Demetri Kofinas:	00:00	Today's episode of Hidden Forces is made possible by listeners like you. For more information about this week's episode, or for easy access to related programming, visit our website at hiddenforces.io and subscribe to our free email list. If you listen to the show on your Apple Podcast app, remember, you can give us a review. Each review helps more people find the show and join our amazing community. With that, please enjoy this week's episode. In the history of human affairs, money has occupied a primacy rivaled only by the word of God. An expedient of civilizations, a progenitor of wars, it has enabled humanity to move mountains along the precipice of its own annihilation. In the years after the stagflation of the 1970s and the deregulation of the 1980s, a period of moderation swept across the western world. The cost of capital declined as inflation steadied and markets rose. Developing economies hitched their wagons to the industrialized west, pegging their currencies to the U.S. dollar; the coinage of a new world order. The Euro project, once a gradual process of integration, was fast-tracked under Maastricht and the reunification of the German right. Communist China, humbled by the fall of the Soviet Union, and motivated by the riots in Tiananmen Square, set itself down the path towards becoming the growth engine of a new sort of global economy. It was the end of history, a neoliberal democratic order, and the final form of human government. Alas, the grand ambitions and lofty ideals of the Washington Consensus proved premature. The rush of capital from western countries into eastern ones precipitated a series of financial crisis, beginning in Asia and ending on the balance sheets of America's most legacied financial institutions, leading to a government engineered bail-out of the country's investment banks. Eventually, the high-flying stock market of the late 90s popped in spectacular fashion, and thus began a series of monetary counter measures, rate cuts, and wealth effects that would lead inexorably towards the Great Financial Crisis. A watershed moment in the history of markets, whose consequences we have yet to fully reckon with to this very day.
Demetri Kofinas:	02:37	This week on Hidden Forces, Barry Eichengreen: Currency, Credit, and the Legacy of the Great Moderation.
Demetri Kofinas:	03:02	So, Barry Eichengreen, welcome to Hidden Forces.
Barry Eichengreen:	03:05	Good to be here.

Demetri Kofinas:	03:06	It's wonderful having you on. Do you remember when you were last on my show?
Barry Eichengreen:	03:10	You're going to have to remind me.
Demetri Kofinas:	03:12	I had a television show called Capital Account, and you were the guest from the California studio. There's like a clock behind that ...
Demetri Kofinas:	03:19	What clock is that? Is that the Stanford campus?
Barry Eichengreen:	03:21	No, it's the Berkeley Campus. We have a Campanile modeled after the tower in Venice on St. Mark's Square. It's not the actual tower, but they project it on to a blue screen behind me.
Demetri Kofinas:	03:32	Now I remember. Right, you guys have a very convenient set-up at Berkeley. So, I had you on the show at the time ... and it was December 2012, I looked. I went back and I watched the video, and I actually went through the run-down. Much of our conversation then focused on the merits of monetary policy, and I think it was highly critical, I can imagine, of central bank policy.
Demetri Kofinas:	03:52	It's been six years since that time. What grade would you give The Fed and global central banks for how they've handled the last six years?
Barry Eichengreen:	04:03	I think I'd give them a better grade than I would've given them on their midterm back then. I think central banks learned that they had to do more, given the depressed state of the economy, and that they weren't going to get much help from governments and others. The European Central Bank finally turned itself into a normal central bank after 2011, after Mario Draghi's "Do Whatever it Takes."
Demetri Kofinas:	04:30	His summer 2012 speech.
Barry Eichengreen:	04:32	And I think Europe is now in better hands monetarily than it was before. The ECB in the pre-Draghi days made some mistakes. Raising interest rates in 2008 after the financial crisis had erupted, raising interest rates again in 2011, but I think they learned over time that deflation was a real and present danger and they moved in the appropriate direction. I'm not among those who would argue that simple banks should have begun normalizing raising the level of rates faster, I think what they did was appropriate under the circumstances.

Demetri Kofinas:	05:10	Why do you think that?
Demetri Kofinas:	05:11	In other words, what in the economy to you suggests that central banks should not have started to raise rates earlier, and do you think that they are correct in having begun to raise them now? And, do you discriminate between Europe and the United States in this regard?
Barry Eichengreen:	05:23	Well, I think the depressed state of the economy in the aftermath of the financial crisis, when households were deleveraging rather than spending ... And there was still high uncertainty about the future, which was making firms cautious. We're now clearly back, in the United States, at full employment. Inflation is showing signs that it will pick up. So, it's appropriate if there isn't another big shock in terms of an escalation of the trade war or something else; that The Fed should be normalizing interest rates, as it's now doing.
Barry Eichengreen:	05:58	Europe is not growing as fast, prices are not beginning to rise like they are in the United States. So, I think it's appropriate for the ECB to move more slowly, to weigh what it's done. It's pre-announced that it will not raise interest rates until the second half of next year, and I think that's appropriate.
Demetri Kofinas:	06:18	Is this quote, "unconventional monetary policy," or these extraordinary measures: the QE, the balance sheet expansion ... Is that just a hack for fiscal policy that governments feel needed to be enacted? Keynesian measures of demand-side economics, of stimulating the economy? Is that just a sort of imperfect work-around for policy makers?
Barry Eichengreen:	06:39	Yeah, I think it was that many economists ... That's code for saying, "I thought," back then, that fiscal policy makers should've done more, and that they began to unwind their stimulus measures too early. Central banks were then the only game in town, as the famous phrase goes, and they took up the slack by cutting interest rates more than they would've otherwise, to zero. Then, turning to unconventional policies, QE, when it was impossible to cut rates any further. And again, I think the world would've been a better place, economic recovery would've been fuller and more successful, if both monetary and fiscal policy had been used aggressively in response to the crisis and a depressed economy. But, in the event, most of the burden fell on the shoulders of central banks and they rightly concluded that they had no choice but to take up the slack.

Demetri Kofinas: 07:38

Let's roll the clock back a few decades. Let's go back to, maybe after the crash of '87, but sometime towards the later of the decade, interest rates were starting to drop. You see this chart I have here of the fed funds rate ... It seems to me that each time we reduced our upper bound significantly. Each time we've sort of gone down to this place now where we have sort of ... Interest rates are playing opossum, the yield curve's playing opossum. And there was that period where Greenspan sort of started to raise rates, it was during the irrational exuberance period, and then he sort of regretted it. Then he raised them a little bit again, and then we had the equity market pop.

Demetri Kofinas: 08:14

Do you feel that monetary policy during the Great Moderation could have been handled better, in such a way that we would have significantly different economic conditions today than otherwise?

Barry Eichengreen: 08:26

I don't think that monetary policy is to blame here. I think central banks ought to have been issuing louder warnings about the so-called Great Moderation, cautioning that it might not last forever. Simple bank says regulators should've been paying better attention to the leverage and risks building up in the financial system. There are those, like John Taylor at Stanford University, who would argue that monetary policy was too loose after 9/11. That the Fed over-reacted to those events, and it was too slow to normalize the level of interest rates. That may be, but I would put that complaint pretty far down on my list in terms of causes of the Great Financial Crisis. I think risk taking in the financial system and lax regulation might have been enabled a little bit by accommodating monetary policy, but fundamentally they were a product of skewed incentives and lax regulation.

Demetri Kofinas: 09:32

You think it was mostly regulatory. In other words, you don't even attribute it to globalization. You don't attribute more of that to globalization and technology than to regulation.

Barry Eichengreen: 09:40

Well, it depends what you mean by "it" in this context. If you're talking-

Demetri Kofinas: 09:45

The go-go, the juicing of the financial markets.

Barry Eichengreen: 09:49

Yeah, I think the increase in depth and leverage and asset valuations in the period leading up to 2007-08 was further enabled by accommodating monetary policy, but fundamentally it was a product of deregulation; increase in competition within the financial system as investment banks began to compete with commercial banks, began to compete with shadow banks, began to compete with others. Globalization plays a role there in that there was cross-border financial competition as well. European banks loaded up on subprime paper issued in the United States, and that had a lot to do with the European financial crisis that followed. That was the fault of European regulators who sometimes, as in the case of the German Landesbanken (the German state banks), were in the pockets of the politicians.

Demetri Kofinas: 10:47 I think it's fair to that point also, if you look at the period after World War II until the 1980s, we didn't have anything like we had later on. But also, the international ... the liberalization of trade and everything else, and also having to compete with these global banks that didn't operate under Glass-Steagall, created a need for regulatory reform. I suppose you could certainly argue that it could've been handled better, but what about this point, which I've brought up before. I don't know that we had brought it up with you, but I brought it up with other monetary economists, which is: Why do we need to have a central bank to set the fed funds rate? To set interest rates for credit? Not as a backstop, not as a lender of last resort, but actually for picking the actual price that credit should be trading at, the price of money? Why is that something that A) a central bank needs to do, and B) can a central bank do that more efficiently than the market?

Barry Eichengreen: 11:42 Well, what the central bank (in our case The Fed) does, is it tries to produce low and stable inflation and conditions conducive to full employment. So, how does it go about pursuing those goals, attempting to achieve those goals? It alters the supply of credit to the banking system, traditionally. That affects then the cost to you and me, and other borrowers of borrowing from those banks. So, setting the fed funds rate, the interest rate at which banks can get credit from The Fed, is simply a lever that it uses to try to encourage the banks to lend a little more, lend a little less; lend a little more if inflation is too low, growth is too slow, and conversely. So, The Fed is setting or regulating one interest rate in the economy; but with the goal of influencing, along with other lenders and borrowers, this whole panoply of different interest rates; with the further goal of trying to deliver an inflation rate and an unemployment rate that makes people, makes the Congress, makes the feds, political masters, happy.

Demetri Kofinas: 13:01 So, there are two questions that I have for you there. One has to do with the Phillips curve, because that's sort of the dominant intellectual framework that supports the idea that lower interest rates cause increasing employment, right? And another one is, we didn't always have the employment mandate, I don't remember when that came in ... But before that The Fed was still intervening in credit markets. So again, I never have been able to understand the reason for why we target interest rates.

Barry Eichengreen: 13:26

Historically, The Fed was created in 1914 because interest rates were extremely volatile in the United States. In the 19th century, we were primarily an agricultural economy and the demand for credit would shoot up in the fall during the harvest season, when farmers needed to pay field workers and crops needed to be moved, and all that. That sharp spike in interest rates in the fall and lesser spike in the spring during the planting season, when farmers had to borrow in order to get seed and all that, caused all kinds of financial dislocations. Problems for banks, problems for people who had to roll over a maturing loan, problems for homeowners with a mortgage-

Demetri Kofinas: 14:12

The seasonal variability in liquidity.

Barry Eichengreen: 14:14

Right. So, The Fed was created to quote, "provide an elastic currency," which meant provide more credit during periods when interest rates shoot up. That was its foundational task, starting in 1914 when it opened its doors. The precise way it goes about that, and the mandate and so forth, changed over time. But, providing monetary stability meant, in the US context, providing an elastic currency and intervening to prevent interest rates from shooting through the roof during certain times of the year.

Demetri Kofinas: 14:50

Do you think that then the open market operations that continued during the off-seasonal period just became a sort of habit of having done it during the periods of seasonal liquidity?

Barry Eichengreen: 14:59

Right. So, The Fed didn't engage in open market operations at the beginning, and it began experimenting with them in the 1920s. Then there was a lot of debate about how extensively they should be used, who should be in charge of those open market operations, the individual reserve banks or the Federal Reserve Board in Washington, D.C.. In 1935, the decision was taken to centralize that authority with the Board, and over time, the ideas about under what circumstances it was appropriate to tighten or loosen credit, mainly now in practice through open market operations, evolved to the point where now The Fed, as I said before, has this dual mandate to pursue full employment as well as price stability since the 1970s.

Barry Eichengreen: 15:54

Other modern central banks have similar mandates. They manage money and credit conditions because the demand for credit can go up and down violently, and a central bank is needed to accommodate those fluctuations and maybe lean against them on occasions when they're excessive.

Demetri Kofinas: 16:16 I want to get your answer on the Phillips curve that you see here, I have a picture of William Jennings Bryan ... We had done a show with Michael Kazin, do you know Michael Kazin, the biographer?-

Barry Eichengreen: 16:22 Yeah.

Demetri Kofinas: 16:22 Years ago, not on this show, and we covered Bryan and his '96 campaign. I saw you wrote a paper about that. You've done a lot of work in economic history, we just sort of started to touch on the tail end of that with the Federal Reserve as a by-product of much of the turmoil and the railing against the money trust of the late 1800s and early 1900s. I definitely wanted to talk to you about that. I want to, though, get your opinion on the Phillips curve and if you think that's even a worthwhile framework? Or is that something that we just have to dump at this point, since it doesn't work?

Barry Eichengreen: 16:54 Right, so the Phillips curve is the idea that there is some kind of stable, predictable, relationship between the level of unemployment and the rate of inflation. So that when you push unemployment down below, say 4%, firms are not going to be able to find workers, they're going to have to pay higher wages in order to attract them, that's going to cause wages to go up, and prices to go up in response. So there ought to be accelerating inflation when unemployment is low. Bill Phillips came up with this idea in the 1950s and it worked reasonably well, with modifications, for a long time. It doesn't seem to work anymore.

Demetri Kofinas: 17:36 Why do you think that is? Is it because the middle-class doesn't have savings? And that this economy that it was modeled on, post-World War II, large middle-class, people saved, had savings ... that the reason why it's broken is because saving have accrued to a small pocket of the population, and therefore lowering interest rates only makes them, for example, speculated financial assets? And financial prices ... the price of financial assets goes up, so we get the inflation in asset prices, but not actually in the consumer price index?

Barry Eichengreen: 18:06 So, I think of the Phillips curve as the relationship between unemployment and inflation, not the relationship between unemployment and interest rates. Although, The Fed will respond, with changes in interest rates, to that inflation if it materializes. But the question about the Phillips curve is: We're at full employment, where is the inflation? It hasn't materialized. There are different theories about why not; one would be globalization, workers are reluctant to ask for higher wages because of competition from abroad. The gig economy is another potential explanation; that rather than offering higher wages to more workers, firms are finding ways to outsource through TaskRabbit or you name it, the tasks they need to have done. My own view is that, no, the Phillips curve is not dead. It's only been sleeping, and that it will awake.

Demetri Kofinas: 19:05 And that we're going to get inflation.

Barry Eichengreen: 19:07 At some point in the not too distant future. If the Fed doesn't anticipate and head off that eventuality, we'll get inflation. So the benign, smooth, soft landing scenario is that The Fed continues to raise interest rates, the unemployment rate stabilizes or maybe turns up very slightly and gradually, and we stay around this level of unemployment for quite a while without much inflation. Historically, what's happen is The Fed has almost always been behind the curve. It sees the inflation materialize. It says, "Whoops, we'd better raise interest rates faster." They crunch the economy and the unemployment rate goes up quickly, rather than gradually. So, they are trying to engineer that illusive soft landing once again. We'll see if they succeed.

Demetri Kofinas: 20:00 The reason I brought up the relationship between interest rates and asset prices is because ... What I was trying to suggest is that if you have the spending power in the economy more broadly allocated, lowering interest rates could result in consumer price inflation, because that's what people would buy. Whereas, let's say, a small cohort of rich people with lower interest rates are going to go speculate on tech companies and private placements and things like that. That was my point.

Demetri Kofinas: 20:25 But, I want to go back to this period in the late 1800s, because you wrote a paper on this in October of last year, with I think two other coauthors, but maybe it was more. You covered the period of the 1896 election, which was William Jennings Bryan and William McKinley, and of course there was a strong wave of populism that Bryan rode during that period. There was also the free silver movement, and that was born out of the tight credit conditions of farmers in rural America. It's a fascinating period. I'm curious why you chose to cover that, and how you found it to be significant or relevant to the contemporary period?

Barry Eichengreen:	21:00	The paper you're asking about came out of a book, so I'm going to plug the book and then I'll come back to the paper. The book is called The Populist Temptation: Economic Grievance and Political Reaction in The Advanced Economy, it came out last month actually, and the book was really prompted by the Trump phenomenon and the Brexit phenomenon. How do I understand why people are unhappy about the economy? Under what circumstances do they react by turning against mainstream politicians and parties? And, under what circumstances is this populist reaction successfully contained or rebuffed by the political mainstream?
Barry Eichengreen:	21:46	So, I wrote about some comparisons between Trump and Bryan in the period leading up to the 1896 election, and after the fact I stopped and said, "Golly, maybe I should actually go back and look more carefully at that 1896 election," and I discovered, to my surprise, there wasn't a single systematic statistical study of the 1896 election; one of the most famous elections, the realigning election in the United States that solidified republican control of the White House and the Congress more or less for three decades. Why did McKinley win? And, Bryan lose?
Barry Eichengreen:	22:27	So, it turned out, in the age of big data, to be relatively straight-forward to download 2,400 county level voting records and line them up with the census of population and production for 1890 and ask, "How important were the populists' economic grievances?" Things like extortion at railroad freight rates, high mortgage interest rates, declining crop prices, for explaining where people supported Bryan and where they didn't. How important was an improving economy in explaining why McKinley, rather than Bryan, won the 1896 election? It turned out that the economy began turning up a couple of years before Bryan finally secured the nomination; and it turns out that the economic grievances were pretty important, that the two decades before the election had been decades of deflation and declining farm prices that made rural interests, in particular, very unhappy about how the economy was performing, how the gold standard was affecting them.
Barry Eichengreen:	23:34	For incidental reasons; gold discoveries in the Klondike and western Australia; prices began to turn up globally, and in the U.S. after 1893. Just by enough to allow McKinley to carry the day. Then there were progressive era reforms of a sort that appealed to working class voters, that allowed republicans to retain control and the Populist Party to become a historical artifact.

Demetri Kofinas:	24:05	It's actually a good time to plug Golden Fetters, also, which is the book that you're best known for. It's a history of the gold standard, and the way it sort of fell apart in the period of the inter-war years and the Depression. A great book. In fact, for anyone that's interested in your most recent book on Populism or Golden Fetters, I suggest they go to the website hiddenforces.io and I'm going to have all that information available in the post for this show.
Demetri Kofinas:	24:30	I want to stick on this point. Now, you've mentioned gold, and we were saying the free silver movement ... another thing that I want to talk to you about, and why I wanted to have you on the show, it has to do with currencies. You've done a lot of work on currencies, particularly on exchange rate mechanisms and the euro. That's not something that we've really had an opportunity to cover on the show.
Demetri Kofinas:	24:50	There's one thing, you've made the point before, I believe, which is it's a false comparison to compare the euro to the gold standard. Maybe you can explain to us why that is? What you mean by that, give us some context? And, what is the current state of the euro?
Barry Eichengreen:	25:05	I often get asked about the Euro for these very reasons; that I have done work in the past on the gold standard, and people see that there are parallels between the two.
Demetri Kofinas:	25:15	The classical gold standard.
Barry Eichengreen:	25:16	Right. Parallels between the two systems; that the United States in the 1890s couldn't devalue the dollar as a way of addressing the farmers' concerns over deflation because the country was on the gold standard, and Italy can't devalue against its European neighbors because it’s part of the euro area. I think the comparison is only partial though, because it was, at the end of the day, possible for our countries to leave the gold standard. Great Britain did devalue sterling, its currency, in 1931. The U.S. did devalue the dollar in 1933 as a way of freeing up monetary policy and countering a slump.
Barry Eichengreen:	26:03	Italy can't do that without precipitating the mother of all financial crisis. Practically, it would take them quite a while to print up the lira bank notes, change over the computer systems of the banks, and so forth, and they would have to close down their economy in the interim. They would have to put up capital controls, close down the banking system, etc. All that would be highly disruptive, and even talking about the possibility would cause a panic. Every Italian who knew how to do so would wire

his money to Frankfurt, where it would be safe in the form of euro deposit. So, it would be the mother of all banking crisis, the mother of all financial crisis. I think we see that, even in the rhetoric of the new government now in Italy, which campaigned against the euro; but once it became clear that they were going to form a government, they have moderated their rhetoric in order not to excite the markets over this possibility.

Barry Eichengreen: 27:06

What are the prospects for the euro? The problem Europe has that it has a monetary union without a full banking union, without a fiscal or budgetary union, without a political union. That makes life hard. What goes on in the Italian banking system affects the German banks. But, until recently, they've had separate national supervisors, rather than a single supervisor. So, a common monetary policy, but separate banking systems, can be a source of instability. They don't have a federal fiscal system to transfer budgetary resources from booming to repressed regions, like we have in the United States, and it is unrealistic to think that they're going to get these things any time soon because they don't have a political union. They don't have a European parliament with real powers that can decide on the creation of a meaningful fiscal union, that can complete the banking union that's under construction.

Barry Eichengreen: 28:12

So, some people conclude from this that the euro is doomed. My conclusion is different. I think the euro is here to stay because history does not run in reverse. It may have been a mistake to construct a monetary union without banking union, fiscal union and political union, but what's done is done, and dismantling what's been constructed would be incredibly costly and disruptive. So, I think they will stumble ahead, as best they can, to complete the process.

Demetri Kofinas: 28:43

Well, that was part of the design, right? They understood that they'd be able to unify the continent's banking system and create the Eurozone, and create a monetary union, but creating a fiscal union would be much more difficult because it would require more coordination of fiscal spending and euro-bonds, which were not as popular. So, that doesn't really come as a surprise as far as the policy makers ... The idea was always that there would be a crisis, and then in the next crisis there would be incremental crisis, and with each one they would create ever closer union.

Demetri Kofinas: 29:10

One of the things you were touching on implicitly before is the distinction between a currency peg and ERM, or what we have ... maybe not so much the ER ... specifically the euro. Something where you jettison your existing currency, so you're no longer pegged. So, it's not like Argentina, because another classic example that was often given during the euro crisis was the Argentine peso crisis. Multiple crisis in Argentina, but the famous one in 2001/2002 with the peso, which was pegged to the dollar. Or, in Mexico, for example, where you've got your own currency, it's pegged to another currency, but all your contracts are still denominated in the domestic currency.

Demetri Kofinas: 29:45 So, if you unpeg, you certainly have a disaster in terms of inflation and everything else, but you don't have this additional problem, which you would have in the case of Europe.

Barry Eichengreen: 29:54 Yeah, I think that's exactly right. The euro is harder to get out of than the Argentine currency peg was, or gold standard pegs for-

Demetri Kofinas: 30:03 You're locked in a burning theater in Europe.

Barry Eichengreen: 30:05 And you have to figure out how to open the windows, right. It's harder to get out of contractually, it's harder to get out of politically as well, because it's one of an interlocking set of political bargains that a country like Italy has made with its EU partners. Look at what the U.K. is going through in terms of Brexit, and then add a monetary component to that, and it gets even more complicated. The U.K. has one slight advantage in terms of getting out of the European Union, which is that it still has sterling.

Demetri Kofinas: 30:38 Right, and it's still difficult because of all those sort of free trade arrangements and contractual obligations that are denominated in currency. Well, no, it's the U.K., but there's a lot of issues with respect to being in the EU, a lot of their contracts were done in euros? I don't ...

Barry Eichengreen: 30:53 Well, they do a lot of banking business in London in euro denominated business-

Demetri Kofinas: 30:59 Right. Foreign companies.

Barry Eichengreen: 30:59 London is the biggest euro based financial center in Europe. But, I think getting out of the euro is even harder than Brexit, because of this point that your contracts are all denominated in what's about to be someone else's money. Your banking system is intertwined with theirs, and how you disconnect that I think would be and almost impossible challenge for a country like Italy.

Demetri Kofinas:	31:26	But there's also a remaining challenge, right, which is highlighted in the relationship between Germany and Greece, is this sort of poster relationship of polar opposites in terms of ... if you prescribe to the idea that you need to have loose fiscal policy during recessions and you want to have tighter fiscal policy when you have booms. You've got Germany, which accumulates massive foreign reserves effectively, even though they're all using euros, because they're running trade surpluses. Then you have the Greeks, who are running deficits. And because of European monetary policy and agricultural subsidies, etc., you had one country that was losing productive capacity as the other was building it.
Demetri Kofinas:	32:01	How does that work? How are we going to move forward in Europe when we have some of these peripheral countries that operate so differently than the core?
Barry Eichengreen:	32:09	It works with great difficulty-
Demetri Kofinas:	32:12	And that’s the populism point, too, right? That brings up the point about politics, which is where a lot of this ends up seeping out.
Barry Eichengreen:	32:17	Yeah, so I think one response would be that these differences in economic structures and performances are not writ in stone, that countries have done important economic reform. We used to think of Ireland as a basket case, and now it's the most successfully performing European economy. Again, as it was before 2007, we used to think about Spain as one of the Club Med crisis countries of Europe, and the Spanish economy is now remarkably successful; growing in healthy fashion, becoming an export powerhouse. So, I wouldn't dismiss the possibility that the Greeks can eventually get their act together, although they have a lot to do.
Barry Eichengreen:	33:02	The other thing I would say is that it's really important in Europe to figure out what functions have to be centralized and overseen by the European Commission in Brussels, and which ones should be given back to national governments and to the people who vote for those national governments. So, I think one of the big mistakes in Europe is to try to centralize control of fiscal policy by giving the European Commission oversight of national budgets. I think national budgets ought to be given back to national governments, and then the populists reaction against those rigid unthinking elites in Brussels will be less.
Barry Eichengreen:	33:44	I think it would be safe to give fiscal policy back to national governments if you break what's called the "doom loop"

connecting government bond markets and banking systems. The problem in Greece was that the Greek banks held much of this Greek debt, so the possibility that Greece would default raised the specter of a banking crisis in Greece, therefore there had to be intervention by the European Commission and the European Central Bank and the International Monetary Fund. I think if the banks are prevented from holding large numbers of government bonds, their own government's bonds or foreign government bonds, then you will have broken that doom loop between the banks and the bond markets, and you can let governments manage or mismanage their national fiscal policies as they see fit.

Demetri Kofinas: 34:36 Are you saying that the ownership of sovereign bonds by the domestic banking system was the primary cause for the convergence of yields across Europe during the boom years of the euro?

Barry Eichengreen: 34:49 Well, I think it was one factor that banks were allowed to attach zero risk weights, not to hold additional capital when they held additional government bonds, that gave them an incentive to load up on government bonds; especially, initially, high yielding ones. So, I think one important reform would be to make banks give banks non-zero capital charges when they hold government bonds, subject them to what are called "concentration rules" where they cannot hold large concentrations of government bonds, so that they are better insulated from fiscal policy problems when those problems occur.

Demetri Kofinas: 35:32 What about the Stability and Growth Pact? If, going forward in Europe, individual countries have the discretion to run budget deficits when they want, however they want, and to accumulate whatever sort of size of public debts they want, how do they remain within the Stability and Growth Pact and the parameters that the European authorities originally conceived of as being necessary for a fiscal union?

Barry Eichengreen: 35:55 I would do away with the Stability and Growth Pact, if the banks were really successfully insulated from government budget problems. Governments, politicians in their wisdom at the national level, should be given control of and responsibility for their own national fiscal policies, and if they mismanage those policies they would be forced to restructure their debts; face higher borrowing costs in the future, presumably, but they would be able to restructure because there would no longer be the danger that doing so would collapse their own banking systems or the European banking system.

Demetri Kofinas:	36:34	Irrespective of whether the Euro Project succeeds or not, or stays together, do you foresee a period in the near future where the euro could regain strength?
Barry Eichengreen:	36:45	I think a lot will depend not only on the Europeans getting their act together ... And there is an effort to push forward with euro area reform. There was a big summit last month bringing together Emmanuel Macron and Angela Merkel, and they came up with a declaration that had some useful ideas in it. But, a lot will also depend on rivals for the euro; what will happen with the dollar, and will there be any enduring damage to the dollar as a result of tensions between the United States and other countries?
Barry Eichengreen:	37:20	Let me mention another paper I wrote called Mars vs. Mercury late last year, which was about the question of whether geopolitical alliances are important for international currency status. What we showed, mainly using data from the gold standard period, although now we have done the same analysis for the modern period, is that governments and central banks are more inclined to hold the currencies issued by their geopolitical partners as reserves. So, countries that rely on the United States for their defense, for their nuclear umbrella (Japan, South Korea) hold a larger share of their reserves in dollars than you would expect; and a larger share than countries like France, for example, or Britain, that have their own nuclear capability and don't need us in the U.S. for their security.
Barry Eichengreen:	38:15	So, there is an issue about whether conflicts between the United States, between this administration on the one hand and its NATO partners on the other, could negatively impact the dollar in the medium term, and rebound to the benefit of the euro, therefore. And similarly, whether trade conflicts between the United States and other countries could have negative implications for the dollar. The latter we have not seen yet, the dollar is still a safe haven when-
Demetri Kofinas:	38:49	Clean his dirty shirt-
Barry Eichengreen:	38:50	Yeah. So, when trade wars get the headlines, the dollar tends to benefit, because people are uncertain about what this means for the global trading system; for the international economy, more broadly; and they scramble into the most liquid asset out there, which is the dollar, the least dirty shirt.
Demetri Kofinas:	39:09	Well, it's a great paper. I read that as well, or some of it.

Demetri Kofinas:	39:12	The point about geopolitical alliances, you hold the currencies of countries that you have alignment with and that there are other benefits to being financially aligned. Saudi Arabia's a classic example, the petrol dollar regime is based on that principle; that the U.S., and in fact the U.S. in the first Gulf War in Iraq, was supporting the dollar in its actions, partially. And of course, that's the origin of the European Coal and Steel Community, right? It was a Franco-German alliance. That's why I think analysis of the Eurozone as a purely economic system makes no sense, because it's a political union first and foremost, above everything else.
Demetri Kofinas:	39:46	But, you brought up China, and the U.S. and trade. That's a fascinating topic I'd love to speak to you a bit about, and that is A) what are the substantive material impacts of the protectionist measures taken so far by the Trump administration, and I'd also like, though it sort of deals with this but it's also a subject on its own, the renminbi, and ... Is the renminbi and its potential to either displace the dollar at some point in the medium-term, near future, whatever ... I don't want to use medium-term, that's an official economic term, but at some non-indiscriminate point in the future ... Is talk about that over-hyped, over-blown? You see, my subtitle here is "The Renminbi-bi Gun." Is it a pea-shooter, you know what I mean? Or is it a real weapon?
Demetri Kofinas:	40:36	And yeah, that's a jumble there. I do that sometimes to guests, I hope that wasn't an explosion of questions, but maybe we can tackle those two.
Barry Eichengreen:	40:42	Well, why don't we start with the renminbi and we can circle back to the tariffs and all that. The Chinese are serious about encouraging other countries, especially their geographical neighbors, to use their currency for cross border transactions; for trade invoicing and settlement as a vehicle for foreign investment, as a form in which to hold central bank reserves; and they're making slow progress in that direction, where the operative word is "slow". The renminbi accounts for less than 2% of global foreign exchange reserves, so far as we can tell, and the dollar accounts for 60%. So, the idea that the renminbi is going to catch the dollar tomorrow is unrealistic.
Barry Eichengreen:	41:30	But, China will be the largest economy in the world within the next decade. It already is the largest trading country, and it is slowly developing its financial markets. Those markets are not very liquid, they're not very open to the rest of the world, things that will have to change for the renminbi to become a true first class international currency and a rival to the dollar.

Barry Eichengreen:	41:56	There's one further point, I like to make this one whenever I go to China and I never get a response: Every true international currency in history has been the currency of a political republic or democracy. So yeah, it is the People's Republic of China, but the dollar, the pound sterling before that, the Dutch guilder before that, the currencies of the republican city states of Venice and Genoa and Florence, were all the currencies of polities where there were political checks and balances; where investors had a voice and could make their interests known, and there were limits on the arbitrary actions of the executive. That's not the case in China, where power is becoming more concentrated in the hands of President Xi and the Politburo rather than less. That will have to change before people are comfortable about parking a significant fraction of their savings, their portfolios, in Shanghai.
Barry Eichengreen:	43:03	And they're going to have to make their central bank independent of politics, as a first step. They're going to have to move toward more transparent financial regulation, and then they're going to have to have multiple stakeholders with a voice. So, I do think the renminbi will someday be a true international currency, I'm just not sure I'm going to live long enough to see it. So-
Demetri Kofinas:	43:27	So, pea-shooter, on the verdict.
Barry Eichengreen:	43:29	Yeah, I like ... If I have to choose between pea-shooter and bazooka, I would go for pea-shooter for the moment. But, you know, the first role of forecasting is: give them a forecast or give them a date, but never give them both. So, I think the renminbi will be a true international currency, someday.
Demetri Kofinas:	43:45	For listeners who haven't heard our episode with Elizabeth Economy on Xi Jinping and the Chinese state, or with Anne Stevenson-Yang on the Chinese banking system, I recommend both of those. From the amount of time that I've spent looking at this, the banking system of China ... And I say this even though it's going to be an inflammatory statement, I say with the humility of not speaking Chinese and not having gone to China ...
Demetri Kofinas:	44:09	So, I've had people tell me that, because of my lack of understanding of the Chinese system, I can't appreciate the way that they allocate capital. I'm willing to accept that criticism and accept the possibility that I could be wrong, but from my western eyes, their balance sheet, their entire economy, looks like a horror show. The way that they've allocated capital, the

extent to which you've seen this boom in construction in China and in real-estate, these ghost cities, this is stuff that ...

Demetri Kofinas:	44:36	The way I think about China, I think about what would happen in the late 1800s with the railway boom if you had a central planning state that just said, "Let's just pile into railroads. Let's just pile into these industries that are already booming, and let's construct a massive amount of infrastructure." And then we have railways going from Nantucket to Idaho, or Colorado Springs or whatever, and no one goes on that railroad. That's what it feels like in China.
Barry Eichengreen:	45:02	I think there has been a lot of capital misallocation in the construction sector, in infrastructure more broadly, too much investment in heavy industry for too long. They're aware of these problems, and as long as you continue to grow at 6.5-7% and begin to gradually-
Demetri Kofinas:	45:20	Unless-you're growing in the wrong direction.
Barry Eichengreen:	45:21	Yeah ... Begin to gradually clamp down, I think there is still a scenario where they can grow out of the problems that you're flagging. They have way too much corporate debt. Corporate debt to GDP ratio of about 160%, one of the highest in the world, but if the corporate sector continues to grow at 7% a year, they can grow out from under that.
Demetri Kofinas:	45:40	Well it's also, you know, when we think about corporate sector it's very different, I suppose, in the west, because the state is so involved in what the corporations invest in and the debt that's being provided to them by the banking system.
Barry Eichengreen:	45:51	And if the state has to write off some of this debt, if it has to socialize further some of the loss-making enterprises, they have the fiscal space to do that.
Demetri Kofinas:	46:02	Let's get back to the trade war and to protectionism, because you've done some work on that, I've seen some recent article's you've written.
Demetri Kofinas:	46:08	Where is it that you write again? What's that outlet?
Barry Eichengreen:	46:11	Probably Project Syndicate.
Demetri Kofinas:	46:11	Project Syndicate is where a lot of your articles come out, but I've seen some other ones on The Guardian or elsewhere. You've certainly written opinions on other publications. What

can you tell us about the state of protectionism today? What are the material impacts of what the Trump administration has done so far? And you made one point in one of your recent papers that I think has merit which is, and it seems that this is what you were getting at, that even if the material impact so far of trade protectionism is not significant, the uncertainty generated by that is significant.

Demetri Kofinas:	46:42	So, how do we measure this, and how do we understand where we are today with this administration and with the politics of populism going forward?
Barry Eichengreen:	46:50	Well, what's happened so far on the trade policy front, honestly, is still relatively limited. Washing machines are $700 more expensive as a result of the tariffs-
Demetri Kofinas:	47:02	Is that right? I'm glad I bought mine already.
Barry Eichengreen:	47:04	Right? Home construction per unit, single family home, has gone up by like $9,000 as a result of the timber tariffs.
Demetri Kofinas:	47:12	Oh really? Is that where we get most of our timber?
Barry Eichengreen:	47:13	We get a lot of timber from Canada, absolutely.
Demetri Kofinas:	47:15	From Canada, right. So, it's not just the Ch ... I mean, I mentioned China, but there's Canada, also.
Barry Eichengreen:	47:19	There's Canada, there are a whole host of countries.
Demetri Kofinas:	47:22	The Europeans, too.
Barry Eichengreen:	47:23	But, in the aggregate, we're still talking about a hundred billion dollars’ worth of imports in a 20 trillion-dollar economy. So, it's a small aggregate. The danger is that it could spiral out of control, and that if you begin to tax imports of everything and your trading partners do likewise, you've disrupted global supply chains. One of the ironies of the Trump tariffs is that mainly, the majority of them, are on intermediate goods; parts and components that go into stuff that we manufacture in the United States. That's why the automakers are up in arms over tariffs that are intended, the rhetoric says, to enhance their competitive position by making it more expensive to purchase imports from Korea and Japan and Europe. What they're finding is that the parts and components they use are also more expensive, and that's making their life more difficult.

Barry Eichengreen:	48:27	The paradox is that the stock market hasn't responded negatively to all this noise over tariffs, and the distinct possibility that there could be many more of them, and that the economy hasn't reacted negatively either. My guess is that they will, both the stock market and the economy, but we have to give it more time. That Brexit was a big unanticipated shock to the U.K. economy, but it took a year and a half before the negative impact began to show up in the numbers and now it has. So, it could take that long before the negative impact on employment and growth in the U.S. shows up.
Barry Eichengreen:	49:09	But, I think a lot of companies are holding fire. They don't know whether to invest or not, they don't know in what exactly to invest, they don't know where to invest. Should Harley be expanding its productive capacity here, or abroad? Decisions like that depend on how far this tariff war is going to go, the extent to which other countries retaliate; and until we know more about that, investors are going to wait. That waiting behavior will show up in the strength of the economy given time.
Demetri Kofinas:	49:44	Do you think that markets haven't reacted partly because of the fact that they haven't been able to identify the risk-free rate for so long? That they've been desensitized by monetary policy, by these very aggressive binge buying of assets and the inflation we've seen in asset prices since the crisis?
Barry Eichengreen:	50:03	I think there's an element of that. I would emphasize not the level of interest rates, so much as the share buy-backs enabled by the December 2017 tax act, which has caused companies to repay create funds and use them for buy-backs and prospective mergers. I also think the market has been held up by an economy that has been performing darn well up to now; but past performance is no guarantee of future returns, and I think there is a distinct scenario where this trade war thing comes back to bite us in a serious way.
Demetri Kofinas:	50:42	Well, Minsky, stability leads to instability. You could draw the opposite correlation or comparison or relationship.
Demetri Kofinas:	50:49	But, going back to this point about the trade tariffs ... It made me think a bit about what we said at the top of the show, which was William Jennings Bryan, end of the 1800s, populism and populism today. I think your point in that paper, correct me if I'm wrong, but your point was that the improving economic conditions were a contributor, if not a cause, for William McKinley's election in 1896.

Demetri Kofinas:	51:14	But today, the economy was doing better when Trump was elected, right? So, what's that relationship?
Barry Eichengreen:	51:20	So, that is a reminder that the populist movements today are about more than simply economic growth. They're also about distribution, that the gains of the last 20-30 years have gone disproportionately to the 1%, and it wasn't the 1% who voted for Trump; or in the U.K. case, voted for Brexit. The dissatisfaction with the political mainstream and support for populist alternatives has a lot to do with insecurity, so even if people are doing okay now, they're worried about the future, and they're worried about whether their kids are going to have a standard of living 20 years from now comparable to their own.
Barry Eichengreen:	52:01	So, I think the insecurity associated with a rapidly changing economy; reflecting the effects of robots, of China, of all the things displacing workers in the U.S.; that insecurity was a factor in the Trump phenomenon. And similar insecurity was a phenomenon in the Brexit phenomenon. I would acknowledge that populism has identity politics aspect to it, as well as simple economic aspect. I'm an economist, so I start with the economics, but the fact that the political system was not responding adequately to these economic changes; that we weren't giving people the education and training they needed in the United States to compete in a globalized 21st century economy, that in the U.K. people felt that the national health service was not being adequately supported, that we weren't dealing adequately with distributional concerns; that enables politicians, provides a platform to politicians who are inclined to say, "It's their fault. The other is at fault here", where the other might be foreigners, immigrants, racial minorities, whatever.
Barry Eichengreen:	53:16	So, I think the identity politics and the economic insecurity feed on one another, and we saw that in 2016 in the United States, they saw it in the case of Brexit in the U.K.
Demetri Kofinas:	53:29	There's definitely a lot of that, no question. I think, though, this notion of identity is very interesting and very true, but runs deeper. I think what we see is; not just around traditional identity groups (racial differences, religious differences); but I think there's a strong sense of insecurity, and I think much of that has to do with the rapid technological changes. And I don't even mean them economically speaking.
Demetri Kofinas:	53:54	I mean, are you familiar with the flat Earth movement?
Barry Eichengreen:	53:57	Sure.

Demetri Kofinas:	53:58	I mean, it's fascinating. For you and I, who understand basic sort of Copernican astronomy, it's not difficult to accept the model that the Earth is spherical and that we have elliptical orbits, and this is why we have seasons, and this is why we see horizons. It's fascinating to me that you can have these types of siloed subgroups pop up, and I think it's a fascinating phenomenon, and I think that is actually a deeper driver of this sort of notion of identity.
Demetri Kofinas:	54:26	Doctor Eichengreen, I know we have a limited amount of time so I want to ask you one more question before you go, because one of the things that we have covered much on this program have been cryptocurrencies and blockchain technology and distributed letter technologies, and there is this holy grail in cryptocurrencies which is the stable coin. I don't know if you're familiar with stable coins at all? Okay, great. And seigniorage shares –
Demetri Kofinas:	54:49	I'm curious, what are your thoughts on stable coins? You're an expert in the history of currency pegs, which is very important. What do you think about this?
Barry Eichengreen:	54:57	I'm a skeptic on stable coins. So there are different kinds of stable coins, right? There are fully collateralized stable coins, like tether claims to be; where for every dollars' worth of tether out there, there's a dollar deposited in a Taiwanese bank. That's expensive to scale up, right? If somebody is going to have to deposit a bunch of dollars in order to issue a bunch of tether, it's not exactly clear that that's going to be an attractive alternative just to putting dollars in your existing commercial bank account. Then there are partially collateralized stable coins, where for every dollar issued you might have fifty cents of bank deposits, but what if people start to sell your crypto-unit and the fifty cents goes away?
Demetri Kofinas:	55:47	The credibility of defending the peg.
Barry Eichengreen:	55:48	Right. Then there are uncollateralized stable coins, basis is the one I'm familiar with, where they issue basis coins and basis bonds, and they have an algorithm that buys and sells the bonds to keep the coin stable against the dollar. There are states of the world where nobody's going to want your bonds, because it's not clear you're going to be able to pay interest on them or redeem them in the future. If nobody wants the coin, where's the income going to come from? So, I think that these stable coins are vulnerable to speculative attacks for all the same reasons that currency pegs partially backed by foreign reserves can be collapsed by speculators.

Demetri Kofinas:	56:34	Most definitely. It's an interesting ... basis is an interesting model. One obvious challenge is, how do you get a system like that out of orbit? To the point that you've accumulated enough value in the shares component where you can defend the currency peg.
Barry Eichengreen:	56:49	Right, but then you still have to continue to be able to issue shares or bonds in the future in order to service and repay the bonds that you've issued in the past, so the platform has to continue to grow over time.
Demetri Kofinas:	57:03	Right, exactly. More value needs to accrue into the shares component.
Barry Eichengreen:	57:06	And if there's a shock to the system where it doesn't grow, what happens then?
Demetri Kofinas:	57:11	It sounds a lot like the U.S. bond market. Sounds like the dollar, the Federal Reserve note.
Demetri Kofinas:	57:17	Dr. Eichengreen, it was such a pleasure to have you on, especially considering that you and I have never met in person, and the only time I've ever seen you on my show was from a studio on the Berkeley campus, as we said, all the way back in December of 2012. Thank you so much for coming on the program.
Barry Eichengreen:	57:33	Good to be here. Thank you for having me here in Times Square.
Demetri Kofinas:	57:36	And that was my episode with Barry Eichengreen. I want to thank Professor Eichengreen for being on my program. For more information about today's episode, or if you want easy access to related programming, visit our website at hiddenforces.io and subscribe to our free email list. If you're a regular listener to the show, take a moment to review us on Apple Podcasts. Each review helps more people find the show and join our amazing community. Today's episode was produced by me and edited by Stylianos Nicolaou. For more episodes, you can check out our website at hiddenforces.io. Join the conversation at Facebook, Twitter and Instagram at @hiddenforcespod or send me an email. As always, thanks for listening. We'll see you next week.