**KEY POINTS**

- Changes to globalization as a result of tremendous shocks such as the most recent financial crisis can be very abrupt and sudden.
- The two primary lessons drawn from the Great Depression pointed toward using massive fiscal stimulus in the face of collapsed demand to prevent the economy from sinking from a recession to a depression, and to continually pushing liquidity into the market to keep interest rates low and credit moving.
- In a globalized, interconnected financial world, central banks' actions reach well beyond their own nation's borders. The spillover throughout the system vastly complicates efforts to prevent bank collapses and revive the economy.
- The financially-driven globalization that has occurred over the last 20 years or so is likely to come to an end. It may well be replaced by a world dominated by large nations exercising "state capitalism." This period may also be characterized by the reduced mobility of people, capital, goods and ideas.

# Can Economics Ignore History? Learning from Past Crises

**HAROLD JAMES** PRINCETON UNIVERSITY

It would be a mistake to assume that globalization and the mobility of people, capital, goods and ideas will continually expand over time. History shows instead that economic and political events can abruptly slow the pace of globalization and, indeed, reverse it. Harold James, professor of History and International Affairs at Princeton University, describes the changes to globalization that he believes will flow from the financial crisis of 2007-08. James projects that the recent financially-driven globalization will give way to an environment in which large states emerge as the power brokers of "state capitalism," more willing to exert their power over corporations, and their influence over the world's economic and financial systems. James also expects a backlash against the mobility of ideas as a long-term result of the financial crisis, and expresses concern with regard to how that will affect higher education. Excerpts of James' remarks at the Forum's 2010 Aspen Symposium are reprinted here.

As an historian, I see patterns of globalization in which there are periods of more intense interconnectedness, more intense flows of people and capital goods, but also of ideas. And then there are periods in which those flows are reversed, and there is a greater skepticism about things that come from the outside—that is, a reduced openness to ideas that come from long distances, and a greater concentration on what it is that we think we do best in our smaller, national community.

Changes to globalization can be very abrupt and very sudden, as a result of tremendous shocks such as the most recent financial crisis. Such a crisis of globalization—a reversal—occurred in the Great Depression of the 1930s. Since 2007—particularly since the failure of Lehman Brothers in September 2008—everybody has been thinking about depression analogies. The Great Depression has been widely looked to for lessons and policies to deal with the current crisis. And that's what I would like to talk briefly about. What were the lessons derived from studying the Great Depression, and what is the source of this tremendous certainty that something like that could never happen again?

## Lessons from the Great Depression

There were two big lessons drawn from the Great Depression of the 1930s and widely applied by policymakers in the United States and other countries. For a long time, the lessons appeared to be contradictory, from rival schools. There was the Keynesian interpretation of the Great Depression:

when things looked really bad, particularly in late 2008, Keynesians argued for a massive fiscal stimulus in the face of the collapse of demand. That is, they argued for using a massive fiscal stimulus as the way to prevent the world of the Great Depression from occurring again. And the big countries did just that: the United States brilliantly applied $787 billion in stimulus; China, $4 trillion renminbi; and India had a big package too.

These countries also knew the monetary policy lessons of the Great Depression. It's not surprising that Federal Reserve Chairman Bernanke—who after all is a scholar of the Great Depression—frequently thought about this. He famously told Milton Friedman at the celebration of his 90th birthday that the monetary mistakes of the Great Depression wouldn't be repeated again. Milton Friedman's analysis of the Great Depression from the mid-1960s has been very influential. He showed that the monetary policy of the United States—the world's major creditor country—had been very badly mishandled because of poor institutional design, and that something different could have been done. If there hadn't been a big monetary collapse in the United States, the Great Depression would not have happened. Again, this lesson was widely known in 2007. At the first signs of danger, the European Central Bank and the Federal Reserve started to embark on very unconventional measures of pushing liquidity into the market. The Bank of England hesitated a bit, but then found that it had its own banking crisis and had to go along with the other central banks. So we used monetary policy and we used fiscal policy, and to some extent it worked. That's the happy story.

The unhappy story is that this isn't quite all that the lessons of the Great Depression involved. It's easier to talk about this unhappy side of learning from the Depression in Europe than it is in the United States, because the Europeans already had in the 1930s a version of the problem that we had in September 2008. They had massive banks—banks that were too big to fail. The United States at that point did not have banks that were too big to fail. We had lots and lots of little banks, and they failed in big waves in the Great Depression, but there were no really massive banks. The Austrian Credit-Anstalt, which collapsed in May 1931 and set off a chain reaction, owned something like 60 percent of Austrian industry. And you can't imagine that a government would just sit by and let something that size just collapse. It couldn't do that. It had to recapitalize the Credit-Anstalt. And in doing so, it started off a very complicated and very destructive process.

The problem, very briefly, is that these big bank failures in Central Europe in 1931 are really what made the Great Depression the Great Depression. They had a contagion effect—with panic spreading first to the U.K. and then, after September 1931, to the United States. And if you look at the United States and just stop at the summer of 1931, nobody would be talking about it as a Great Depression. It was actually the contagion from Europe that pushed the big, severe waves of bank failures from September 1931 onwards.

But the problem with the big bank failures that produced the Great Depression is that there isn't any very obviously convenient or easy lesson to be derived from it. So, the monetarists say, put more liquidity into the economy and the Keynesians say, we need more demand; they are right but they don't deal with the banking problem.

What was tried in the 1930s in terms of restructuring big, failed banks was fundamentally what is being tried today: partly nationalize the banks, partly inject new capital, partly move bad assets into what's now called a bad bank. All of those solutions were tried back then too. The problem then and now is that all that doesn't really get the economy moving again. It doesn't start the process of new bank lending. Bank lending contracted after 1931 for the rest of the decade in almost every country. Restructuring banks creates long-term problems

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as well, because the way these bank failures were managed often involved states taking over assets. I'm living in Italy now, and Italy has one of the worst stories—or the best story from the Depression, it depends which way you look at it—because government action avoided bank collapses like those in Austria or Germany by transferring problematical bank assets (industrial securities) to the state. But, on the other hand, the state holding company that took the bad assets out of the Italian banks in the 1930s retained control of them for 60 or 70 years, and essentially mismanaged them during the post-war period. So the bad bank solution turned out to be very costly, and in the long-term not a terribly good solution.

So, this third lesson of the Great Depression is really a much more unpleasant one, and gets at the question of, "What kind of government can deal with these problems? What level of response is appropriate?" We've seen a number of different kinds of actions, including central banks providing liquidity. But in an interconnected world, central banks don't just provide liquidity to one country; rather, it spills out all over the system. And for that reason, they come under a considerable amount of criticism.

A great deal of that criticism is frankly and straightforwardly nationalist. One of the most frightening bits of political reaction to the rescue operation I've seen was when Chairman Bernanke was testifying before Congress in July 2009. He was being asked (by Florida Democrat Alan Grayson) in precise detail about the central bank swaps that show up at the end of the Federal Reserve's balance sheet. He was asked why it is that the United States was lending $3,000 for every person in New Zealand, for example, at a time when the American economy was suffering. But that transaction wasn't a gift or a subsidy, it was a short-term operation that allowed international financial and trading flows to continue, with no credit risk to the Federal Reserve or to the American taxpayer. The ferocity of the attack was astonishing. But I think you see in that line of questioning a feeling that is very common in depressions and financial crises: that things really should be better looked after at home, that we don't want to extend credit internationally.

The immediate aftermath of major financial crises involves the strengthening of governments and states. But not every state can really manage the crisis. In particular, bigger states tend to do financial and monetary rescue more effectively than smaller states, which often have problems in terms of their degree of openness.

So when I think about what the future of globalization is going to look like, it seems to me that we're going to have a very different sort of globalization in the coming years than what we've had over the past 20 years. The financially-driven globalization of open markets is likely to come to an end and be replaced by something else. Most people, if asked about the winners of globalization ten years ago, would have come up with a list of really quite small countries. They would think, New Zealand, Chile, Singapore, Taiwan, the Gulf States, the Baltic Republics, Slovakia, or Slovenia—tiny places. Nobody would say that now. Actually, what we're seeing now is a different sort of globalization in which the states that will come out of this crisis with greater strength are big states. People think of them as the BRICs: Brazil, Russia, India and China, perhaps other big emerging markets too such as Turkey.

The "Global Trends 2025" report published in 2008 by the National Intelligence Council projects what the world is going to look like in 2025. The guess there, which I think is quite a good one, is that the world then will be one in which big states are more important and have a different form of economic organization than they do today. The report describes this phenomenon as "state capitalism."

We truly are in the midst of a quite profound shift, one produced by the economic crisis. This shift is going to continue, and it's going to be difficult because the kind of medicine that was based on the lessons learned from the Great Depression wasn't exactly designed to deal with the ills that the world financial system is suffering from now. It's not quite the right kind of medicine, and it's going to have big side effects.

## Higher Education and Globalization

How does this big picture affect the university world? Well, the American university, as it emerged over the course of the 20th century, was absolutely the archetypal product of globalization. It was a perfectly, beautifully globalized product—very open, very internationalized.

And it seems to me that if we're going to see a general backlash against globalization, we may also see a backlash against the vision of a globalized university. How is this story connected with the story of financial globalization? The links are there: I think it would be wrong to think that something like the powerful financial globalization that we have seen over the last 20 years, this enormous expansion of financial activity, cannot have effects on the rest of culture and on the rest of society.

Indeed, in some ways it actually molded the way we treated culture, how we treated the rest of life. Even people a long, long way away from the world of finance started to see things through the lenses of finance. Let me give you an example of this just to make it more concrete and to show how it arises.

It strikes me that during the extraordinary boom in the 2000s, the time of the great easy money bubble, that an equally extraordinary boom in the market for contemporary art also occurred. It was a relatively isolated part of the art market that behaved in this way—the old masters, for example, didn't see the same kind of appreciation. Why contemporary art? I think it was driven in large part by buyers who came out of the financial sector, and who influenced things more widely. And the important thing to realize is that in every era, finance is something that's a bit obscure and a bit hidden. We don't know exactly what it is that financiers and banks are doing. And so, financiers and banks need to show that they have discernment and judgment by being good at something else. As I said, I'm living this year in Italy, and I sit overlooking the city of Florence. And that was exactly the story of Florence in the 15th and 16th century. The Medici were extraordinarily powerful bankers, but they were also patrons of art, and they could show the wisdom of their financial judgments by making smart bets on the right artists.

The world of the 2000s was exactly like this; people thought about the contemporary art market exactly the same kind of way. You can't really see what's behind the black box of the complicated derivatives products. Instead you can see contemporary art, see it appreciating, and use it as an exemplar of your financial skill. Some people were really extraordinarily open about this process. In fact, some Swedish business school people wrote a book saying that avant-garde art, contemporary art, is really just like a financial product: the customers don't know what it's about, but they can be sure it's sophisticated. The artists and the bankers consider themselves as way ahead of the public, and look at the public with some disdain. Contemporary art was supposed to be unintelligible, like finance. In that sense, it really was the perfect embodiment of the bankers' financial acumen.

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This is just one example of how the particular type of thinking in the financial sector affected the way we think more generally. Another example concerns what kind of organizations are appropriate. Many of you probably have heard people from these big, iconic firms that became so heavily internationalized telling you that universities should imitate their model. I remember in particular listening to John Reed from Citigroup making exactly this point. That is, that Citigroup was becoming really internationalized as it developed this fantastic business model that allowed it to be present in over 100 countries all over the world, and that universities should follow the same kind of model, and be present in as many countries as possible too. I think by now we can see that model has, to say the least, its limitations. The Citigroup model is fundamentally problematic because it's really hard to control the management if you're present in 100 countries.

Citigroup found, for example, that they were operating 50 to 60 different, incompatible software systems. They couldn't control what they were doing. And if you're a big institution like Citigroup, you're tremendously vulnerable to reputational damages that arise out of the bad behavior of individuals—who can even be quite low down in the operation, in places a long way away. It's very hard to control that. And so I think we're seeing a backlash against this idea of globally-active corporations, and that we are also going to have a backlash against the idea of a global university.

This world in which countries try to use state power in new ways has, I think, come partly out of 9/11, and partly out of the financial crisis. A good example of this is the way the British government in 2008 used antiterrorism provisions that had been enacted after 9/11 in order to take action against the Icelandic government because the Icelandic banks had lost the savings of British customers.

We're seeing in general a period when states, particularly big ones, exert their power over corporations, but also over universities. The big states are becoming much more powerful, much more assertive, much more bossy. And it confirms to me something that I see very much as a lesson of the inter-war experience. That is, when there is a reaction against one particular aspect of international mobility, the other aspects subsequently provoke the same kind of reaction. The spread of policy nationalism may begin with restrictions on financial mobility, but the new approach does not stop there. If capital doesn't flow any more, maybe more commercial goods can flow instead. But then the attention shifts to trade issues. So today we also have a discussion of big current account imbalances, and countries with deficits are upset about China's surpluses or Germany's surpluses, and want to take corrective action.

Then, if goods shouldn't and can't flow so freely, maybe people can move instead. But then a backlash begins over worries about the effects of migration. And so in the end you have reactions against capital mobility, against the mobility of goods, and against the mobility of labor. And reactions against the mobility of ideas also come to be really important.

Historically, big financial crises have produced reactions against the many elements of mobility. We in universities should be extremely worried by the likely backlash against the mobility of ideas that the political realignments flowing from this financial crisis will produce in the long-term.

## Discussion

Speaker: Given your drawing from various historical analogies and worry about the mobility of ideas, I'm just curious how you factored in the Internet. It almost seems impossible to block the mobility of ideas these days. I'd just be curious to hear how you map those two things together.

Mr. James: It's probably harder, but I'm not quite sure that just the physical transmission of ideas is enough. The argument that technology has generated a new level of interdependence is, historically, ambiguous. Before the First World War, people made exactly the same arguments about the transatlantic cable, which we'd had since the 1860s, namely that technical interconnectedness would produce better understanding. And then it was the telephone; there was a belief that we could avoid big political crises by using the telephone. The Internet makes it easier to distribute ideas very widely, but it also makes it easy to distribute your niche ideas and to ignore others. And there is an alternative literature that suggests that the Internet fragments people and societies, because users associate with just one particular segment that conforms to their vision of the world, and they're just going to blank out everything else. In that sense—that is my view as well—the Internet could actually be helping to destroy some sense of the global interconnectedness of people that we had before. So technology offers us a very paradoxical story.

Speaker: Well, that concerns fragmentation, but not along geographical lines.

Mr. James: Yes, it certainly goes to fragmentation. I think the geographical lines come into play more by the logic of how we face financial crises, because everything that I've talked about involves the use of public money. And public money is paid by taxpayers in a nationally defined entity.

So it's the fiscal character that really produces the national story in the response to the financial crises. But the fragmentation of politics and an intense concern with the national use of money will go together.

Speaker: What counsel or caution would you give to university presidents who are contemplating a global strategy for the university?

Mr. James: I would be very worried about embarking too readily on a Citigroup-style strategy. In other words, having lots of campuses all over the world that are mostly locally managed, because you're going to have to make concessions to local social attitudes, different religious practices…just worlds of differences. And then you will suddenly find that people get caught in the intersections between the American open view and the view, say, in the Middle East. You'll get conflicting views. I think globalizing too quickly may be a way of building up vulnerability on many levels, including vulnerability in terms of reputation.

Speaker: Could you imagine calculating the rate of return on the investment in higher education and research universities? We've been investing as a country for at least 60 years, and no research university has done so. Do you know of anyone who has ever tried to calculate a rate of return and compared it to rates of return on other kinds of broad social development?

Mr. James: Yes—it's been done. In a sense, this goes back to the 1960s and the origin of growth accounting, the notion that growth occurs because of a particular mix of labor and capital. But there's another component of this—innovation and technology. Edward Denison, who really systemized this kind of calculation in the 1960s, made exactly this argument for expanding investment in education because it's a long-term way of shifting the growth rate. This is open to all kinds of obvious objections, and it's a very crude way of measuring, but it's certainly possible to do it.

Speaker: It would be interesting to take those kinds of calculations and look back over the last 40 or 50 years, and see if those differential rates of return have been sustained. That's in some sense the argument we need to be able to make—that investments in higher education and research have been very good investments and continue to be very good investments in lots of ways.

We can say that in words, we can point out examples. But to be able to quantify it would add a dimension to the argument that I think most of us at the moment don't have.

Mr. James: That's a good and important point, but what I think starts to get worrisome is when you try to make this argument in terms of particular national calculations. Shouldn't this be done at a global level? It seems to me that one of the features of the innovation world is its relative openness, and how easy it is to take innovations from somewhere else.

So, I think to pursue the logic of your question, it would be better in the end to ask, "What does it do for all of humanity?" rather than, "What does it do for citizens of the United Kingdom or the United States or Luxembourg, or any other country?"

Speaker: I guess the frustration is that clearly in other countries, the policymakers have made a judgment that higher education is a really good investment to make. You see what's happening in China and India and a variety of other places, based on the returns that they've seen the United States get from higher education.

Speaker: I think the National Bureau of Economic Research is trying to find multiple measures of national well being, rather than just using GDP exclusively as the key index for measuring national well being. Instead, a new index would also look at education, at health, and other areas to try to develop a broader composite. That may be an interesting answer to your question.

Mr. James: I think it's a potentially endless discussion because of the difficulty of separating the effects that you could get in countries that don't spend much in a world that's very open. There will be people flowing forwards and backwards, and ideas going forwards and backwards. That really is the world of globalization, but that is also a world view that will come under increasingly bitter attack.

**HAROLD JAMES** is Professor of History and International Affairs at Princeton University. Prior to joining the faculty at Princeton in 1986, he was a Fellow of Peterhouse (Cambridge University) for eight years. In 2004 he was awarded the Helmut Schmidt Prize for Economic History, and in 2005 the Ludwig Erhard Prize for writing about economics. He is a regular contributor to *Project Syndicate: A World of Ideas,* and co-author of *Deutsche Bank 1870-1995* (1995), which won the Financial Times Global Business Book Award in 1996. His most recent book is *The Creation and Destruction of Value: The Globalization Cycle.* (2009). James can be reached at hjames@princeton.edu.