talked about the Ball standards or the Basel III Accord, when you look at the change in the infrastructure for international financial regulation, the change from financial stability forum to financial stability board, working in concert with the G-20, a revamping of the existing international standard-setting bodies, a rethinking of how the

IMF should act as a monitor for the compliance with international best practices and standards, when one thinks about the slew of international standards and the varying kinds of disciplinary mechanisms that are involved requires really a much more -- you know, it's a difficult process because it requires a kind of nuanced perspective.

We're not talking about hard law where you have formal international legal obligations, in part because of the dynamic change and the transformations in international markets, but we're dealing with something called soft law. That is explicitly non-binding standards that, though non-binding, can be -- and not always are, but can be -- at least institutionalized in a manner that actually gives them more bite, more discipline even than some formal treaties that you may see in international human rights.

MR. WESSEL: So basically your bottom line is it's not over yet. We should be patient. They're moving in the right direction.

MR. BRUMMER: I think so.

MR. WESSEL: And it's not as easy as just passing a Glass-Steagall.

MR. BRUMMER: I think so.

MR. WESSEL: David --

MR. BRUMMER: And this is why you has the Pulitzer Prize and I'm just (inaudible). (Laughter)

MR. WESSEL: No, this is why they have reporters' moderate panels, so that when people talk too much, they interrupt. (Laughter)

David, you know, I think that sometimes people who handle the big global economic crises think, to coin a phrase, this time is different and we haven't been through this before. Barry's book is obviously a reminder that, well, actually, in strange ways, we have. What do you take away from this book that you think is relevant to where we are today?

MR. LIPTON: I guess I better be brief. (Laughter)

MR. WESSEL: It's all right. I'll interrupt you, if necessary.

MR. LIPTON: First, I want to say I think for any of you who haven't read this book, it's a fabulous book. It does history the way economists have always wanted in applying economic concepts carefully and considering alternative hypotheses carefully, number one.

Number two, it shows things you would not -- I've read a lot of history of the period. The extent to which in the earlier period already there were things that we would recognize, that there was a huge amount of interconnectedness. There were sovereign bank linkages that became a problem, which we've been dealing with; kinds of fancy constructs that were created by private sector financial institutions; the fact that non-bank institutions caused so many of the problems. You see so many features that came before.

At the same time, I think it's almost a tautology that a crisis never repeats itself. If it was exactly the same, we would find a way to prevent it. There's the parable of a physicist and a mathematician are shown into a room with a pot hanging on a wall and a stove and an egg, and they're asked to cook an egg. And the physicist takes the pan down, puts it on the stove, turns on the gas, drops in the egg. And then it's the mathematician's turn. He looks at it for a few minutes, he picks the pan up, and he puts it on the wall. He says now I've reduced this to a problem I've seen before.

Now, it's not mathematics doing economics. There are differences and they're troubling.

The book looks at the history to date, but put yourself in the eyes of policymakers today. How clear are the choices that we face right now? And I think in the fog of economic war there are always new features, new complications. Yes, you can draw from history and, hopefully, draw the best possible conclusions, but life is complicated, and let me give a few examples.

Barry tells the story how in the 1920s and ’30s, as interest rates were brought down, people thought they had succeeded in stimulating the economy, but they couldn’t distinguish nominal from real interest rates. In Europe, two years ago, fragmentation of Europe was the big issue. The Portuguese finance minister came to me once and said should I issue bonds now or do I really have to wait until Portuguese interest rates fall below 6 percent? The Portuguese 10-year interest rate now is 2.5 percent. Is fragmentation over or are these low interest rates telling us there’s some other huge problem that is happening in Europe? And the low interest rates in the periphery of Europe mean that, you know, should we question whether it’s good or bad that people are lending money at 10-year maturities to Ireland, Spain, Portugal, and others? Interpretation is difficult.

We now have the unconventional monetary policy being practiced by the three largest central banks and the United States is considering, the U.S. Fed is considering what is the proper exit. Clearly, keeping interest rates low for a long time leads some to reach for yield. And there’s a lively debate going on about whether this is dangerous, whether it might lead to financial instability.

We have two views. The BIS thinks that this is so dangerous that interest rates should be raised in a sense irrespective of conventional monetary policy considerations. What’s the inflation rate? What’s the unemployment rate? The IMF has been arguing that one really has to assign monetary policy to the interest rate and use macroprudential policies to deal with any risks to financial stability that might come from risk-taking behavior by financial market participants. This is a good, lively, and complex debate, but we know what we think, but I think there are a range of views on this subject.

On listening to Christopher, I hear all of what you say, but I can’t say that it makes me optimistic because to me financial and regulatory reform is, as you say, complex and will take time to put in place. But think of what’s going on right now. We’ve gone through -- we went through this crisis and we tried to do two things, the world tried to do two things: to end the crisis, but then to make changes to make sure it would never happen again, which, of course, sounds familiar. But the main arena for that was financial and regulatory reform.

I say two things. One, that you use here in the United States the debate over Dodd-Frank. And more generally, I think there is the following conundrum. The financial and regulatory reform had as a principle objective to make banks more cautious. It succeeded. There are various things banks used to do they don't do anymore because they have to hold such capital and there are various liquidity requirements, a whole set of requirements.

Then the question arises, what happens to the activities that would have been funded? Are they things the economy doesn't need? Are they things the economy needs and maybe will be funded by someone else in the non-bank sector? If they're funded by someone else, will that be done safely or not? Should those things be inside the regulatory perimeter or not? Or worse, do you have a situation where they aren't done and the government thinks they should be done, so they start subsidizing the banks to do it because it's a social objective? And there have been support programs, say, for mortgage lending in some countries that are exactly that. The banks won't do it because of the regulatory reform and then the countries step in and say, well, let me subsidize you to do that thing.

What do you do? Do you just spend a while longer doing regulatory reform? Do you conclude that some parts of the regulatory reform may have been misguided and change them? You know, this is, I think, a very complex area and, again, we have our views on each and every or most of the pieces of this puzzle, but I think it is a conundrum.

So I would just say that the economic policy-making, whether it's in crisis or now in the post crisis period, will always throw curve balls and it's not easy necessarily to hit them and you can't necessarily -- I mean, one has to do the best one can in understanding the lessons of the past and trying to apply them, but it's not always a simple guide to action.

MR. WESSEL: You want to respond on the financial part?

MR. BRUMMER: You know, I think that when you look at the way in which the world has responded to the global financial crisis, you do see several dramatic improvements. Right? You see generically a raising of capital standards for financial institutions. And indeed, this is important because when one looks at the Basel Accord for banks, this is sort of the third iteration, the very first iteration, you know, to Barry's point, hadn't even defined exactly what a bank is. You know, is it a deposit-taking institution? And when you look at the international accord, you do see that financial institutions writ large raised their capital standards.

You look at derivatives and what's going on in IOSCO and these other international standard-setting bodies; you see more pre-trade transparency, trade recording, and clearinghouse usage for what were over-the-counter derivatives. You're seeing enhanced standards for credit rating agencies. You're seeing across the board a global response that, on balance, is certainly moving towards a much more collective and interoperable world of financial regulation with lots of really embarrassing disagreements that sometimes spill themselves on the front pages of the *Financial Times*.

But from a -- I'm not a historian, but as someone who's sort of participated in some of these dialogues, you know, I have to be more satisfied with where we are now at a global level certainly than where we were in 2008. And I do think that there will absolutely be lots of unexpected issues, but there is some flexibility in the system to respond.

MR. EICHENGREEN: If I may summarize, Mr. Chairman.

MR. WESSEL: Please, yes.

MR. EICHENGREEN: You know, I agree with Christopher that there has been some impressive and surprising progress. Capital standards for big banks in particular are more demanding now and more demanding than we might have expected. There are leverage ratios for banks to prevent them from doing off-balance sheet fiddling of capital requirements. There may be a little bit of rating agency reform coming down the pike. So there has been real progress and now there is the possibility that many of things that have been done in the United States in particular are about to be undone.

So I think it's very much a story to be continued. And I think the risk here is that because we averted a very serious crisis, the period of forgetting of what came before, which took us half a century after the 1930s, may be compressed into a much shorter period this time.

MR. WESSEL: This argument always makes me nervous, Barry, the notion that we'd be better off if we had been more miserable is kind of uncomfortable, although it may be the approach that Europe takes. (Laughter) So, in a way, it's too bad that your book is set in type because I think if you were writing it today there would be more at the end about Europe, and so I want to steer you in that direction.

If you think about a country which has a crushing debt load, which has been forced to undergo enormous austerity, which has banks that are really not strong enough to maintain its financial system, where a government has fallen and another government has come into place, and that new government is being challenged by the populace, you would obviously think correctly that I'm describing Greece. But if you're read Barry's book, it kind of looks a little bit like Germany.

And so help us understand, how can it possibly be that the Germans have learned only one lesson -- that if you print too much money, you have hyperinflation -- and don't seem to remember the lesson that if you do too much austerity and the people lose faith in the government, you can get really nasty populist results? Let me underscore I'm not suggesting that Syriza is Adolf Hitler, but I do think that there are political consequences to running these kind of policies.

MR. LIPTON: But also, to be clear, you're not talking about Germany today.

MR. WESSEL: Right, I'm talking about Germany then.

MR. LIPTON: You're talking about Germany in the early '30s.

MR. WESSEL: Yes, correct. Thank you, David.

MR. EICHENGREEN: And similarly, there is no straight line between unemployment in the early 1930s and the rise of the Nazis, although I would agree there is a connection there.

Historical memory is a tricky thing, obviously. And it's quite perplexing to me why there is so much emphasis in Germany about the corrosive and destructive effects of the hyperinflation of the early 1930s and not equal emphasis on the impact of the high unemployment of the 1930s, which would suggest a rather different policy response Europe-wide to the current situation.

There's the argument that the problems of the 1930s flowed from the hyperinflation of the 1920s. Given that experience, they tied their own hands. The banks were weak. Confidence was fragile. And that caused the Depression in Germany to be so severe. I don't buy that entirely.

There is the argument that the economics of the 1930s are too problematic and painful to be taught in high schools in the same way the hyperinflation of the 1920s is taught. But it's a reminder that there are many historical precedents and analogies out there. Sometimes policymakers cherry-pick. They pick the historical analogy that justifies their preferred policies rather than the one that might inform their policies.

MR. WESSEL: Chris, what's your view on why Germany has taken the stance it has in the current European situation?

MR. BRUMMER: Well, you know, I think it's interesting when you just think about the intellectual history of Germany, and that intellectual history is a profound one. It goes past and far past the 1930s. I mean, one aspect of German culture, and you can see this if -- this if for my German Ph.D. -- you know, you look at like the Enlightenment and you look at German idealism and German philosophy, there are certain kinds of traditions of industriousness and of discipline that sort of feeds itself in what's part of the culture and it feeds itself into this idea of discipline economically.

And, you know, I think that it's not hard when you look at sort of the larger, not 100-year, but 2- or 300-year history of the formation of the German state, how some of these ideas that sort of permeate your culture have certain economic applications. And I think that I lived in Germany for a while and went to high school in Germany for a while and, you know, you certainly do see a certain pride taken in that industriousness. And there's a sense even in the post war period that that industriousness was what allowed Germany, along with the help of the Marshall Plan and international assistance, to sort of pull itself up by the bootstraps and rebuild German society.

And when Germans look at the periphery, they sort of naturally ask themselves, well, if we could do it, why can't you? And that, obviously, then creates all kinds of interesting diplomatic quagmires.

MR. WESSEL: David, if you were holding Barry's book as a guide to history, where are the lessons that you think Europe ought to pay particular attention to?

MR. LIPTON: Barry's book says that in crisis, I mean, there's crisis prevention and there's a lot on that, but in crisis, you need to respond quickly, you need to provide liquidity, you need to distinguish in financial institutions liquidity problems from solvency problems, you need to deal with solvency problems quickly, and you need to support the whole macro economy as you do that. And then, of course, you need to do things to make sure it never happens again.

I think another important lesson from the gold standard and of Barry's earlier work, also, is that when you're in -- in the case of the gold standard, when countries are linked together with a monetary system that has the kinds of disciplines of the gold standard, you have to take account of those strictures.

All of those lessons apply to Europe. And I think in some respects and at certain times they were not quick enough to do steps in that list or to do them -- and I suppose another lesson is that when you act, you have to act strongly enough and with enough persistence. I think, you know, things have been done. They have perhaps not been done as quickly, as forcefully as they might have.

On the point that you folks were discussing a moment ago, the question of austerity, there's been a reluctance to provide the macro support. Part of it comes from concerns about the complications of the European Central Bank's mandate and strictures that come from both the European Union and the euro zone.

So I think that the lessons from the book to Europe are that there's a need to act in all of these areas. Act quickly, act forcefully. And, you know, while some things have been done perhaps too slowly and without enough force, there is still time to act. I think that the present discussion about the disinflation in Europe is one that should drive the Europeans to do more, to be accepting of more forceful central bank action and to be supporting that with other policies that can help the European Central Bank achieve their goal of avoiding falling into a prolonged low inflation or negative inflation situation.

MR. WESSEL: Barry?

MR. EICHENGREEN: So I argue in the book that the euro is just like the gold standard in two respects. Number one, it was a monetary union or a quasimonetary union without a banking union, a fiscal union, and a political union. And the gold standard was, therefore, problematic. You can complete the sentence.

I argue in the book that the gold standard was not only a monetary arrangement or a monetary regime, but it was also a mind frame or ideology, that countries on the gold standard subscribed to the ideology of balanced budgets and so forth. And the euro system, it would seem, is not only a monetary arrangement, but something of an ideology. It comes with a lot of ideological and political baggage.

MR. WESSEL: You mean like the growth and stability baggage?

MR. EICHENGREEN: Yeah. And then I go on and argue in the book, maybe I shouldn't have, that the gold standard and the euro system are different in one fundamental respect: the gold standard was easier to back out of because countries still had their own currency. And when a bad economic or financial system happened, it was straightforward to suspend convertibility and allow what was still your own currency to depreciate. Abandoning the euro for a variety of economic, political, and technical reasons, I argue, would be much more difficult. And dissolution of the euro area is not likely to be the route through which Europe ultimately solves its problems.

MR. BRUMMER: And I just want to say, this is why both this book -- Barry Eichengreen's work has been incredibly influential for my own work and for I think almost everyone in the room, but to explain in very clear prose, as has always been the case, not only this historical message, but as a lawyer what I've gotten out and what I continue to always get out of his work is this connection between both regulatory policy, the rulemaking, on the one hand for financial markets and then looking at sort of what the monetary -- how regulatory decision-making in and of itself can't occur in the vacuum, no matter what ideology you have. But it is, instead, informed in part by other kinds of decisions that are occupying a larger economic ecosystem, in this case, the monetary affairs.

So the gold standard, what does this mean with regards to how do you regulate your currency? How do you regulate your markets, free flow of capital? These same kinds of questions inform how you then create a banking union. Whether or not the European Union also needs to take further additional steps for some kind of deposit-taking vehicle, like the FDIC, these kinds of things become more understandable for me, certainly, as a lawyer after I get to read this book and his other books.

MR. WESSEL: So, Barry, if David's right, David said that these problems of too little inflation, of very high unemployment, lack of confidence in the banks, some of it justified, require very decisive action, the kind of action that, for better or worse, we've seen in Japan, where there's no doubt that the Bank of Japan and the government of Japan have decided like, okay, we've got to take this thing by the lapels and shake it out. So it seems to me Europe is particularly ill-equipped to do that. I mean, no matter what Mario Draghi does on January 22nd, it has to be in part constrained by what the Germans will accept.

And then secondly, we have this new set of events that not only did we have the rise of populist parties because the economies were so bad and there was so much resentment of the austerity and whatever the other reasons were going on, but now we have the terror in Paris and a new opportunity for the populist parties to say not only are they screwing us on the economy, but they can't even protect us from Muslim terrorists. This seems to me like a particularly worrisome and toxic combination: a set of authorities that can't be decisive because they don't agree and some political extremists or populists -- not all of them extremists' -- who are poised to take advantage of this. This seems to me like a recipe for, holy cow, this is going to be an awful period in Europe. Am I being too pessimistic?

MR. EICHENGREEN: No, I think holy cow is an appropriate characterization. (Laughter)

MR. WESSEL: It wasn't the first phrase that came to mind, by the way.

MR. EICHENGREEN: FDR was able to take concerted action in response to the crisis, so he took the U.S. off the gold standard. He took personal control of monetary policy. He signaled clearly that the future was going to bring inflation rather than deflation. Fiscal policy worked in harness with monetary policy, and he was able to transform people's expectations against a troubling political backdrop. So there was Father Coughlin in the 1930s. There was Huey Long. There were other even less savory political characters with constituencies and economic growth was the bond that healed --

MR. WESSEL: So do you see an FDR on the horizon in Europe?

MR. EICHENGREEN: That wasn't where I was heading, actually. (Laughter) So the political as well as the economic contexts were troubling in the '30s and economic growth was the solution. Is Europe capable of replicating that experience? You know, I would just repeat your holy cow remark, that I don't think Europe is constitutionally or temperamentally set up to implement economic policies of shock and awe, which is what it needs now.

MR. WESSEL: Thanks. I'm going to turn to the audience. I want to say one thing about the book that I don't think we've fully captured in the conversation. So it has all the lessons and generalities that we've been discussing, but there are all these little nuggets of detail and history and anecdote that make it all come to life.

In the discussion of the 1920s and the real estate boom in Florida, which Barry captures the reality of what was on *Boardwalk Empire*, it's really remarkable that texture. And similarly, in the discussion of Europe, there are just these moments where you could substitute a different name and a different date and you'd think we're going through this all again. So I don't want that to get lost in this discussion, but now let me turn to the audience.

The gentleman in the back in the maroon shirt -- in the lavender shirt. Tell us who you are.

MR. WEISS: Hi. Marty Weiss with Congressional Research Service.

So my question is about the IMF's role in financial sector regulation surveillance. I think an interesting issue is over the past 15 years or so the IMF has played a much, much more assertive role on these issues. So a kind of broad question, is this a good idea? How do you characterize IMF-FSB cooperation, coordination?

And more broadly, I guess -- no, more specifically, if this is a good idea and we want the IMF to have a stronger role, does the IMF have the tools needed in its current articles to actually do it? Does it have the -- you know, do countries have to provide enough information to the Fund? Can the IMF actually do this kind of surveillance?

MR. LIPTON: Very, very good question. You know, for some years, the Fund has had a staffing-up to be able to cover this area and has had begun a process of doing what we call financial sector assessment programs, which are going to our members and looking at financial sectors very broadly to ask whether the framework as well as the application of the framework is strong enough and appropriate to support stability.

The work has really intensified now in the wake of the crisis. We give advice to each of our members every year. But a new area for us and a very important one comes from the interconnectedness and the fact that financial and regulatory reform isn't just about how the United States system works or the UK or European, but how they work together and whether, if you will, the web of financial and regulatory efforts in countries is woven together at a global level.

One important project that we've worked on is to help develop resolution mechanisms, a subject that Barry talks about in his book. He points out that much has been designed, but, generally speaking, not everything has been put in place. Here, too, because banks operate internationally, it can't just be that London has a way to resolve banks and the United States has a way to resolve banks and Germany has a way to resolve banks. It has to be that there's a way for all of these efforts to be brought together because if a big international fails, it will have assets as well as operations in different places. And you need to be able to -- as we learned during this crisis; resolution may often have to happen over a weekend. And questions about coordination, questions about who bears which portion of the burden, all of that has to be dealt with ahead of time.

There's also an effort that's, I think, very important to make sure that banks have some form of assets that can be converted to equity, so there is an automatic recapitalization under duress.

Now, we feel that we have a good handle on this, that there's good cooperation on this with the FSB, where we have an observer role, is the proper forum for the discussion. I think we need more data in some areas. We don't aspire to -- there was a lot of concern by individual countries that their supervisors not provide anyone -- us or anyone else -- institutional data that may be proprietary. We feel that we, for the most part, can operate with data that's somewhat more aggregated. We don't need to look at Bank X and know everything that it's doing. But there are some tensions here and I think we need to explore and we are exploring with countries whether we can have enough information to do our job.

I should have added that on the subject I mentioned before, the need to deal with instability threats through macroprudential policy, we are advising countries on what the possible toolkit is and the proper use of the toolkit on macroprudential policies. But, of course, for the same reasons of interconnectedness, the macroprudential policies in Country A, if they are diametrically opposed to the macroprudential policies in B, may be conflictual. So at some near point in the future, there'll be a need for some coordination of macroprudential policies. I think we're the logical ones to be helping countries move towards that kind of cooperation. For that, as well, we need more information.

So I'd say we are well equipped, but there's more in the way of capacity we need to go.

MR. WESSEL: Chris, isn't there a democratic accountability problem here? So if the way we're going to avoid the next crisis is to have all these interconnected capital standards that are negotiated at Basel and the FSB, which is unelected central bankers doing this, and David's talking about coordinating macroprudential policies, which have to do with such fundamental things as who gets a mortgage in the United States, if we're going to do this, is this going to be a problem? There's no governance of this other than the kind of cooperation of these various independent regulatory agencies.

MR. BRUMMER: And by the way, that's also a problem that Europe is sort of facing. One of the challenges in the European response is where you have largely an unelected body, particularly the EU level, federal level in the European Union and European Commission, that's sort of driving certain kinds of reforms alongside the European Central Bank, and that interface with the elected politicians is creating problems.

One of the major challenges with accountability is that we're entering into a world, in the soft law world, where treaties are being increasingly supplanted by administrative process. Right? So where the SEC or the CFTC or the Fed, through the Basel Committee, creates these international standards, right, they are soft law, they're explicitly non-binding. But then you go back to your home jurisdiction and in the United States, we have the Administrative Procedure Act, where you go through the APA process to try to then implement those standards under the mandates that are given to you as a domestic regulatory agency. So it does create and change the relationship between sort of elected officials and the rulemaking process. And that creates all these questions of legitimacy.

Can I just say one thing about the FSAP program? The FSAP, what's also challenging is that --

MR. LIPTON: Financial Stability Assessment Program.

MR. BRUMMER: The Financial Sector Assessment Program, that is an IMF program which, interestingly enough, the vehicle by which you do this is under Article IV, as your question implies, which is a formal legal obligation. And it's been sort of reinterpreted in a way so as to take these standards that are promulgated by unelected bodies and soft law to give them a bit of a harder edge through international law and then bringing in the IMF as a formal international organization to provide some surveillance as to those standards. Now, prior to the crisis, they were voluntary and the results didn't necessarily have to be even published, right? Now you're trying to ramp this up by creating this harder edge.

But the question, and I think that there still is a considerable amount of debate, particularly to this last point, where I would question whether or not the folks over at the BIS would agree that the macroprudential policy-making component should really be at the IMF or at the FSB or at one of those international bodies, which then ramps back up this legitimacy question. How can we participate democratically?

MR. WESSEL: Let's take a couple questions. A lot in the back. Do you want to -- Emily, back there. I'm sorry, the guy, right there, with the white hair and the glasses. Distinguishes everybody else with white hair and glasses. (Laughter)

MR. RIEMER: This is guy with white hair and glasses is Jeremiah Riemer. I'm a political scientist. I've taught at Hopkins and Georgetown and other places.

I actually have a bit of an explanation to this, a partial explanation to this question that's been bothering you, which is basically why is it that Angela Merkel doesn't realize that deflation is more important than hyperinflation? And it has to do -- you know, economic historians can say, well, Hitler didn't come to power when there was hyperinflation. He came to power when there was a Depression and unemployment and low prices.

The partial explanation has to do with the long-term effects on the German political establishment of the stabilization that followed the hyperinflation, which involved favoring economic elites over middle-class savers. That had a traumatic effect on the post-war political class, which created the catch-all party that tries to keep all these groups that were once alienated from each other in a big tent together.

Now, that's only a partial explanation for what's going on because it's not exactly as if Angela Merkel and Wolfgang Schäuble are running around with that particular lesson of what happened in the mid-'20s in mind. And it's not as if you put them in a seminar and you said read Jerry Feldman or Charlie Mayer on the stabilization of the 1920s, you'd realize you'd get a different perspective on things.

So my question to you is given this problem of the political dimension of this and the fact that political leaders trying to create this big tent party often are not totally aware of the historical forces that are shaping them somewhere sublimely, how could an economic historian continue to referee this sort of discussion about the lessons of history?

MR. EICHENGREEN: So I'm not sure my comparative advantage is as referee. You know, I thought your point about an additional channel through which the hyperinflation could have continued to shape the structure of politics as well as the content is very well taken, and I would just say I agree.

MR. WESSEL: I think that where you can blame economic historians for not warning us that this was coming, the evidence was there, but you can find plenty of people who said, you know, this euro idea, the way you've done it, isn't the best thing since the creation of sliced bread. And so there's a limit, I hate to admit it, to what economists can convince politicians of.

MR. MATTHIJS: Thank you very much. Matthias Matthijs. I'm an assistant professor across the street at Johns Hopkins SAIS.

I always assign the first chapter of your *Golden Fetters* book, which has this gold standard analogy, I think, and in my own work I've used this very often. What it has in common with the euro, the gold standard is, of course, it has a deflationary bias, as you said, this kind of mindset. So I guess my very simple question to you is if I listen to some of my colleagues across the street at Peterson, some suggest that this policy seems to be working. The Eichengreen thesis of the '30s was that deflationary policy this long term is not compatible with democracy needs or the collapse of democratic government in Europe. I mean, that's the political science simplification of your work.

What's different now if you look at Greece and Spain? Is it just that this could still collapse democratic governments? It could be another two years? Or are welfare states stronger now or are democracies stronger now? Can you elaborate a little bit on the difference between the '30s in Europe and now? Thank you.

MR. EICHENGREEN: Yes. I think both welfare states and democracies are stronger, which is how it is that Europe has suffered through the better part of a lost decade already without our seeing yet the rise of extreme anti-system parties on either the left or the right. European countries, including Greece, have more than a quarter of a century of experience with democracy now and their links to the European Union solidified that democratic tradition.

I also think that the extent of the social safety net means that you see plenty of graffiti and homeless people on the streets in Athens, but not to the same extent you saw bread lines in the United States in the 1930s, because even middle-income European countries have gone a long way in building social safety nets that provide some insulation from bad economic times. So none of this is an argument that it couldn't happen and that we're not about to see rejectionist governments, anti-system, anti-European, anti-euro governments. It could happen still if nothing is done. But I think the strength of democracy and the development of social safety nets is why it has taken so long.

MR. WESSEL: David?

MR. LIPTON: Just a broad observation on the state of democracy. Strobe Talbott, the head of this institution, has observed that leadership appears to be somewhat weak right now in the sense that the leaders aren't that popular in their own countries and aren't that strong when you compare it to some past episodes. And it leads one to puzzle why that might be the case. You know, I think it surely differs from place to place. And if any, Angela Merkel is a strong and popular leader.

But I think something that is -- maybe it was true in the '20s and '30s, Barry can say, but I think that there's a new phenomenon, which is that no national leader right now really has the instruments under their control to assure their people of all the things that their people want because of the interconnectedness of the world, both the globalization of trade, but also -- not just on the opportunity side, but on the risk side there are so many things that can happen abroad and be transmitted.

So I guess my hypothesis is that national leaders won't be stronger until international cooperation and collective action is stronger. To me that is an argument for the G-20 and it taking an important role. It's an argument for the use of, the reliance on institutions like ours to convene -- what we do mainly is convening central bank governors and finance ministers to try to puzzle through these kinds of issues, to try to deal with problems. I do think it's our job -- personally, I think, and I think our institution believes, that there are still huge benefits to global integration and connectedness, if nothing more than the promise for emerging market countries and developing countries to accelerate their growth rates and some day converge to advanced country living standards. That, I think, is a huge opportunity and will only happen at a rapid clip if the interconnectedness is maintained.

But I think whether it's the '20s or the most recent crisis, we see the risks, the risks of interconnectedness. And so managing those, finding the opportunities, capitalizing on the opportunities, and managing the risks can't be done by President Obama. It can't be done by David Cameron. It can't be done by Jean-Claude Junker. They can only do that together.

MR. EICHENGREEN: David, can I echo that real briefly?

MR. WESSEL: Okay, and so then Ian Talley in the back.

MR. EICHENGREEN: That no national policymaker had the tools necessary to resolve the crisis in the 1930s under the gold standard and they dealt with that by abandoning the gold standard, imposing capital controls, imposing great protectionism, which is one way to regain control at the cost of globalization. International cooperation, in principle, would have been the other way.

MR. WESSEL: Ian?

MR. TALLEY: Ian Talley, *Wall Street Journal*.

I wonder about the extent to which financial regulations have evolved given the processes and progression. I see two examples of that: one, the exemption of sovereign debt in both the Volcker Rule and the European Union regulations, which may be contributing perhaps to the low risk-taking pricing; and, two, the shift of risk-taking to the non-bank financial sector and the lack of oversight there. I wonder if you can comment a little bit more on that.

And secondly, to the extent that governments are responsible for encouraging markets and investors through raising potential growth expectations, it seems to me that there's not the leverage that the IMF has in a bailout program for the ECB. It seems not generating the structural reforms that are necessary in a central component here. Am I wrong?

MR. WESSEL: Let me take two more questions, and then we'll let them pick and choose. The woman here on the aisle and the gentleman over here. Quickly, so we don't stretch our time.

MS. D'ALTE: Good morning. Sofia D'Alte from the Embassy of Portugal.

I just would like to ask regarding the ongoing reform on financial regulation, how do you see the need to tackle the challenges posed by credit rating agencies, having in mind, for instance, the case of Portugal, that can be described pretty much as a poster child for a country that has been doing everything it can? It has regained market access. Yields have been coming down. But nevertheless, in the last review for Moody's, for instance, it still stands at junk level. So my point is how can we trust in this kind of assessment and how can we improve the regulation of these agencies? Thank you.

MR. ODIE: Antony Odie, formerly with the World Bank.

For Professor Eichengreen, you've told us several things you don't expect Europe to do: give up the euro, shock and awe. Beyond the answer of "muddle through," could you give us some specific changes you think they may, in fact, take to make the euro less painful to live with?

MR. WESSEL: Okay, David and Chris, do you want to take the first couple questions?

MR. LIPTON: Chris, I think it was addressed to you.

MR. BRUMMER: Those are good questions, really hard questions. Just working backwards, I think with credit rating agencies one of the challenges is, well, how do you develop a best model? Right? So IOSCO, the International Organization of Securities Commissions, have basically a credit rating agency code of conduct. And that code of conduct is supposed to at least govern and police the kinds of conflicts of interest that have traditionally inhabited the ratings process for derivatives instruments.

But what Portugal, Greece, many European countries, including the European Commission has identified is that there are other kinds of conflicts of interest, particularly when you move into the sovereign debt space where the metrics for evaluating a country become much more ambiguous and, frankly, somewhat more personalized to the extent to which you have to -- I've been part of a credit rating agency sort of process, and some of the judgments that are made can often reflect one's own sort of cultural bias. Right? But the problem is, you know, how do you improve that system?

If you try to create a sort of national -- like Portugal and Spain at one time sort of proposed, along with the European Commission, this idea at one point in time creating a national-based credit rating agency, then there's going to be bias there, particularly when it comes to sovereign debt. They're not going to downgrade its own debt, particularly then when it affects the ability to self fund, say, the European stability mechanism or something like that.

So I think that the only way in which you can work towards a better system is if you start to make more transparent specifically what those metrics are. And you have to make the ratings process, those judgments that are actually made, more transparent. And I think that's the best you can do.

MR. WESSEL: Well, David, I think Ian had two questions, one of which you've touched on about the risk --

MR. LIPTON: I have to answer the second one.

MR. WESSEL: Yes, exactly.

MR. LIPTON: Barry's book shows other episodes of fiscal dominance. It is often a concern that if a central bank provides support to governments by buying their bonds that it can lead to indiscipline. And that's a generic problem in economics. Many discussions have happened in this room on the Brookings papers that talk about this subject.

But there have been many suggestions for things that the ECB should do over the last few years and the ECB's response is we have only one mandate, is to get inflation to be a little bit below 2 percent. And I think they really have to pursue that mandate. It's their job. That job is assigned to them.

There are some who suggest that in doing so, that may lead to either fiscal indiscipline or delays in undertaking structural reforms. Clearly, from an economic standpoint, the first best is to do it all. And I think it's way too soon to be abandoning an effort to get the various countries to undertake the policies they should. After all, when they fall into such difficult times that they have no choice but to come to us, of course, that's what happens. The most significant fiscal adjustment and structural adjustments, perhaps excessive in some people's views, have happened in the Fund-supported programs in Europe. Surely, it would be best if sensible policies were adopted now.

MR. WESSEL: So if I hear what you're saying is the ECB has a mandate and they should achieve that mandate and they shouldn't make achieving that mandate contingent on other people doing structural reforms.

MR. LIPTON: Well, no, I'm saying they should take the steps to achieve that mandate. If the politicians -- I think a wise political course of action would be to support their efforts to achieve that mandate by banding together, having discussions among the countries of Europe about the other policies that need to be taken. In essence, joining together to have a policy of support, say, through infrastructure investment, something we have advocated, as well as programs of structural reforms that will help raise potential growth, which is surely a part of the long-run answer to the issue in Europe, that potential growth has been sliding and that the demographics are adverse to a continent that has a lot of debt to work through and can't easily do that at low inflation and low growth.

MR. WESSEL: So, Barry, you were offered an opportunity to write an epilogue to your book in which you predict what's going to happen in Europe.

MR. EICHENGREEN: Let me answer that one and two others in one minutes.

MR. WESSEL: Okay.

MR. EICHENGREEN: To the Embassy of Portugal, I would say don't pay too much attention to the rating agencies because nobody else does. (Laughter) They don't have any inside information that the markets lack. What's important is that they be prevented from both advising issuers and rating the resulting issues, and that they be disconnected from the regulatory process. And I think in the U.S., slow progress is being made by the Fed and the SEC in that direction. Europe needs to do the same.

To Ian, I don't think, to put a point that has been made in more blunt terms, I don't think a central bank like the ECB should be allowed itself to be painted into a corner where it is the enforcer of structural reform because as the enforcer of structural reform, growth becomes the enemy. And that's not a posture that a central bank should adopt.

And on Europe, the pie in the sky answer would be that Europe needs a grand bargain of monetary expansion, fiscal stimulus, and structural reform, where everybody agrees to this quid pro quo. Everybody gives something and takes something.

More concretely, Europe needs to solve its banking problem, its debt problem, and its growth problem. It's making slow progress toward solving its banking problems under the rubric of banking union and all that entails. It needs to address the debt problem. Is the Italian debt sustainable? We could have a long discussion of that question. But more generally, there are big issues of debt sustainability lingering in Europe. And the best way of dealing with the above is to grow the denominator of the debt-to-GDP ratio by getting economic growth going. Deal with weakness in the banks by getting economic growth.

MR. WESSEL: What are the odds you give that those are happening?

MR. EICHENGREEN: Not very high. So, you know, the lost decade is baked in. Japan was able to survive two lost decades.

MR. WESSEL: After those optimistic notes, three announcements. One, look at your feet. If there's a paper or a cup there, we'd appreciate it if you'd pick it up and put it in one of the barrels in the back.

Secondly, on Friday at 9:00, in the room next door, we're going to continue the conversation about Europe with Lucrezia Reichlin from the London Business School, a former director general of research at the ECB.

And finally, please join me in thanking Barry, David, and Chris.

(Applause)

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