

History and America's Great Recession

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The American debate over the current crisis offers different attitudes towards history. Analyzing the way historical knowledge has been brought to bear on the crisis, Adam Tooze especially focuses on the analysis put forward by Paul Krugman, and emphasizes the possible contradictions between history and political action.

“History shows that when public debt passes 90 percent of gdp it begins to weigh heavily on economic growth”, or so it was claimed by Reinhart and Rogoff in their now notorious paper, “Growth in a Time of Debt”.¹ Except that it turns out that this depends on accidentally excluding five countries from the sample and assigning the same weight to the experience of the UK and its tiny dominion New Zealand. The scandal surrounding the spurious “90 percent” result has thrown a stark light on the risks involved in marrying historical research to policy advice. Statistical results are highly sensitive to the vagaries of datasets compiled from obscure sources. The more obscure the sources the easier it is for small but significant errors to slip through even the most painstaking fact-checking. Even the best-informed expert is unlikely to intuit the difference that the inclusion or exclusion of ten years of Belgian, Danish or Canadian data can make. Furthermore, in fairness to Reinhardt and Rogoff, historical facts when unleashed into the public realm have a life of their own that even the best efforts of responsible authors may not be able to control.² But the argument over the errors in their influential paper have had the unfortunate effect of narrowing the discussion of historical thinking in the crisis to the level of Excel cursor controls. The Reinhart and Rogoff phenomenon is telling not only for the embarrassment of their proof reading error. Their interventions beg far more serious questions about the way in which historical knowledge has been brought to bear on the crisis. In presenting their result as a law-like regularity derived from most complete survey of world history, Reinhart and Rogoff reduce the record of human affairs to an inert databank. The results are deeply paradoxical. This is policy-oriented history writing premised on the assumption that human nature and thus history are in fact unchangeable. As this paper will show the current American debate offers two other distinct attitudes towards history. One which sees the present as conditioned by evolving historical structures and asks how one might gain leverage and

¹ Reinhart, Carmen M.; Rogoff, Kenneth S. (2010). "Growth in a Time of Debt". *American Economic Review* **100** (2): 573–78.

² “Verrechnet”, Die Zeit No. 27 27, June 2013, 17-19.

historical agency within such a process; another which locates the current moment as a moment of radical crisis and opportunity, and challenges us to rise to the demands of the moment. Of course, such stances are not peculiar to the US or to the current crisis. They are basic modes of relating to national history. But what is striking, is the extent to which the US can still be imagined as a classic, self-enclosed and self-referential arena for thinking the relationship between history and political action. The most fluent, contentious and widely read commentator in this arena is Paul Krugman. Driven in part by his virtuosity and in part by the unresolvable tensions both within and between these different approaches to history, Krugman puts all three genres of historical argument in the service of his agenda of activist liberalism. When pushed to its logical conclusion this results in a discourse of national activism that begs wider questions about America's position in the world.

Our Time is Different

The success of Carmen Reinhart and Kenneth Rogoff's *This Time is Different* is one of the surprises of the great recession. The former Director and associate director of research at the IMF, Kenneth Rogoff and Carmen Reinhart³ offer an 800 year survey of financial crises and debt defaults. Boasting of their command over one of the largest data sets of its kind ever assembled they cite examples of default both domestic and international ranging from medieval England to late twentieth century East Asia, by way of England's seventeenth-century Glorious Revolution and nineteenth-century Latin America. Though its prose is well-nigh unreadable, it has become an obligatory reference point in policy discussion. As such it has a strong claim to being the most practically influential piece of history written since Milton Friedman and Anna Schwartz' *Monetary History of the United States*. But what does history mean to Reinhart and Rogoff? Their vast range of evidence is mobilized to demonstrate not the incessant pace of modern change, the experience ironically alluded by the title, but its opposite, a pattern of monotonous repetition. Astonishingly, at a moment when capitalism is once more demonstrating its unrivalled capacity for creative destruction, the text that has most captured public attention is bent on demonstrating the Solomonic folk wisdom that "there is nothing new under the sun". Reinhart and Rogoff's is not a progressive history of capitalism. It is a timeless chronicle of human nature. Decisive moments of modern innovation such as the automobile, or the IT revolution enter their story only as passing investor fads, aiding and abetting the latest unsustainable boom. According to Reinhart and Rogoff: "Our basic message is simple: We have been here before. No matter how different the latest financial frenzy or crisis always appears, there are usually remarkable similarities with past experience from other countries and from history." (p. xxv) "... financial crises follow a rhythm of boom and bust through the ages. Countries, institutions, and financial instruments may change across time, but human nature does not." (p. xxxiv-xxxv)

Though touted as a groundbreaking work of scholarship, Reinhart and Rogoff's book is, in fact, internal to the incestuous world of policy-making, high-brow investment advice, economics departments and financial media whose habits of mind it criticizes. The perspective into which they quite unselfconsciously inveigle their readers, is that of the world-weary rentier, who, surveying the last 800 years of human history, has learned just one thing:

³ Reinhart and Rogoff, *This Time is Different: eight centuries of financial folly*, Princeton University Press, 2009.

The most commonly repeated and most expensive investment advice ever given ... stems from the perception that ‘this time is different’. ... financial professionals and, all too often, government leaders explain that we are doing things better than before, we are smarter, and we have learned from past mistakes. Each time, society convinces itself that the current boom, unlike the many booms that preceded catastrophic collapse in the past, is built on sound fundamentals, structural reforms, technological innovation, and good policy.

Somewhat puzzlingly however, they cannot deny themselves at least some basic practical intent. “We hope that the weight of evidence in this book will give future policy makers and investors a bit more pause before next they declare, “This time is different.” It almost never is.” (p. xxxiv-xxxv). Not only does this result in a profoundly contradictory relation to the question of policy and its effects. Would the world not be different, if the key policy-makers took Reinhart and Rogoff’s insights and abandoned hope that the world could ever be different?

No less ironic are the implications for history of this enormous effort in historical data collection. As Reinhart and Rogoff incorporate more and more evidence, history as narrative or process, disappears. Instead, we have a vast collection of episodes strung out in graphs and tables, many organized by country in alphabetical order, regardless of size, significance or chronology, as if to defy any more meaningful organization. At times their obsessive compilation of numerical arrays is reminiscent of that lowest form of market superstition, the numerology of the so-called chartists. It is in this approach to history not in an excel spreadsheet error that the ultimate source of the 90 percent illusion is to be found. Even the data that Reinhart and Rogoff have correctly analysed betrays them. The larger the data-set the more varied the methods of metrication, the more numerous the indices of crisis and bank failure, the more inescapable the conclusion: some times truly *were* different. Furthermore, determined policy interventions almost certainly had something to do with it. The intensity of banking, currency and fiscal crises between 1914 and 1945, but most particularly in the 1930s is without parallel in any period of history before or since. Then, after a no less undeniable and remarkable period of calm, lasting the best part of half a century, there was a second striking escalation of financial stress beginning in the 1980s and reaching spectacular new levels since 2008. Two questions follow, questions which though they are framed by Reinhart and Rogoff’s data, fundamentally challenge the ahistorical conclusions that they draw. The first demands an explanation of why since 2008 we have faced not a regular crisis, but an extraordinary conjuncture, unprecedented in the sheer scale of financial and monetary instruments involved. The second question, rather than looking backwards, focuses on the drama of the particular moment that we find ourselves in. Given that *our* time *is* different, how should we react?

The Historical Roots of the Crisis

In a column of May 2012 the conservative columnists David Brooks distinguished two types of response to the crisis. Those he dubbed cyclicalists focussed on the drama of the crisis and the need for an urgent and immediate response. Despite the apparently quietistic implications of their book, in the superheated rhetoric of the 2012 presidential election Reinhart and Rogoff made clear that they were amongst those favoring a major fiscal stimulus. But for Brooks that was insufficiently historical. For him, what is at stake in the crisis is not merely another

investment bubble gone bad, but deeper historical trends. The future of America was at stake. To exemplify this approach Brooks cited the prize-winning work of Raghuram Rajan, *Faultlines. How Hidden Fractures Still Threaten the World Economy*. Rajan teaches finance at Chicago and has recently been appointed chief advisor to the Indian Central Bank. He first made a name for himself at the 2005 economic policy gathering at Jackson Hole, when as chief economist of the IMF he had the temerity to confront Alan Greenspan, the then-legendary Chair of the Fed, with an alarming diagnosis of the huge tensions that had built up within the US credit system under his watch.⁴ Despite his establishment credentials, Rajan is both a wide-ranging and unconventional thinker. Not the least remarkable feature of *Faultlines* are his sources. In the footnotes he credits Wade, Brenner and Streeck as inspirations, all of them favourites of the defiantly neo-Marxist *New Left Review*.

Not surprisingly, Rajan's use of history is very different from that of Rogoff and Reinhart. Beneath the credit policy of the 1990s and 2000s Rajan sees not timeless human nature at work, but new and deeply entrenched historical processes – above all the transformation of the global division of labour resulting from the enrollment of hundreds of millions of new workers in Asia. Globalization set the stage for the crisis because for a large part of the US population it challenged any possibility of realizing the “American dream”. In a chapter memorably entitled “Let Them Eat Credit” Rajan offers a sketch of successive Republican and Democrat administrations in the 1990s and 2000s seeking to compensate for the fading fortunes of the American middle class by subsidizing cheap housing credit.⁵ Huge mortgage debt was thus added to the system of private health insurance and unregulated credit card debt, to expose an ever larger fraction of American society to unprecedented levels of financial risks. With one of the weakest social safety-nets in the Western world, American society has become not just the chief motor of global demand, but also the polity that responds most dramatically to any threat of a downturn. As unemployment mounts and millions are thrown into severe distress, Congress responds with ad hoc and ill-targeted fiscal measures. The Fed is more susceptible to political pressure than any other central bank. Knowing this, Wall Street cynically calculated that it could count on the “Greenspan put”. The Fed would not act to prick bubbles, but it would intervene in the event of a crash to prevent a meltdown. Driven by the needs of an increasingly anxious middle class, America has become a profoundly destabilizing force in the world economy.

With his emphasis on the need to strengthen the social safety net and the education system, Rajan can hardly be classified as a simple-minded marketeer, but he attracts the ire of many American liberals for his insistence on the need for structural solutions. Blaming globalization, he appears to refuse the urgency of the unemployment crisis.

Something has to be done, however. Over the last ten years there has been no commentator more assertive, aggressive and widely read than Krugman. As a Nobel prize-winning macroeconomist and columnist at the *New York Times* he has had a remarkable echo. Since 2008 Krugman has led the charge against the conservative structuralist reading of the crisis. The idea that the crisis was triggered by state intervention, that the current bubble was inflated by public lending authorities, Fannie Mae and Freddie Mac, to appease struggling blue

⁴ Raghuram G. Rajan, *Fault Lines: How Hidden Fractures Still Threaten the World Economy* (Princeton, 2010), 2-3.

⁵ Rajan, *Fault Lines*, 21-45.

collar voters, Krugman rejects as absurd. Given the way that big money currently talks in US politics the idea that Congress acts out of concern for those with poor credit rating is deluded. It was not the votes of Middle America that drove the boom, but the reckless greed of the money managers whose lobbying swayed Congress towards a disastrous failure of regulatory oversight. Conservative structuralism is both wrong in its diagnosis and an excuse for inaction. Krugman likes to figure himself as a man of action. *End this Recession Now!* he demands in true revivalist style. Whatever its origins the crisis threatened to become an old-fashioned failure of aggregate demand which could be remedied only the old-fashioned way, i.e. with full-blown Keynesian medicine.

This is polemically effective, but it is not a posture that Krugman can consistently maintain. In his wide-ranging writings over the last twenty years, he has offered us much more than a diagnosis of the immediate crisis. He too recognizes the structural issues at stake. Despite the urgency of his calls for action he is far from indifferent to the question of how we got here. He adopts what might be called a left-structuralist position. “To understand the deeper reasons for our current crisis”, he insists, we must “talk about income inequality and the coming of a second Gilded Age.”⁶ As he put it to *Wired Magazine*, “it’s quite possible that the long run state, that the natural state, except for special episodes, is one of extreme inequality. We still think ... that ... pretty decent society ... that we had for a generation after World War II as being somehow the natural end state of modern technology, modern development, and I guess the balance of the evidence says, no, that’s not how it works” ([interview with Wired Magazine](#)). What created the “decent”, reasonably egalitarian society in which the baby boom generation grew up was not the operation of technology and factor endowments alone, as Rajan seems to suggest, but politics, specifically the so-called “great compression” that began in the 1930s. What gives Krugman’s analysis its force is the way in which he marries the historical depth of a structuralist account with the energy and force that derives from seeing history as revelation. It was the “big leveling” of the New Deal that made America a “middle-class country”. And the key to that rebalancing was the consolidation of the position of organized labor. Since the 1970s this has been reversed. This breaking of the regime of high unionization and relatively low inequality “was a political decision”, not an economic necessity. “The choice” America made, Krugman insists, “was to make Walmart jobs low paying. They didn’t have to be. In a different legal environment, a megacorporation with more than a million employees might well have been a company with a union that resulted in decent wages. ... If the rise of big-box stores had not taken place under the Reaganite rules of the game, with employers free to do whatever they wanted ... we might have had a different result.” (Krugman playboy interview 2012) What impelled this roll back was the insurgent force of the new right, of so-called “movement conservatism”. Playing on the divisive racial politics stirred up by the civil liberties revolution, they broke the stranglehold of the Democrats on the Solid South and brought to power first the Nixon and then the Reagan administrations.

But if the New Deal is the touchstone of Krugman the left structuralist, for Krugman the Keynesian high priest the New Deal provides a remarkably unrewarding source of inspiration. The problem for those who, like Krugman, advocate massive stimulus spending is that between 1933 and 1940 the Roosevelt administration delivered nothing of the sort. In fact, once the

⁶ Krugman, *End this Depression Now!* (2012), 70.

effects of unemployment on government budgets are allowed for, there was little or no fiscal stimulus from the New Deal. As Christina Romer, Obama's first chair of economic advisors, demonstrated in a series of fundamental papers, the recovery of the US economy from the Great Depression was sustained not by fiscal but by monetary policy – by the stabilization of the banking system by the Glass-Steagall act of 1933 and the relaxation of monetary policy made possible by the abandonment of the gold standard. In 2009, Romer argued for a large-scale fiscal stimulus package in terms that were explicitly counterfactual. The full effect of fiscal policy had not been demonstrated because it had never been tried. Krugman, characteristically, is more assertive. There *was* a major fiscal policy experiment under the FDR administration. However it was not the New Deal, but the war that restored full employment. But Krugman goes further than this. There was a full-blown fiscal experiment conducted in the 1930s, just not in the United States. To make this point he has invoked series of papers by the economic historian team of Barry Eichengreen and Kevin O'Rourke who showed that the arms race initiated by Imperial Japan, Fascist Italy and Nazi Germany did, indeed, deliver a very powerful stimulus.

Krugman is clearly delighted with this result. But in political terms, he knows that invoking Mussolini's invasion of Abyssinia as a successful case of fiscal stimulus is to sail close to the wind. As he remarks on his blog, every time he issues such pronouncements, the *New York Times* is inundated with emails accusing him of war-mongering. Krugman's reaction to such ideas is justifiably caustic. He was one of the loudest opponents of Bush's wars. But justified as Krugman's frustration may be, he is not innocent. It is not good enough simply to dismiss his critics as fools. Their confusion arises from the acrobatics that Krugman performs when he shifts between historical registers. What Krugman expects us to understand is that when he enthusiastically employs convenient empirical findings about fascist regime to justify the call for government spending today, he is doing so in the manner of a politically and historically detached technician. He is approaching history in the Reinhart and Rogoff mode. The past is not being treated as determining our present, or as a moment to be emulated, but simply as a mine of information, a treasure trove of technical data.⁷ As Krugman insists: "*economics is not a morality play*. It's not a happy story in which virtue is rewarded and vice punished." ("[Economics Is not a Morality Play](#)") But Krugman's own method is less consistent than this implies. In fact, constant shape-shifting is part of Krugman's method. At one moment he is mobilizing Eichengreen and O'Rourke's results about the fascist regimes. But he clearly means us to understand that he does so side with their politics. Similarly, when in urgent, Keynesian mode, he insists with an impatient wave of the hand that we should spend money on anything, literally anything, he does not mean us to take this as the last word. He does not really mean that we should be indifferent to the likely long-run consequences of short-run decisions. He has, after all, set out a critical reading of America's recent history and what progressives might hope for. But that process of separation also works in reverse, so that in reviewing recent history or looking forward in science-fiction mode to a distant future he allows himself a bleak pessimism that is at odds both with the optimistic sense of possibility that he insists upon in his political columns and the counterfactual possibilities constantly mobilized by wide-ranging comparative and technical analysis.

⁷ For the Abyssinian reference see New York review of books *Our Giant Banking Crisis—What to Expect* [May 13, 2010 Paul Krugman](#) and [Robin Wells](#).

Every time he moves, Krugman wants us to acknowledge that he is actually, already “somewhere else” in the argument. But, what if we attempted to pin him down? Krugman commits himself to four distinct propositions:

1. Fascist rearmament demonstrated, under the forensic microscope of retrospective quantitative analysis, the existence of a large fiscal policy multiplier.

2. But, as Krugman knows from his tireless political battles in the present, to launch a spending program on the scale of fascist rearmament is politically difficult. “Politics. Intellectual confusion. Inertia. Misplaced fears”, stand in the way of an adequate policy response. And this is precisely what sets dictatorships apart. “There’s nothing special about military spending from an economic point of view, but as a political matter Hitler managed to override the usual objections to stimulus.” ([Bubble, Bubble, Conceptual Trouble](#))

3. Suffering from its usual divisions American democracy in the 1930s was not capable of matching that performance, until it was galvanized into action by the war. “...it would have been much better if the Depression had been ended” by “massive spending on useful things, on roads and railroads and schools and parks. But the political consensus for spending on a sufficient scale never materialized; we needed Hitler and Hirohito instead.” ([Economics Is not a Morality Play](#))

4. Finally, we know that Krugman believes that, if anything, the impasse in American politics today is worse than it was in the 1930s. And yet he nevertheless doggedly maintains that it makes sense to advocate for a spending programme on the scale of that in World War II.

How are we to make sense of this? Specifically, does the logic of his structuralist historico-political analysis (history as structuration) not refute the possibility of action (history as moment of revelation) suggested by his cold-blooded calculation of the real economic impact of the armaments booms (history as data)? Is a truly gigantic civilian spending program, outside the context of an either hot or cold war, a plausible historical counterfactual for the US?

Beyond the Complexity of History

To anyone familiar with the intellectual debates within the twentieth-century left, this impasse cannot but seem familiar. Krugman’s thought mirrors the problems that the tradition of Western Marxism broke itself upon, from Lukacs’s *History and Class Consciousness*, down through Sartre and Castoriades writings of the 1960s and 1970s.⁸ How is one to bring together a positivist science of society with a complex sense of historical determination and to integrate both of those with a political calculus for which time is a syncopated series of moments and opportunities for insight and action? Western Marxism even at its most ambitious struggled to offer a coherent answer to that question and since the 1970s, along with the philosophy of history in general, the attempt has largely been abandoned. From what we know of his writings and his education it is safe to assume that Krugman is innocent of any exposure to these dilemmas. But this makes it all the more intriguing that Krugman has himself provided a revealing explanation of the deeper sources of his own thinking about history, expertise and political action.

⁸ Milestones in this tradition: G. Lukacs, *Geschichte und Klassenbewusstsein*, J.P. Sartre, *Critique of Dialectical Reason* (Fr 1st edition 1960), C. Castoriadis, *L’Institution imaginaire de la société*, 1975.

In autobiographical reflections after winning the Nobel Prize, Krugman described his domestic and high school existence in the suburban 1960s as entirely mundane except for “those science fiction novels. Indeed, they may have been what made me go into economics.” His chief inspiration was the classic *Foundation* trilogy by Isaac Asimov. As Krugman points out “it is one of the few science fiction series that deals with social scientists -- the "psychohistorians", who use their understanding of the mathematics of society to save civilization as the Galactic Empire collapses.” As Krugman admits “in my early teens my secret fantasy was to become a psychohistorian. Unfortunately, there's no such thing (yet).” He discovered this at Yale in 1970, where he went with Asimov’s psychohistorian-hero Hari Seldon in mind to study history, only to discover that academic history was “too much about what and when and not enough about why”. By contrast economics offered a view of the same infinitely complicated social reality that revealed patterns and rules that made the complexity seem simple. As Krugman explained to Larissa MacFarquhar for *The New Yorker*, if one wanted to explain why some societies have serfs or slaves while others did not, “one could talk about culture and national character and climate and changing mores and heroes and revolts and the history of agriculture and the Romans and the Christians and the Middle Ages and all the rest of it”. Or, like Krugman’s economics teacher Evsey Domar:

You could argue that if peasants are barely surviving there’s no point in enslaving them, because they have nothing to give you, but if good new land becomes available it makes sense to enslave them, because you can skim off the difference between their output and what it takes to keep them alive. Suddenly, a simple story made sense of a huge and baffling swath of reality [...]⁹

For Krugman it was none other than Keynes who introduced this mode of thinking to American economics departments which in the early twentieth century were mired in historical institutionalism. Institutional economics “in opposition to neoclassical economics, emphasized the complicated interactions between political, social, and economic institutions and the complicated motives that drove human economic behavior.” “Then”, Krugman explains, “came the Depression, and the one question that people wanted economists to answer was “What should we do?” “The institutionalists said, ‘Well, it’s very deep, it’s complex, ...’. Keynes by contrast “was coming out of the model-based tradition”. His response was simpler and more in keeping with the urgency of the situation: Push this button—print more money, spend more money—and the button-pushing worked. Push-button economics was not only satisfying to someone of Krugman’s intellectual temperament; it was also, he realized later, politically important. “Thinking about economic situations as infinitely complex, with any number of causes going back into the distant past, tended to induce a kind of fatalism: if the origins of a crisis were deeply entangled in a country’s culture, then maybe the crisis was inevitable, perhaps insoluble—even deserved.”¹⁰

For Krugman, in short, it is precisely the insufficiency of historical explanation that gives him hope. Structuralism may be essential. But, both the freedom for clear-sighted analysis and action depends on their not being a fully determined reality. But it is also because of this incompleteness, the impossibility of an all-encompassing master science of society that Krugman

⁹ Larissa MacFarquhar, “The Deflationist. How Paul Krugman found politics”, *The New Yorker*, March 1 2010. Read more: http://www.newyorker.com/reporting/2010/03/01/100301fa_fact_macfarquhar#ixzz2HupVHWPE

¹⁰ [Ibid.](#)

is constantly on the move. It creates the opportunities for creative arbitrage between different forms of knowledge and modes of intervention - translating a Noble Prize in trade theory into the basis for political opposition to the Iraq war and visa versa. But it is a movement impelled as much by constant frustration as by possibility and it can lead to disturbing places. Krugman needs enemies to motivate his politics. "The fact is", Krugman insists, "the Great Depression ended largely thanks to a guy named Adolf Hitler. He created a human catastrophe, which also led to a lot of government spending." (Interview with Playboy Magazine, 2012) Obama has not had this polarizing effect. Nor did he push the search for culprits after 2008. This for Krugman was a mistake. "My sense is that in the face of this catastrophe, people needed some sign, a kind of symbolic sense of who was to blame." By failing to define an enemy, Obama helped create a political monster, the Tea Party "that's now come and bitten him. If you're not going to point fingers at the people who actually caused the problem, then those fingers may end up pointed at you." In the 1930s, there "was a genuine attempt to say who the evildoers were. This time around the powers that be are desperately afraid that Wall Street might be mad at them." Could an enemy be found elsewhere? Krugman is deeply frustrated at the refusal of Americans to rally around civilian infrastructure. "We really have slid backward for the past 200 years from the kinds of things we used to understand needed to be done now and then." On the other hand, "if it were announced that we faced a threat from space aliens and needed to build up to defend ourselves, we'd have full employment in a year and a half." A rather more terrestrial and all the more alarming option emerges from a piece Krugman co-authored with Robin Wells in the desperate winter of 2010-2011 following the tea-party's triumphant march into Congress.¹¹ In the pages of the *New York Review of Books* Krugman and Wells canvassed the limited range of measures that Obama might push through in the face of Congress, by executive order. They then struck upon another way of wrong-footing the Republicans. "Democrats could also demand that the administration—specifically, the Treasury—act on the problem of China's currency manipulation, which keeps the renminbi artificially cheap compared to the dollar. While China's actions are not the main factor in our economic woes, they are a factor. China's unprecedented level of currency manipulation siphons off demand for US products that is much needed in our depressed economy, and shifts our imports away from other countries such as Mexico that are much more likely to reciprocate with purchases of American goods. The obvious American response is to threaten, and if necessary actually impose, countervailing duties on Chinese exports ... Such a move would have overwhelming Democratic support in Congress, and would put Republicans on the spot if they tried to block it." As recently as February 2012 Krugman was willing to say that "under current circumstances, with mass unemployment and a complete absence of policy levers to do anything about it, China is hurting us, period. There's no ambiguity about it. Chinese policy right now is our enemy." (Krugman Playboy interview 2012)

Of course, a trade war with China to rally the Democratic troops is not the same thing as a shooting war against Hitler's Germany, let alone an unprovoked assault on Abyssinia. Furthermore, in the course of 2012 Krugman has backed away from this issue entirely ("An Issue Whose Time Has Passed"). On the basis of the numbers there is good reason to believe that, due to rapid Chinese inflation, the currency rates are no longer fundamentally misaligned. Conveniently, this allowed Krugman during the 2012 election to score points off Romney, who

¹¹ New York Review of Books "Where Do We Go from Here?" [January 13, 2011](#) Paul Krugman and Robin Wells. See also the aggressive tone of "Taking On China" By PAUL KRUGMAN Published: March 14, 2010

was still focused on the China issue. Romney was indulging in “bluster aimed at making voters think you’re tough”. But tactically-motivated “bluster” was precisely what Krugman himself had advocated in 2010 in the face of the democrats electoral rout. It is a temptation that lurks behind any aspiration to dramatic national self-assertion, especially if this is expressed not merely as a revolt against domestic constraints, but cast as a matter of urgent confrontation on the international stage. It is not for nothing that many on the American progressive left fear that moments of national political re-founding must be coupled with domestic or international confrontation.

Whither Bretton Woods II?

But, Krugman and Romney’s tirades aside, this does not mean that there is not in America as well a clear awareness of the massive interdependence of the world economy. America may be a military hyperpower *sans pareil*, but it is popular once more to invoke stories of the rise and fall of great powers. Strategists speculate about a moment of apocalyptic clash in the South China Sea. On the inside of the policy debate it is clear that the US is already caught up in a historical process which over the last ten years has begun to significantly constrain America’s absolute economic sovereignty. In his hugely influential position paper on the so-called “global savings glut” in 2005, Ben Bernanke highlighted the torrent of money flowing from the high-saving surplus economies of Asia and Europe. By unilaterally pegging their currencies to the dollar at undervalued rates, large peripheral exporters were accumulating sustained surplus, which they were recycling to the United States, driving down US interest rates and preventing the Federal Reserve from effectively reining in the upward spiral of the US credit boom. Bernanke’s argument has been widely criticized as deflecting blame away from the US financial authorities for their failure to effectively regulating their banking and mortgage sectors. But this reduces the argument once more to a debate about US national policy and misses Bernanke’s main point. What the future Fed chairman was highlighting was that Washington was losing control of interest rates, the main lever of macroeconomic policy. Furthermore, Bernanke hinted at a further argument, which was spelled out in starker terms by both Rajan and Martin Wolff, the chief economic columnists of the influential FT. What had triggered the new strategy adopted by the Asian states was their experience with the vagaries of the international financial system since the disintegration of the Bretton woods system in the 1970s. The Asian financial crisis of 1997-1998 followed the Latin American and Mexican debt crises of the 1980s and 1990s. Too often forgotten in the West, the humiliation dealt out, notably to Indonesia by the IMF in 1997, left an indelible impression, an impression only driven home by the Argentinian disaster of 2001. Joining the global economy offered great advantages, but the US had failed in the aftermath of the Cold War to create legitimate institutions to govern the global economy. The strategy of fixing Asian currencies at undervalued rates against the dollar was a means of managing the risks attendant upon integrating with an asymmetric world economy.

The team of economists at Deutsche Bank who in 2003 first identified the significance of the phenomenon of exchange rate pegging and dubbed it Bretton Woods II did so because they believed it to be a highly functional and internally stable arrangement that could be expected to last.¹² The peripheral surplus countries would eventually graduate to full inclusion in the core of

¹² Michael P. Dooley, David Folkerts-Landau, Peter Garber, “An Essay On The Revived Bretton Woods System”

the system, in the same way as Japan and Germany had done. But it was an unprecedented and anxiety-provoking interdependence. Already in March 2004 Lawrence Summers, Clinton's former Treasury Secretary, warned that the stability of the world had come to depend, in a haunting echo of the Cold War, on a "balance of financial terror".¹³ The terrifying risk was of Mutual Financial Destruction. Confidence in the US bond market might collapse, leading the dollar to plummet and interest rates to sky-rocket. Meanwhile China would suffer epic portfolio losses and see a surging exchange rate ruining its export-based industrialization program and unleashing massive social unrest. Though this nightmarish scenario cannot be ruled out, what has been remarkable since 2007 has been the durability of the Pacific axis of the world economy. There has been no dollar sell off, despite the antics in Congress. The landslide came not in the foreign exchange market, or in the US bond market, where yields remain close to zero, but in the mountainous pile of US private credit. But if Bretton Woods II is for now proving robust, this begs the question. How does the story end? In 1971 Bretton Woods I disintegrated, helping to set the stage for global stagflation and an unsteady system of floating exchange rates. Europe responded with the succession of projects of monetary coordination that ended with the Euro. How might the story of Bretton Woods II develop?

Like Krugman, the Fed and the US Treasury seemed determined that Bretton Woods II should in due course go the same way as its predecessor, giving way to a truly global system of free exchange rates with the renminbi floating against the dollar, yen and Euro. Under the current system, the vast monetary expansion undertaken in the US is putting huge pressure on those determined to maintain their exchange rates. But in the United Nations, in the IMF and the G20 there is increasing impatience with the US stance. In the fall of 2012 this vented itself in the remarkable decision taken by the IMF to give conditional approval to the capital controls through which peripheral countries might insulate themselves against inflows of US capital. A truly central element of the Washington consensus has thus come undone. Export-promoting industrialization strategies will be upheld even at the expense of free capital movement and persistent global imbalances. Does this suggest that the history of Bretton Woods II might be different from its predecessor? Rather than careening towards a 1970s break-up, might Bretton Woods II embark on a journey back to the future? In a self-conscious historical reprise it was precisely to the founding moments of the postwar era that governor Zhou of the Chinese central bank referred in March 2009 in his widely quoted speech calling for fundamental monetary reform.¹⁴ In light of the current crisis, he reminded his audience of the basic decision made in 1944 to opt for a world financial system based on a national currency, the dollar, as opposed to a synthetic global currency, the Bancor, favored by Keynes. America's muscle distorted Keynes's master plan. Already by the 1960s the imbalances in the dollar-based system were proving unsustainable. By 1971, after only 14 years of full operation Bretton Woods was history. Is it not now time to learn from this experience, Zhou asked? Is it not time to move to a truly global currency system, based not on the dollar, or on gold, but on a synthetic, "super-sovereign", collectively-managed reserve currency. These are not the remarks of a postcolonial intellectual

NBER Working Paper 9971, September 2003.

¹³ Lawrence H. Summers, "The United States and the Global Adjustment Process" Peterson Institute for International Economics 3rd Annual Stavros S. Niarchos Lecture 23 March 2004.

¹⁴ Zhou Xiaochuan: Reform the international monetary system 23 march 2009
<http://www.bis.org/review/r090402c.pdf>

calling for the provincialization of Europe. They are demands articulated by a growing Asian power, America's largest official creditor. They are self-consciously derived from the history of the trans-Atlantic system itself and they were promptly endorsed by a high-level commission of the United Nations headed by Joseph Stiglitz.¹⁵ Whatever comes of this Chinese intervention it marks a major turning point. Not since the advent of the modern world economy in the early modern period has there been a multilateral conversation of this kind about its history or its future. It serves notice that the days in which the trans-Atlantic dialogue of the deaf between the Europeans and Americans will monopolize the definition of our collective present, may be passing into history.

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¹⁵ UN, *Report of the Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System* Sept 21, 2009.