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The Newsletter of the Cliometric Society

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An Interview with Michael Bordo

Michael D. Bordo is Professor of Economics and Director of the Center for Monetary and Financial History at Rutgers University, New Brunswick, New Jersey. He has held previous academic positions at the University of South Carolina and Carleton University in Ottawa, Canada. He has been a visiting Professor at the University of California Los Angeles, Carnegie Mellon University, Princeton University, Harvard University, Cambridge University where he was Pitt Professor of American History and Institutions, and a Visiting Scholar at the IMF, Federal Reserve Banks of St. Louis and Cleveland, the Federal Reserve Board of Governors the Bank of Canada, the Bank of England and the Bank for International Settlement. He also is a Research Associate of the National Bureau of Economic Research, Cambridge, Massachusetts. He has a B.A. degree from McGill University, a M.Sc.(Econ) from the London School of Economics and he received his Ph.D. at the University of Chicago in 1972. He has published many articles in leading journals and ten books in monetary economics and monetary history. He is editor of a series of books for Cambridge University Press: Studies in Macroeconomic History.

This interview of Michael D. Bordo was conducted by Christopher M. Meissner on May 20, 2014 at the Federal Reserve Bank of Atlanta.

So, Michael, when did you become a "cliometrician"?

When I first got interested in economic history—before the word "clio" ever came up—was when I took an introductory course in economics in my first year at McGill University taught by, F. Cyril James, a famous British economic historian. He wrote the definitive book on the Chicago banking panic of 1932. He gave a terrific course on global economic history, and I remember the finale of this course was 1931 and the *Creditanstalt* crisis. I thought: This is great stuff! So it was always at the back of my mind, and I think that course first sparked my interest.

When I went to the LSE, I didn't do economic history. I did economic theory.

When I got to Chicago, I took Bob Fogel's course because we had to take it. I really liked it, and I liked Bob Fogel a lot. So I took all his courses. Then I also took a course from Arcadius Kahan. So I was hooked! I was also taking courses from Milton Friedman. He was my principal advisor when I got to Chicago–they assigned someone to be your advisor—so it was Friedman. I got on just fine with him, and I got interested in monetary history. So it goes back to that time. Cliometrics is what Fogel taught—the "new economic history." I have always been a fan of that approach.

When you were at Chicago you became a student of Milton Friedman. Later you collaborated with Anna Schwartz, the authors of the Monetary History of the United States*. This is a book that has stood the test of time. What is the most significant intellectual contribution that these two giants of the field have had on you?*

They have had a very strong influence on me. The *Monetary History of the United States* was a book that just captivated me. We had to study it to take the money prelim in Chicago, so I went through that book with a fine-toothed comb. But then, the emphasis on it was as part of the modern quantity theory of money and the monetarist approach to macro.

The *Monetary History* wanted to present evidence to show the independent influence of money on prices and real output. It was an identification strategy even though at that time they didn't use the terminology. That came along later with the Romers. It was a good way of making a strong case for the role of money. It was a supplement to all of the empirical work they (Friedman and Schwartz) were doing. It was also a supplement to the econometric analysis and the business cycle analysis that Friedman was doing with Anna and a lot of others. The *Monetary History* was trying to show how, when you have these different episodes in history, where money is, in a sense, coming from different sources and different institutional arrangements, the effects on the economy are similar. Using history as identification is a very good way of testing the theory. That was the lesson I took from a *Monetary History:* Ultimately, when you want to provide evidence for the importance of something in monetary history, you have to look at economic history. That's the testing ground. That's the laboratory that economics has. It's very hard to setup a lab experiment. Back then we didn't think about experimental economics. Economic history was the experiment!

At the same time, some of your work I would define as "presentist." In some cases, taking things that interest people today and events that have occurred today, even using theoretical models from today, to understand the past. Some people might view that as anachronistic, but Cliometrics specializes in it. Is there any harm in approaching economic history this way?

I think it's very useful. Again let's get back to the Friedman and Schwartz identification issue. History gives you the laboratory, and it gives you the examples where you can look back and understand why monetary policy makers did what they did. What were the influences on the policy makers? What was the effect on the economy? What other things were going on? You can identify those things. And when you are looking at current issues, trying to evaluate what should the Fed do right now, it is also useful. Should they be exiting faster from current monetary policy, or should their policy be to delay tightening? There are many arguments on both sides looking at the current data. But history gives you a very good pair of glasses to look at these issues. You can look at earlier periods where there were serious recessions with financial crises and ask: what was done? You can ask: did they do the right thing? So that's been my approach from the very beginning.

It also brings in a wider audience than just historians. Because if you start off really interested in current policy problems, and you know that there are examples from history, that you the economic historian knows, you can bring those to the table and show how relevant they are. Then monetary economists, macro-economists, politicians, policy people, and Fed people suddenly become interested in economic history. Whereas if you just talked about a debate from the past, which a lot of the historians do, and just focus on "old" issues, no one is interested except economic historians. So what I have done, and Barry Eichengreen has taken the same approach, is to use history to provide evidence for current issues. I think it's a very good way to go.

What shape is the Monetary History *in after 50 years?*

I think it's doing just fine. It emerged as the dominant view after the Temin debates in the 1970s and 1980s, and I think it still is. The fact is that Bernanke developed his credit view as a spinoff of Friedman and Schwartz. He never doubted that it was monetary causes, and that was what he was talking about. He focused on the transmission mechanism coming through the bank lending channel and the failure of financial intermediation. In his view, the way in which the banking panics impacted on the economy was what was important, and that's a variation on the basic story that it was monetary, primarily monetary, and not due to other sources like demand or technology shocks or other things. I haven't changed my views at all. I have sympathy to the lending approach, but I haven't changed my views at all. The view that it was other sources of aggregate demand or technology shocks has not convinced me.

I remember being at the New York Fed in 2008 and 2009 and hearing people say the recent crisis is some evidence against the Freidman and Schwartz view and that the Fed can only do so much. And here we are stuck at the zero lower bound. Although I know that's not something Anna Schwartz liked to blame for the Great Depression, have we learned anything about being at the zero lower bound?

Yes. I think, for example, the policies of quantitative easing that the Fed has followed—imperfectly, but they have nonetheless followed—is something that came out of the 1930s. You know that what really matters is that you need massive monetary expansion. When Freidman and Schwartz talked about the Great Depression, they always had this counterfactual in mind. They said, if the Fed had conducted open market operations of a billion dollars at certain key points in 1930, 1931, and 1932, in each of those cases, what would have happened? And they argued, quite convincingly, using what nowadays would be called primitive tools, that the downturn in money growth and the decline in the economy would have been reversed. Well, there has been a lot of econometric work, that I have been involved in, and Bennet McCallum and others, Christy Romer too, which shows that this would have indeed attenuated the Great Depression.

We never talked about the zero lower bound, because the economy wasn't there until after the contraction. Some rates were low in 1932, but never that low until 1934. So the lesson that came out of that research was massive monetary expansion could have attenuated the Great Depression. When we hit the zero lower bound in the late fall of 2008, that's exactly what the Fed did with quantitative easing. And what they did, and which I think was a problem, is that they didn't go all out. They were paying interest on excess reserves and the spread was positive between the rate paid on excess reserves and the zero lower bound. The banks didn't have an incentive to lend. They were bottling up all of the expansion in the reserves held at the central bank by the banking system -- as deposits in the central bank. Those funds could have been lent out. I think they could have gone a lot further than they did. I think the quantitative easing idea, which the Japanese also followed a decade ago, if done properly, and enough, should work. That's the lesson I took from the Great Depression.

So more broadly, when we look at the history of US business cycles. What do you think? Is there a role for real forces: harvest failures, TFP shocks, uncertainty, fiscal policy and so forth?

Oh yes, definitely. Lots of forces like wars, extreme political events, harvest failures, they all definitely are triggers for business cycles downturns, just as foreign shocks are triggers for business cycle downturns. But, what I think is a lesson that came from Friedman and Schwartz's work, not just the *Monetary History*, but other work, was that minor cycles were often caused by real factors, and movements in money were an endogenous response. But also, some of the major recessions involved contractionary monetary policy and they also involved financial crises—banking panics—which often had a monetary effect. And so, I think that the lesson of history is that there might be a lot of other things going on and that mild cycles can have monetary and non-monetary causes. But major cycles and major recessions often have dominant monetary element to them.

Shifting gears to other times and places, we have seen big differences in monetary rules and approaches to monetary policy. Based on your reading of history, does one size fit all in terms of monetary and exchange rate regime policy?

I think the most important thing, based on looking at this issue for a long time, is the importance of rule-like behavior. The rules have changed. So the gold standard was a very good rule for the 19th century. This was a world where the role of government was less than it is today, where people didn't place as much importance to unemployment and to using monetary policy as a stabilizing instrument. So in that world, I think the gold standard worked well. It gave us price stability. It gave the world a backdrop to globalization. It wasn't the cause of globalization, but definitely it was an important positive determinant or contributing factor to globalization. So the gold standard was great before World War I.

It took us a long time to get off the gold standard. But the gold standard had its problems which became more manifest in the 20th century. But even in the 19th century, people like Irving Fisher and Alfred Marshall, and others were talking about the "vagaries" of the gold standard. There were shocks, like technology shocks and political shocks, that would affect the membership of the gold standard. There was the fact that the price level, even though it was mean-reverting and you tended to get long run price stability, the price level had cycles in shorter periods. These reflected gold discoveries and the price-specie flow mechanism or other factors. That is, prices weren't really stable except secularly. In response to these issues, Marshall, Wicksell, and Fisher came up with plans to make the gold standard more stable. Moreover, fiat money, if managed properly, will give you the same results as the gold standard did. In fact, you would do better without the vagaries of the gold standard. And that's what we have moved towards in the 20th century. But it took a lot of learning to get there. We now follow a rule which is "credibility for low inflation." It's reached its apogee in inflation targeting, but what mattered most was getting the number one emphasis for the monetary authority to be price stability. Inflation targeting was icing on the cake, but which is very good. The Taylor Rule, which is a rule, in the sense of a rule of thumb, has been a pretty successful way of achieving credibility for low inflation and also dealing with the business cycle.

One of the questions we ask when we teach about the Great Depression is "Can it happen again?" So have recent events in the US, in Europe, or emerging markets significantly changed your beliefs about whether another Great Depression can happen again?

Not really. I think we did learn a lot from the Great Depression, and the structure of the economy changed. We developed automatic stabilizers. The role of government became larger. So, I think the Great Depression which happened in the 1930s isn't going to happen again. But a major financial crisis? Sure! Financial crises occur all the time unless you completely seal up the financial system, as they did in the period from the 30s until the 70s. Once you open up the world to financial innovation as, occurred in the 1970s, financial crises are going to come. So the question is, how do you deal with them? You deal with them with the tools that monetary and fiscal authorities have learned to mitigate their effects. They didn't have those tools in the Depression. We didn't get the Great Contraction five years ago! Real GDP in the US fell by a little over five percent. The recession was a little bit bigger, or the same size, as the Volcker shock in the early 1980s. Unemployment was even higher then, than now. So I don't think we replicated the Great Depression, and I don't think that had the Fed not gotten it nearly, completely right that we would have had a re-run of 1931. There were other forces at work that helped attenuate and prevent another Great Contraction. It would have been worse if the Fed had not done basically the right thing with respect to the financial panic in 2008. If the Fed hadn't worked out the swaps with other countries to prevent it (the crisis) from spilling over, then we would have had a worse recession. So maybe it would have been a 10 percent fall in GDP but not 25 percent.

But when I look at events in Argentina in 2001-02 and I look at Greece, the Baltics, and other Southern European countries, I think, "it" could happen again.

Look, there is a difference between advanced countries and emerging countries. Emerging countries have not developed the institutions to create overall economic stability. They are where we were in many respects in the 19th century—the US was an emerging country at that point—and they haven't developed. So nothing that happens there surprises me. A number of emerging countries don't have democracy. They don't have rule of law. They don't have good governance both at the state level or the corporate level. The number of problems in the institutional background in those countries is daunting. The UK, US, Canada, and other advanced countries, they have gone through a lot of institutional development going back to the Glorious Revolution of the 17th century. These other countries have not yet figured these things out.

So at times like this, say the Eurozone crisis, and other events like that one, do they tell us something about how important political forces and institutional forces are in shaping current economic policy and outcomes?

Definitely. I think those forces are really important. I think that economics and politics have always been closely interacting with each other. I have been quite convinced by those who argue for the role of institutions and institutional development. If you ignore institutions, you are not really going to explain much in terms of cross-country variations in economic outcomes.

Does monetary and financial history have anything to add to how we understand the process of long-run development? Does development come from financial development?

There are two things here. I do think there is a lot of evidence that economic growth is tied up with finance. The story that Dick Sylla has long told about successful financial revolutions in the UK, the Netherlands, Japan, and Germany and others, I have always been on board with. You need financial innovation, but to get financial innovation you need the politics. You need to have a stable polity. You also need monetary stability and fiscal stability. In an environment of economic instability, it's hard to have sustained economic growth.

One last question. Some of your early work was related to history of thought. You have worked on Richard Cantillon, John Cairnes, and others. That's very different from the standard cliometirc approach of developing a hypothesis and testing it against an alternative. Is there any role for history of thought in today's modern economics departments or in general?

I always liked history of economic thought. My work on John Cairnes was my first foray into history of thought. That came out of a class paper in a course we had to take at Chicago: in the history of economic thought with George Stigler. It was related to my interest in the effects of monetary change on the economy, and I was interested in the monetary effects of the gold discoveries in the 19th century. So, I wrote a paper on Cairnes. That led into a paper on Richard Cantillon who had many of the ideas that Cairnes put forward a couple of centuries earlier. Then I did a big history of thought piece on the classical gold standard. I haven't kept up in that field. Sometimes I wish I had. I went to a number of history of economics society meetings in the 1970s and 1980s, but I had a feeling that the field was losing influence. The fact that most graduate schools dropped it—Chicago dropped it 10 years after I left—meant that the people left working in that field were on the fringe. I just didn't get much out of going to those meetings. I guess I thought that the payoff would be higher in economic history.

But, I think it's really important that we know where our ideas come from. The current generation of macro-economists, and even the one before this one, haven't a clue where their ideas come from. If you look at reading lists in macro, the oldest article might be from Lucas in the 1980s; they might have Friedman and Schwartz in there. But there is so much other work that is really relevant. It's not known, and people don't cite it. Back then, when I was a student at Chicago, when people wrote articles, they would go back and consider where a concept came from. They would talk about Ricardo and Smith, and I think it's a shame that we have forgotten where we come from.

Selected Publications

- with Owen Humpage and Anna J. Schwartz, "The Historical Origins of US Exchange Market Intervention". *International Journal of Finance and Economics*, Vol. 12, No. 2, April 2007, pp. 109-132.
- with Oliver Jeanne, "Monetary Policy and Asset Prices: Does "Benign Neglect Make Sense?" *International Finance (*December 2002).
- with Barry Eichengreen, Daniela Klingebiel, and Maria Soledad Martinez-Peria. "Is the Crisis Problem Growing More Severe?" *Economic Policy (*April 2001).
- with Christopher J. Erceg and Charles L. Evans. "Money, Sticky Wages and the Great Depression." *American Economic Review* (December 2000).
- with Anna J. Schwartz. "Monetary Policy Regimes and Economic Performance: The Historical Record." Chapter 2 of the North Holland Handbook of Macroeconomics edited by John Taylor and Michael Woodford. North Holland, New York. (1999).
- with Hugh Rockoff. "The Gold Standard as a `Good Housekeeping Seal of Approval'." *Journal of Economic History* (June 1996). ■