Barry Eichengreen, *Hall of Mirrors: The Great Depression, The Great Recession and the Uses—and Misuses—of History*
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HOW TO MISHANDLE A CRISIS

The current crisis may not have shattered the ossified shell of economic theory, but it has unleashed a cascade of arguments within the policy-making elite. The Bank for International Settlements and the IMF are at odds. The Bundesbank is pitted against virtually every other major central bank in its dogged adherence to deflation. Larry Summers, Clinton's Treasury Secretary and once a cheerleader of market liberalization, has announced that what we have been living through since the 1980s is a steady slide into secular stagnation disguised by a series of credit-fuelled bubbles. The unlikely success of Piketty's *Capital* has provoked a half-hearted debate about inequality in the financial press. Barry Eichengreen's latest book, *Hall of Mirrors*, is most interesting when read as a voice from within this establishment turmoil.

Eichengreen belongs to the last generation of so-called 'saltwater' macroeconomists trained by Yale, MIT and Harvard in the 1970s and early 80s. His interest in the historical development of international finance was sparked by the influential lectures given at MIT by Charles Kindleberger, a veteran of the Marshall Plan, which Eichengreen attended along with Peter Temin, Larry Summers, Paul Krugman and Ben Bernanke. Also in the crowd were Christina Romer, first chair of Obama's Council of Economic Advisers, and Brad DeLong, who did time in the Clinton Treasury under Summers and is now an influential blogger, based like Eichengreen and Romer in the Berkeley economics department. For this generation, there was one central problem. As Ben Bernanke put it, 'to understand the Great Depression is the holy grail of macroeconomics.' As they rose through the ranks, their professional self-confidence derived from the sense that they were getting closer to grasping that grail.

The starting point for their quest was the monetarist interpretation of the Great Depression offered by Milton Friedman and Anna Schwartz in their 1962 *Monetary History of the United States*. By the same logic through which they attributed inflation to the expansion of the money supply, Friedman and Schwartz blamed the disastrous deflation after 1929 on the failure of the Federal Reserve to prop up the American banking system. It was the implosion of the private credit system that collapsed the money supply, driving prices down, upsetting the balance sheets of indebted businesses and farmers and triggering a wave of bankruptcies. Keynesians responded that expenditure flows—such as savings and investment or government consumption—were more important than monetary aggregates. But by the mid-1970s a commitment to aggregative macroeconomic argument, whether Keynesian or monetarist, for or against Friedman and Schwartz, put all of the saltwater group at odds with the so-called freshwater, supply-side economics that was bubbling up through the research departments of the Midwestern Federal Reserve banks. The freshwater approach, as Krugman would cruelly remark, reduced the Great Depression to the 'Great Vacation'—a voluntary adjustment of labour supply, triggered by over-generous welfare systems and labour-market distortions, misdescribed in official statistics as a surge in involuntary joblessness. For dogmatic believers in market equilibrium, only distorting interventions could wrench demand and supply out of balance. By contrast with this freshwater school, the differences on the East Coast between monetarists, who emphasized central banking as the driver of the Great Depression, and Keynesians, who emphasized the fall in private investment, were small indeed.

The version of the monetarist interpretation that Eichengreen laid out in his field-defining *Golden Fetters: The Gold Standard and the Great Depression* (1990) was distinctive for the fact that he moved beyond the personalized, parochial focus on the leadership of the US Federal Reserve, insisted on by Friedman and Schwartz, to emphasize the structural and institutional constraints of the international gold standard. What prevented the Fed from counteracting the implosion in the money supply after 1929 was not a lack of economic understanding or initiative, but the risk that gold would flee the country; these same 'golden fetters' propagated deflation and the downturn across the world economy. But this begged the question: between the 1870s and 1914, the gold standard had provided a durable framework for the first wave of globalization, so why did it no longer function after World War I? The most obvious, and perhaps still the best answer, is that the War created vast new imbalances and therefore new problems of international regulation.

One could blame the French for their one-sided hoarding of gold; Charles Kindleberger highlighted the lack of American leadership in the 1920s. Eichengreen and his generation were shaped by the collapse of Bretton Woods in the early 70s. They had learned, they believed, that American hegemony was neither necessary nor even functional for the working of the world economy. What was required was cooperation and the unquestioned credibility of conservative monetary institutions. That was what had been lost in the early twentieth century—the erosion was in train even before the disaster of 1914. For Eichengreen, the vulnerability of the gold standard was best grasped in terms suggested by Karl Polanyi in *The Great Transformation*: a mounting conflict had developed between the rigid institutions of the world economy, inherited from the mid-nineteenth-century 'golden age' of liberalism, and the imperatives of mass democracy. Workers and debtors resisted free trade, mass immigration and the rigid imperative for deflation demanded by the gold standard. William Jennings Bryan's populist crusade in the 1890s against the 'Cross of Gold' was a harbinger of the future. This anti-market resistance—even if it could be defeated, as Bryan was in 1896—undermined the confidence required to make the gold standard a stable and self-equilibrating system. As the Great Depression was to prove, upholding the gold standard in the face of sceptical bond markets was a recipe for disastrously lopsided deflation.

Golden Fetters provided inspiration for an entire generation of economic historians, offering an open-ended framework into which the fortunes of territories as far apart as Latin America, Japan and Bulgaria have been integrated. Apart from its historical persuasiveness, Eichengreen's narrative harmonized with the policy consensus of the 1990s and 2000s. *Golden Fetters* rejected any nostalgia for the apparent monetary stability of the gold-standard era—or of Bretton Woods. This was the basic lesson of the 1930s. The countries that left the gold standard earliest, like Japan and Britain in September 1931, recovered most rapidly from the Depression. Given the unquestioned imperative of free capital movement, fixed exchange-rate systems were fetters upon modern politics. As the period since the 1970s had confirmed, nations were best served by setting their own monetary and fiscal policies, whilst allowing free-floating exchange rates to adjust away any discrepancies in competitiveness.

This was the historical lesson taught by *Golden Fetters*; it was also the mantra of the IMF. In tune with the spirit of the Great Moderation, omnivorous in his geographical and chronological range, Eichengreen became one of the most influential economic historians of the 1990s and 2000s; a phalanx of works on international monetary systems flanked a major 2006 study, *The European Economy Since 1945*. The embryo of his latest book was a presidential address to the American Economic Association, a pinnacle of the US social science establishment. But *Hall of Mirrors* is no longer couched in the self-confident tone of the 90s. Instead, it reflects the state of critical self-reflection prevailing within that establishment in the wake of the crisis. For the most part the measured prose is muted in tone, resigned where not despondent. Yet *Hall of Mirrors* delivers a devastating attack on the complacent self-confidence of Eichengreen's own generation—the assumption that in understanding the Great Depression they had learned from history and could thus govern better.

The simple version of the triumphalist story focuses on Ben Bernanke, economic historian turned monetary superhero. As a prominent researcher on the Depression, Bernanke was foremost amongst those who imbibed the monetarist lesson. The oft-cited expression of his sense of filial connection was the occasion of Milton Friedman's ninetieth birthday in 2002, when Bernanke pronounced: 'I would like to say to Milton and Anna: regarding the Great Depression. You're right, we did it. We're very sorry. But thanks to you, we won't do it again.' Everyone in the room knew the script of Milton and Anna's *Monetary History* by heart. When the crisis struck in 2007, the Fed would stand ready. There would be no repeat of the monetary disaster of the early 1930s. Meanwhile, Christina Romer, another student of Depression-era policy making, would lead the push for a fiscal stimulus. For her too it was a case of learning from history: despite the propaganda around the WPA, the New Deal had never delivered a sustained fiscal stimulus; FDR's inclination was always to balance the budget. In fiscal as well as monetary policy, Obama's administration seemed set to write a new chapter. And certainly if we compare the track record of the American economy after 2007 with that after 1929, or with the current experience of the Eurozone, it is evident how a self-congratulatory view can take hold. The American trough in 2009 was far less deep than in 1931–1939, and America's recovery since 2010 has been notably stronger than the Eurozone's.

Eichengreen does not dispute these facts. But as he shows in *Hall of Mirrors*, the complacent story woven around the American policy elite is inconsistent and unconvincing. Their most fundamental error was to assume that, thanks to the work of Friedman, Schwartz and their followers, the policy mistakes of the 1930s had been understood and would not be repeated, and that a new crisis was therefore impossible. While they congratulate themselves on having avoided the worst, the policy elite ignore the question of why the 2008 disaster was allowed to happen in the first place. Both in the 1920s and the 2000s, the most basic observation is that the authorities failed to recognize the build-up of catastrophic levels of financial risk.

Hall of Mirrors proceeds by way of a stage-by-stage comparison: the 1920s run-up to the Wall Street crash, on both sides of the Atlantic, is contrasted with the build-up to 2008—beginning not with the end of the long boom and revocation of Bretton Woods, but with banking deregulation from 1980 on as US banks, exposed to the Third World debt crisis, fought for more favourable terms. This was followed by Clinton's 1993 turn to 'finance for growth' and then the late-90s housing bubble, prolonged and expanded by the Fed on the rationale of the Great Moderation. Next, Eichengreen sets the stubborn insouciance of Hoover and company in 1929–33 beside the relative complacency—and sheer ignorance—of the Fed and Treasury in 2007: 'The alphabet soup of CDOs, SPVs and CDSs was not part of the staple diet of erstwhile Princeton professors of economics. Nor were these complex financial structures incorporated into the Federal Reserve's model of the economy.' As late as mid-2008, real-time data forecasts indicated continuing modest growth, with 'little appreciation of how the financial system was amplifying the shock to the housing market'. Paulson and Bernanke, having been harried by JPMorgan Chase's Jamie Dimon into an unnecessary bail-out for Bear Stearns, were loath to repeat the trick for Lehman and missed the extent to which AIG had insured Goldman Sachs and others against its failure. Europe was even blinder: the 'single greatest failure' to learn from history, Eichengreen now argues, was the decision to adopt the euro, with its 'unquestionably disastrous consequences'. A final section compares NIRA, Glass–Steagall and the 1930s exit from gold—a programme stronger on reform than recovery—with Obama's policies, prioritizing recovery but notably weak on reform: the 'Good Housekeeping Seal of Approval' affixed by Geithner's 2009 stress test on the biggest banks amounting to a 'colossal guarantee', 'opening the door to moral hazard on a massive scale'.

In both cases, Eichengreen argues, the authorities were not oblivious to the risks building up in the financial system in the run-up to crisis. They did worry, but about the wrong things. In the 1920s the Fed worried about sterling and other weak members of the gold standard, and set US interest rates too low. In the 2000s, it was once again international macroeconomic imbalances that preoccupied Washington; Larry Summers warned of a 'balance of financial terror' entangling America and China. But the big sell-off of US Treasuries by foreign investors is the crisis that did not happen—after 2008, funds actually flowed into the dollar. What exploded was a gigantic credit-fuelled boom in the housing market.

How then to theorize the dynamics of such private-sector credit booms? The BIS has elaborated a right-Minskyian model of the credit cycle, with which Eichengreen seems to sympathize. Alternatively, he could have thrown his lot in with a new and energetic generation of muckrakers who have begun to unpick the competitive expansion of the big banking groups from the 1990s onwards. Heterodox economic historians, both right and left, have offered alternative theorizations: Richard Duncan's diagnosis of a credit explosion unleashed by the fiat-dollar system, in symbiosis with global wage deflation; Robert Brenner's explanation of financialization as outcome of declining profitability in the 'real economy', owing to manufacturing overcapacity built up during the long boom. Regrettably, *Hall of Mirrors* makes no decisive analytical move in any of these directions. With regard to the 2007 crisis, most of the stories are well known—the hubris of mortgage providers such as Countrywide and Northern Rock, their brash bosses, the toxic combination of automated underwriting with high-tech mortgage-backed derivatives. Where Eichengreen's narrative does veer productively off the beaten track is when he compares the recent boom-to-bust with that in the roaring twenties. It was in the bootlegger bars of Prohibition-era Florida that mortgages were first packaged, sold and resold. And it was in Florida then, as on the Costa del Sol now, that an extraordinary real-estate boom came to a shuddering halt, bringing down with it the local banking system.

But for all these moments of real novelty, the basic narrative offered by *Hall of Mirrors* is disappointingly familiar. From an author of Eichengreen's calibre it is worth enquiring why this should be so. In part it is because *Hall of Mirrors* is a book about the policy elite for the policy elite, written by a member of that group in its own idiom. It is less a history of crisis than a handbook. The purpose is to learn lessons, indeed to learn lessons about learning lessons, and to minimize 'unnecessary' polemics. At crucial points of division between fresh and saltwater schools of mainstream economics, Eichengreen's search for the middle ground is painful to behold. Eichengreen is not the man to deliver a Ben Bernanke-style credo: 'Dear Maynard. You were right. We were wrong to doubt. The fiscal multiplier is positive and greater than one.' But beyond these rhetorical tactics, there is a more basic mechanism of neutralization operating in Eichengreen's text. One might expect a book about the Great Depression entitled *Hall of Mirrors* to have things to say about Versailles and the highly political drama of reparations and inter-Allied debt. But already in his earlier work, Eichengreen surgically removed any substantial discussion of international politics during the interwar period by focusing his analysis on the Polanyian couplet of domestic politics and international economics. International politics—and thus the entire field of hegemony—was relegated to the margins. In his latest offering, the rereading of the 1920s in light of our present-day subprime crisis pushes this depoliticization one step further. Out go the trade unions and insurgent debtors' coalitions, the contending class forces that populated the political economy of the 1970s and 80s and the histories that people like Eichengreen wrote at that time. In comes a thoroughly suburban account of economic crisis as an effect of consumerist desires and the real-estate speculators and hucksters who prey on them. In 1920s Florida what drove the bubble was sunshine and cars. In Weimar Germany it was public swimming pools. In Spain in the 2000s it was sun once more.

If one truly seeks to govern capitalism, Eichengreen seems to be telling us, it is these generic biopolitical dynamics that must be grasped. What *Hall of Mirrors* distills from the twin crises of 1929 and 2008 is an archetype of the boom-to-bust cycle and the failure of policy to anticipate and contain it. This basic vision is derived from historical experience and involves passages of piquant narrative. But the back and forth between the 1920s and the 2000s is flattening of both historical moments. It is as though each crisis cuts the other down to size. What is left of connecting historical sinew, what spans from one episode to the next, is not the development of financial capital, which is portrayed as essentially repetitive, but the hubristic career of the policy-making elite, driven forward by their assumption that they understood the lessons of the past and would not repeat them. Pushed to its most naïve and bombastic extreme, this was the kind of ironic 'history' that Carmen Reinhart and Kenneth Rogoff offered up in their bestseller *This Time is Different*. In that book, eight centuries of financial history were reduced by way of a mass of undigested data and charts to a flat, repetitive cycle of human nature and its follies.

Whereas Reinhart and Rogoff fell into a form of paradox—lecturing policy-makers on the eternal recurrence of financial cycles, presumably with a view to avoiding that repetition—Eichengreen's practical intent is lucidly articulated. We are not condemned to repetition. The half-century of financial calm that followed the New Deal demonstrated that. But to break the cycle requires institutional change and unfortunately, the very effectiveness of the counter-measures taken in the US in 2008–09 served to de-escalate the crisis sufficiently to demobilize further efforts at reform. In the 1930s the hardship suffered by millions generated a crescendo of political mobilization both in the US and Europe. It was not until 1936–7 that a conservative backlash pushed the US economy into a second downturn. In the age of Obama, whatever reform impetus there was in 2008–09 was stifled by Geithner and Bernanke. As of 2010 the talk was of fiscal retrenchment. Dodd–Frank was half-baked. Riven by internal divisions, the Fed dragged its feet before introducing QE2 and QE3.

This critique puts Eichengreen squarely alongside the likes of Paul Krugman. His own prescription is that governments should sustain fiscal and monetary support 'until households, banks and firms are ready to resume business as usual', as if the latter were unproblematic. But whereas Krugman has gone on to sketch a comprehensive account of American democracy and its malfunctioning—even flirting with the Polish Marxist economist Michał Kalecki, to explain the resistance to any true policy of full employment—Eichengreen's account is truncated. The welfare state kept people off the streets, he tells us; the misery index was kept at bearable levels. But in *Hall of Mirrors* there is no development of the Polanyian themes that were so central to Eichengreen's early work. This is all the more surprising since it can hardly be denied that the history of capitalist democracy entered a new phase in the 1970s, with the evisceration of popular politics going hand in hand with the politics of the market and disastrous efforts to 'govern at a distance'. This has been noted, not only on the left—Wolfgang Streeck's *Buying Time*, for example—but also by imaginative conservative economists such as Raghuram Rajan, who recently moved from Chicago to head the Indian Central Bank. In his book *Fault Lines*, Rajan argued that the bankruptcy of the American dream had driven both the spiral of consumer credit and the increasingly erratic and populist mood swings of Congress. By contrast, Eichengreen comments lamely in his final pages that the connection between inequality and the dynamics of the crisis is important, but that Piketty has little to say about it and that further work is needed. In the meantime even an institution as impervious as the IMF has taken up the question of the inegalitarian impact of central bank monetary policy and the causal role of growing inequality in rendering market economies more vulnerable to credit crises.

At this point we realize that something remarkable is happening. It should not perhaps surprise us that Eichengreen's comparative method has the effect of emptying out some of the historical and political complexity of the 1930s crisis. Few if any other eras can measure up to the interwar period in terms of the sheer entanglement of political and economic dynamics. The remarkable fact about *Hall of Mirrors* is that the vector of depoliticization runs both ways. Eichengreen compares our current crisis with that of the interwar period and produces a less political image even of our present situation. In this double-sided action, the analytic engine of *Hall of Mirrors* reveals itself to be a veritable anti-politics machine.

The effect is most telling in one of the rare concessions that Eichengreen makes to Bernanke's management of the Fed. When disaster struck Austria and then Germany in 1931, the financial authorities of the world were painfully slow to respond. By contrast, as Eichengreen remarks in an aside, when stress began to build up on the transatlantic currency markets in 2008, the Fed stepped in by offering currency swap lines. He does not elaborate. The point seems clear enough: this was one area where the mistakes of 1931 were not repeated; true enough. But in describing the Fed's actions in these terms, Eichengreen spectacularly understates what did happen. The Fed's swap-line activities in 2008 are the great untold story of the crisis, and constitute perhaps the most dramatic action of transatlantic financial diplomacy since the advent of the Fed in 1913. They cannot be understood on the assumption that financial crises are essentially repetitive phenomena with an unchanging basic logic, because they were necessitated by the historically unprecedented formation of a Euro-American banking system integrated and leveraged as never before in its history. The liabilities of Deutsche Bank and BNP Paribas amounted to over 80 per cent of their respective countries' GDPs, and the flows of funds back and forth between Wall Street, London, Paris and Frankfurt dwarfed the more incremental accumulation of net balances of American government bonds by Chinese sovereign wealth funds. And whereas the China–America axis was politicized through and through, the new financial economy of the 1990s and 2000s lacked any effective governance. It was into that breach that the Fed stepped in 2008. It opened unlimited credit lines for all the central banks of the world, and provided liquidity for private European banks as well. To the tune of more than a trillion dollars, the Fed asserted itself as the lender of last resort for the entire global financial economy. But it did so—and this is not the least remarkable aspect of the intervention—entirely below the radar of public scrutiny. The contrast with the propaganda that accompanied the Marshall Plan could hardly have been more striking. To capture this kind of historical change, however, would require a narrative structured quite differently from that of *Hall of Mirrors*.

Through its form as much as its content, Eichengreen's book forces us to a grim conclusion. He offers no grand narrative of the 2007–09 meltdown, because in his terms there was none. He focuses on the recurring, archetypal features of financial crises because, after the reform failures of 2009–11, that is what we should expect. Despite their youthful enthusiasm to learn from history, when 'their' moment of historic crisis arrived, his generation fell short of their New Deal predecessors. Since 2008 they have built no new institutional structure that would mark a break with the past. The thin narrative of Eichengreen's *Hall of Mirrors* may be unsatisfying history, but it might serve all the better as a manual for the future. We have good reason to prepare for a repeat.