Research Notes

Historians' Moment

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The never-ending pursuit of happiness (and dollars) in the United States usually involves a relentlessly forward-looking focus. That awesome drive for success often hinges on finding the next new thing, and it doesn't usually leave a lot of time for reflecting on history. The current moment then, seems most unusual. Talk of a Depression-era-like recession has spawned a great deal of interest in the views of some important students of economic history.

Many analysts and commentators are looking back much farther than they usually do and producing new analysis on stock market histories and economic data from the pre-War era. Four of the highest profile examples of this rise of the historians include: Niall Ferguson, Ben Bernanke, Christina Romer and Paul Krugman.

Historian Niall Ferguson is currently on tour promoting his book *The Ascent of Money: A Financial History of the World*, so I seem to hear him on all the podcasts that I follow regularly from both the U.S. and the U.K. I have not read his book but I expect it will sell well in the current environment of massive uncertainty. He certainly doesn't shy away from big questions and I look forward to reading his book. It is unlikely that he can offer more insightful prescriptions for policy makers than economists or business people, but his omnipresence at the moment does tend to remind us of the historical nature of the current crisis.

In the economics profession, students of economic history are currently in important positions of influence. Ben Bernanke, Fed Chairman, has famously studied the Great Depression era and produced influential research on it and on credit cycles and deflation. Generally, I am thankful that the Fed Chair at present is such a scholar of the most important event in economic history. He knows deeply what is at stake. The main risk is that perhaps he sees the bogey-men of Depression and deflation in more places than they actually inhabit.

As has been pointed out many times by now, it was the Fed's overzealousness in avoiding deflation in 2003 that contributed to the house price boom. Now the Fed has waged all out war on the credit crisis. The Fed's actions have been bold and unprecedented. They may well lead to greater problems down the road, such as a dollar crisis or serious inflation, but at present I think they are doing the best that they can in a very difficult situation.

Most recent of the four to make it to the spotlight is President-elect Obama's new adviser, Christina Romer. She is an economist from Berkley who has a published research on business cycles of the 19th and 20th centuries, and who has also researched the causes of the Great Depression and the recovery from it. I like her detailed early work that involved poring over Fed minutes text and comparing old (pre-WWII) data and more recent data collection methods. That work seems to show a kind of dedication to hard work, attention to detail and knowledge-seeking that will could provide a useful perspective on today's problems.

The 2008 Nobel Prize winner, Paul Krugman has studied and written extensively on the Japanese situation in the 1990s. He has been commenting recently on the current situation and the Great Depression. While not officially advising the government, his public commentary is helpful and influential. I used to follow his webpage postings regularly in the 1990s. I loved how he wrote once that he decided to sit down and think hard about Japan's situation. That was before the situation had attracted much attention and it struck me, as a young grad student, that this was what intellectuals were supposed to do but often did not. Sit down and do some serious thinking about the hard problems that the real world faces. It's very easy to get so caught up in theory and modeling of simple scenarios that one somehow never remembers to go back to the real world. The real world has a way of throwing up enormously complex problems. Luckily, getting the best brains working on practical problems is something that America has always been very good at and the current moment looks like that tradition will continue.

Will all these history-literate economists save us from repeating the mistakes of history?

It's clearly too late to say definitely "yes". Many of the housing and financial industry economists and analysts have already fallen for the for the biggest trap that markets create – the belief that cycles are tamed and that things are different this time.

I've worked with many young economists who believe, as many young people do, that we are just so much smarter, better organized and better informed now than in the past, and that the big problems of history could never happen again. I hope that they are right, but I don't think we are that much smarter than people of the past.

We are however, better organized and better informed (at least about past mistakes) than previous generations. So there is hope policy makers today will handle the situation better than they did in our grandparents and great-grand parents' time.

Overall, I'd rather have a historically-literate team in place. I'd like to think that the guys driving the bus at least know how badly things can go wrong with an economy. We can't know if this means Bernanke and the others can prevent another Depression from occurring. But, they will at least not make the same kind of mistakes that the 1930s Federal Reserve made. This is progress of a sort. First, the Fed's current, unprecedented; actions may actually solve the current problems by unlocking credit markets enough to avert real economic disaster. Second, even if they don't work, they also provide future economists with another strategy to study if the financial and real asset markets get into such a mess again.

By now, however, Bernanke might well have run out of ammunition. It will be up to the big guns on the fiscal side to take over. Let's hope they deliver a historic success.

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