ECONOMIC VIEW

The Depression's Unheeded Lessons

By Neil Irwin

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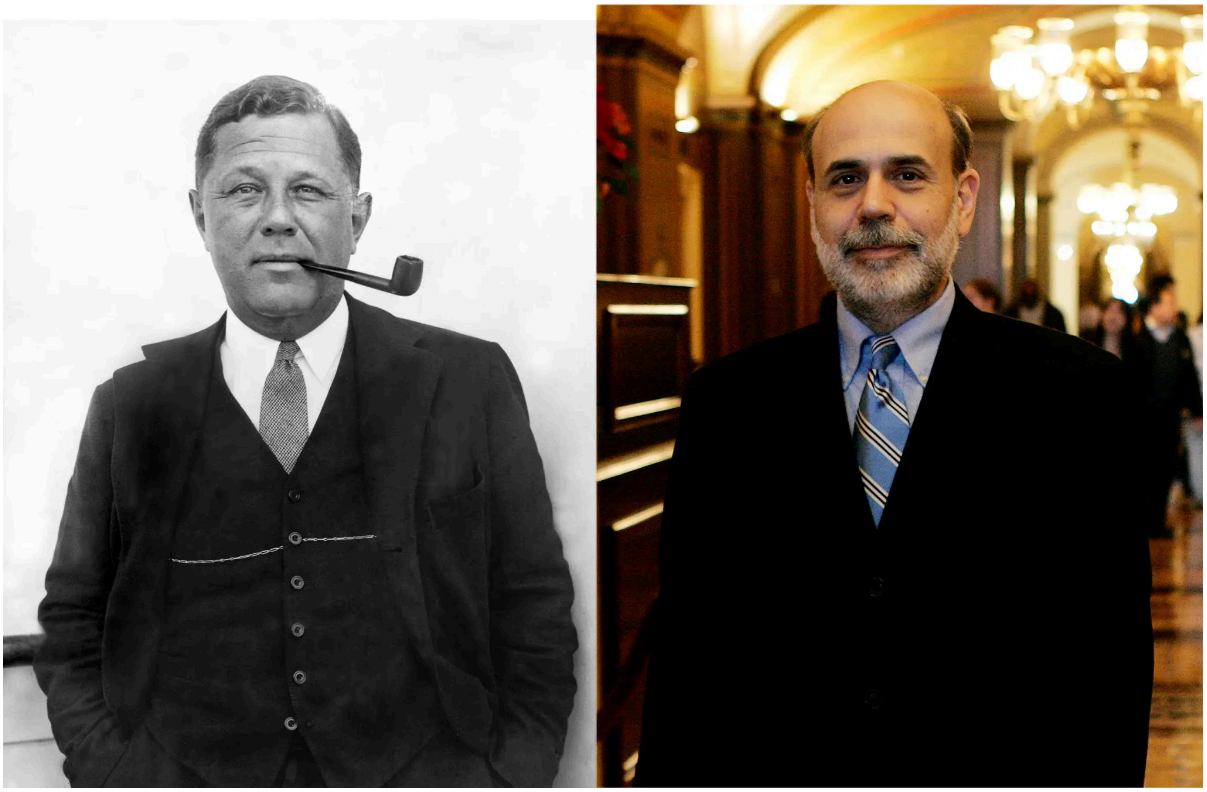
The global economy stood on the precipice, making the possibility of a descent into the horrors of the Great Depression — the despair our grandparents told us about — all too real. Then some brave leaders with a knowledge of history and names like Bernanke, Geithner and Paulson (or if you have an international bent, Trichet, King and Darling) stepped in, applied the lessons of that brutal period and pulled us back from the abyss.

That, anyway, is the oversimplified history of the crisis of 2008 that has become commonly accepted thanks to book-length journalistic narratives (one of which I wrote) and the memoirs of several major officials involved. To the degree that these officials are faulted, it is usually for the large budget deficits or multitrillion-dollar central bank balance sheets that resulted from years of interventionism and still haunt us.

Now one of the world's leading economic historians, Barry Eichengreen, has come forth with an alternate view: Rather than hoist anyone to our shoulders for preventing another Depression, we should be more cleareyed about the ways in which global leaders did not really learn the lessons of the 1930s at all and made many of the same mistakes as their Depression-era counterparts.

His new book, "Hall of Mirrors" (Oxford University Press), accuses the global leaders of the 21st century of failing to heed the warning signs that a crisis might occur and then becoming too self-satisfied with the initial success they had at containing the worst effects of the banking crisis in late 2008 and early 2009.

The reason the global economy is still in rough shape seven years later, in this telling, is that leaders in the United States and Europe drew the conclusions they wanted to hear from the Depression.



George L. Harrison in 1934, when he was chief of the New York Federal Reserve, and Ben Bernanke in 2006, the year he became the Fed chairman. Left, The New York Times. Right, Doug Mills/The New York Times

“Once we averted a Great Depression, we succumbed to the instinct to do less in order to sustain economic growth,” Mr. Eichengreen, an economist at the University of California, Berkeley, said in an interview. “The fact that we successfully averted a depression enabled policy makers to declare that we were ready to go back to normal policies before that was the reality.”

It is perhaps all the more surprising given the high-ranking officials who were scholars of the Depression in their own right, notably Ben S. Bernanke, the former Federal Reserve chairman, and Christina D. Romer, President Obama’s first chairwoman of the Council of Economic Advisers. However, they had little control over the political forces unleashed by the steep economic downturn, and both were voices in favor of more sustained action to try to right the economic ship.

When the crisis first arose, policy makers of all political stripes could agree that fiscal stimulus would help the economy weather the rough times. In early 2008, the idea that fiscal stimulus could help encourage economic growth was uncontroversial enough that President George W. Bush and overwhelming majorities of a Democratic Congress agreed to a $152 billion package. By 2009, the idea had become politically polarizing. President Obama's much larger stimulus passed, but with hardly any Republican votes. And by 2011, even many Democrats accepted that it would be a year of pivoting toward deficit reduction. With the economy still ailing despite hundreds of billions spent, "stimulus" had become a dirty word.

Why did public opinion turn so decisively, and quickly, against a stimulus strategy that had been considered uncontroversial to generations of economic policy makers?

"Politicians are prone to overpromising," Mr. Eichengreen said, and policy makers did not grasp how bad things were or how high joblessness would rise in spite of stimulus spending. "We didn't understand in real time how fast the economy was contracting in 2009. We overpromised in terms of what would be achieved in terms of the unemployment rate, not knowing the extent of the rise in unemployment that was already baked in."

In monetary policy, Mr. Eichengreen finds plenty to fault as well.

In the three years following the most intense phase of the crisis, the Federal Reserve responded to the disappointing recovery with a series of half measures. "Q.E. 2," the second round of quantitative easing, drew public attack far out of proportion with its ability to bolster growth. Anyone remember Operation Twist? It was also known as the maturity extension program, a gimmicky effort by the Fed to stimulate the economy by trading short-term bonds for long-term ones. It was the Fed's main stimulus program in 2011.

In October 1930, thousands of unemployed people in Cleveland waited outside City Hall for a chance to apply for a job. Associated Press

It was not until September 2012 that the Fed unveiled a program that finally seemed to help jolt the United States economy to life, with its open-ended pledge to keep buying bonds using newly printed money until the outlook for jobs improved substantially.

Public pressure on the Fed was, to a startling degree, one-sided. Many conservatives and financial market commentators assailed the central bank for its easy money stance, and there was little in the way of a crusade from the left to try to encourage greater activism by the Fed.

In judging the individual actions of policy makers, Mr. Eichengreen is reluctant to place personal blame, acknowledging that decisions that seem crystal-clear in hindsight are considerably harder to make given imperfect information and fastmoving events. Seeing the challenges that officials confronted in responding to the unfolding crisis has even made him rethink some his views of the failures of the 1920s and ’30s.

“It makes me much more sympathetic than I was before, in understanding the uncertainty that George Harrison faced or Herbert Hoover faced,” he said, referring to the chief of the New York Fed and the president at the onset of the Great Depression. “They really didn’t know how quickly the economy was contracting in 1929, and the same was true at the end of 2008.”

But there is a broader lesson here about the challenges of applying the lessons of history to modern policy, whether in economics or any other field. Even when faced with a close historical analogue and high officials with deep historical knowledge, our leaders came up short.

The clichéd quotation from George Santayana, “Those who cannot remember the past are condemned to repeat it,” might have a coda: So, sometimes, are those who remember it.

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