A Conversation on New Economic Thinking

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with Martin Wolf of Financial Times at Bretton Woods Conference

M: Leaving the ghosts aside and understanding that despite the protestations of Fox News, none of you need have a heart attack, because this is only a conference among people across the spectrum talking about a whole variety of issues with no authority to impose any kind of conspiracy. (laughter)

I think we should move now to the more – how do I say, the more serious dimension of the evening. I do recall that Martin Wolf probably did not get a Valentine from Larry Summers (laughter) on February 14 of 2009. (laughter) He wrote a column that said something, and I'm using my own words, not his, that "Is it too early to judge this to be a failed administration?"[1]

Tonight he will be in conversation with Larry Summers who undoubtedly has sat at the pinnacle of responsibility. And whatever you might say, agree or disagree, with what's taken place, no one has had to calibrate all of the responsibilities for the care of this nation and this planet like Larry Summers has in these last couple of years.

And in addition, as he demonstrated again today in our press conference, he has a very supple mind and imagination. He understood and answered very, very clearly about questions of the last ten years and what kind of things have changed his mind in that context.

But I actually would say the capacity to bear the weight of that responsibility and reflect upon how economics does and does not serve that ultimate social purpose no one has had that position like Larry Summers had. So I very much look forward tonight to the conversation between Larry Summers and Martin Wolf. And please join me in welcoming them.

WOLF: So, I am going to have a conversation with Larry. Larry is one of an incredibly tiny handful of people who have been both at the pinnacle of the economics profession and at the pinnacle of policy-making. And I personally, as a journalist, actually like most journalists I think, deeply respect and admire those people who are actually prepared to take responsibility as well as criticize, which is, of course, our role. So I think that Larry is preeminent among modem economists in willing to do this.

Again, I'd like to start in the following way. Obviously most of the people here, and I'm certainly one of them, think that what happened in the crisis indicates that at the least there are some very big questions, if not some pretty obvious symptoms, of a profound failure in modern economics, and in the way we think about how the economic system works, both in macroeconomics and in finance.

So what I would like to start with, Larry, is how far you share that perspective, how far do you feel that what has happened in the last few years, what we've left with, just simply suggests that economists didn't understand what was going on?

SUMMERS: There are things economists didn't know. There are things economists were wrong about. And there are things where some economists were right.

When I was in the government, I got a lot of papers in the mail. To the first approximation, I attempted to read all the ones that used the words 'leverage,' 'liquidity,' 'deflation' or 'depression.' And I attempted to read none of the ones that used the words

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'neoclassical,' 'choice theoretic,' 'real business cycle,' or 'optimizing model of.' (laughter) There were more in the second category than there were in the first. But there were a reasonable number in the first, and they told you a lot.

There is a lot in Badgett that is about the crisis we just went through. There's more in Minksy and perhaps more still in Kindleberger.[2] There are enormous amounts that are essentially distracting, confusing, and problem denying in the stuff that is the substance of the first year courses in most PhD programs.

So I think economics knows a fair amount. I think economics has forgotten a fair amount that's relevant. And it has been distracted by an enormous amount.

I don 't think the general macroeconomics kept up with the revolution in finance as it was realized that asset prices show large volatility that don't reflect anything about fundamentals.[3] I don't think contemporary macroeconomics adjusted or adapted to changes in the patterns of financial intermediation and the ways in which that took place.

I think people who were practical understood concepts of liquidity finding its way into price inflation or into asset price inflation and being problematic either way. But I think those concepts of liquidity into asset price inflation were at the very edge of, and in many cases not even at the edge, of contemporary macroeconomics to the great detriment of contemporary macroeconomics.

On the other hand, it's common in a moment like this to go into a general bash on economics. And everyone who hates economics because they don 't like markets in any context, or because they don 't do math and so if you do a subject with math you just have a bias towards believing that math is useless. Everyone who doesn't like economics has piled on at this moment to regard this crisis as a repudiation of economics, and I don't think that's right. I think the wisdom that's in the Badgett, Minsky, Kindleberger, Eichengreen, Akerlof, Shiller, many, many others actually runs way ahead of those who mostly bring negative attitudes about economics.[4] And I think that we make a serious mistake if we throw the baby out with the bathwater here.

WOLF: I'm going to come back to babies and bathwater in a few moments. But let's just push this a bit further, because you came very close, it seemed to me, to saying that modern academic economics as taught in graduate schools, along with vast parts of the research work that goes with it, was as it were, an organized and systematic system. I'm not saying a conspiracy, but a systematic system for forgetting what economists actually knew. Is that what you're saying? (laughter)

SUMMERS: It would be interesting-

WOLF: They want all this.

SUMMERS: It would be interesting, actually, to look at surveys.

I was heavily influenced, as I did whatever it was I did, by the basic Keynesian ISLM framework as augmented to take account of the liquidity trap.[5] I was heavily influenced by a variety of the kinds of writings of Jim Tobin about financial intermediation, in particular about debt deflation and the prospect instability.[6] I was substantially influenced by work on bank runs, multiple equilibria, and the theory of bank runs that is more recent.

I was influenced by a good deal of what modern finance understands about bankruptcy and restructuring as we thought about treating the banks, and as we thought about treating the automobile companies.

I would have to say that the vast edifice in both its new Keynesian variety and its new classical variety of attempting to place micro foundations under macroeconomics was not something that informed the policy making process in any important way.

Now to be fair, I have heard it said that if you actually wanted to know where a planet was, the Talmudic astronomical system did better than the Copernican astronomical system for 50 years after the world moved to Copernicus.[7]

So a variety of that research may find its day and may find its moment, but it wasn't a moment that had enormous influence during this crisis. And it is my impression that it would be quite easy to graduate with a PhD in economics from many prominent economics departments in this country with only the most vague notion of what the liquidity trap is, while at the same time being familiar with a substantial amount of subtly surrounding dynamic stochastic general equilibrium. And that later subtly did not inform our policy making process.

And having read the policy prescriptions of those attached to dynamic stochastic general equilibrium, I'm not led to think that the world would have been in a better place had their laissez-faire recommendations been pursued.

WOLF: I remember the, I think one very, very famous Nobel prize laureate in macroeconomics said that one of his great achievements was to eliminate the name of Keynes from all textbooks on macroeconomics. Obviously you don't share this view.

But let's just push a little further on what's going on. I mean did this happen, in your view, because economists at the top of the profession were seduced by the idea of elegance, formal elegance and completeness of the theoretical model? Or was it actually something deeply more ideological at work – political ideology at work? What was the sociology, if you like? What was driving this?

SUMMERS: I don't know completely. I think it's a – I think there are three aspects.

The first aspect is that after a 30 year period of very substantial stability it is not insane that people would be led to think about models that would predict stability as being the ones that were currently – as currently operative. So I think a first aspect was the substantially subdued business cycle that took place for the last 30 years – following on what was a Keynesian disaster.[9] Following on the crude application of totally demand oriented policies that had produced an inflationary disaster.

So I think you had an unfortunate backlash from crude Keynesism, and as often happens with pendulums, it swung too far in the other direction supported by the 30 years of relative stability.

I think that was reinforced in significant part by the attempts at science and there was a tendency to study issues which were more tractable rather than to study issues that were less tractable. And the set of issues having to do with volatility and asset markets, having to do with multiple equilibria arising from bank run type phenomena are in a variety of ways less tractable. And scientists study things that they find tractable and that is some of the tendency.

And I think in economics we are moving there, but we have not evolved nearly as far as we have in other fields in separating people who do different things. There was a time when the physicists and the people who built bridges were the same people, that but has not been the case for a very long time. And it wouldn't occur to anybody to go to one of the world's great theoretical physicists to get advice on how to build an airplane. And we're not quite there in economics, although we're much closer to that point than we would have been many years ago.

And so those at the cutting edge of theory and of practice know that division has taken place less than it has in other areas of science. And I think that also contributes to this tendency.

WOLF: What you're essentially suggesting there is that our universities, if you think of engineering and physics, should have completely separate departments of what I would think of as useful economics and stuff that people play with. (laughter) I'm being provocative, I know.

SUMMERS: You are being…

WOLF: That's my job.

SUMMERS: You are being provocative, and I have on occasion been drawn to ideas of the kind that you suggest. I had a knack for ideas that really appealed to the faculty. (laughter)

WOLF: Yes. You can try again.

SUMMERS: No, no, I'm one of the very few people who went to Washington to get out of politics. (laughter)

I think, Martin, it's – I'm the guy who once wrote a paper called The Scientific Illusion in Empirical Macroeconomics.[10] And I have been a very harsh critic of a lot of this stuff. But I do take seriously the observation I made about the Talmudic astronomical system and the Copernican system. And we don 't know where things are going to go.

So I think it's a mistake to be – I think it's a mistake as a policy maker to be guided by research that seems irrelevant to the problem. But equally, I think it's a mistake as an observer of intellectual life to be overly confident about what types of directions are going to prove fruitful over time.

When I was an undergraduate it was generally believed, outside of a relatively limited number of economists, that carbon taxes were cap and trade and were deeply immoral because they represent – because polluting was immoral, and they represented a license to pollute.[11]

So I think we need to be careful about – we need to be prudent about applying research. But we also need to be cautious about attacking research.

WOLF: That's a – those are very simple and powerful basic economic ideas – in light of the crisis and what you found useful, the sort of writing, and thinking you've found useful as a policy maker in analyzing and doing macro policy, where do you feel that researchers are moving towards or should move towards? Also, in light of your experience as a policy maker, where would you like to know more, where would you like to see more penetrating analysis? What are the questions that concern you in macroeconomics, which you feel at the moment we just aren't addressing properly?

SUMMERS: The general equilibrium aspects of financial intermediation and the regulation of the financial sector. We know a lot about an individual bank's incentive to take risks, versus not to take risks, moral hazard all of that. How that integrates up to the entire financial system is a matter where from Bill White's writings,[12] others, it's not that we don't know anything, but we don't know nearly as much as I would have liked.

What is the nature of the dynamic and the reasons for its change in the relationship between employment and output? Where we had a set of relationships that seemed quite regular between employment and output, the behavior has really now been quite different in the United States in several recessions, the behavior has really been quite remarkable in Germany with huge changes in output and no changes in employment.[13] How is one to think about the relationship between employment and output? I don't think economists know nearly what they should know about that.

How to think best about aspects around liquidity and confidence is a question that actually goes to deep aspects of economic theory around coordination. And I don't think we understand that as well as I would like us to.

I also don't think, and I think this is a very- actually a different kind of answer, and is a little away from macroeconomics- I don't think we have serious situationally adapted ways of thinking about the public choice aspects of regulation, and the conduct of discretionary monetary policy.

We have a bunch of people who kind of assume that the regulators are smart and that the private sector is greedy and that they'll figure things out right. And that we have a bunch of people who assume that the private – that the government always gets co-opted and the regulators always end up working for the regulated.[14] And we have sort of a dialog of the deaf between them.

And the truth is the regulators haven't done a terrific job. The truth is we have a broad social problem that covers everything from finance, [15] to deep sea drilling,[16] to nuclear, [17] and that in all kinds of areas that are technical and hugely important to society there's roughly nobody who knows about them who doesn't have some set of deep interest in them. And that creates all kinds of questions of legitimacy and knowledge. So we don't really want legislation by the co-opted. But we also don't really want regulation by the ignorant. And there's hardly anybody who is both knowledgeable and un-co-opted.

And how we think about the design of regulatory institutions to address those structures – I think we economists have a tendency to spend too much time on whether the Basile system should say 7% or 7.8% and not enough time thinking about how over many years as accounting conventions have to be set – as there are all kinds of interactions between the regulated and the regulator, how the system will adopt in terms of incentives of all the actors is important.

The public choice school has taken that very seriously, [18] but they have driven it relentlessly towards nihilism in a way that isn't actually helpful for those charged with designing regulatory institutions. But their recognition that regulators who are people that have incentives too is, I think, a very important one. And so that would be an additional area that I would highlight to research.

WOLF: I want – let me – I'd like to go a bit further into the financial area anyway, because that's the other side of what's happened. And obviously going back to the work of Keynes and further, the integration of finance and macroeconomics, they're pretty well the same thing, they're incredibly closely tied.

OK, we have had a huge development of financial economics of the last 40 years. Very many different kinds in, of course, in option theory and efficient market theory and all that stuff. And another set of ideas of rate of symmetric information, principal agent, the bank run stuff.

From a policy-making and analysis point, analytical point of view, as a policy maker, what of all that stuff do you think is actually useful? And what of all that stuff is just a trap? Given that it's clear, everybody agreed, we don't really understand how the financial system operates as a whole – I'll come to that in a moment – but just with all these bits, where do you find enlightenment and where don 't you?

SUMMERS: Well, there are two different aspects of it. There's a question, which is insofar as this development of financial thought has driven financial innovation, there's a debate to be had about the extent to which the financial innovation has been stabilizing or destabilizing. And that's an important set of questions.

I have tended to be more cautious than many about condemning financial innovation, not because it's unassociated with all sorts of problems – but because my observation has been, over time, that if I look for example at the Japanese financial crisis,[19] or I look for example at the Nordic financial crisis,[20] to take the two examples preceding this one that were biggest in the industrial world, both of which were actually far more costly for their countries than this one looks likely to be – both really involved, overwhelmingly, bank lending to real estate? And that is what the Irish crisis involves,[22] while the Greek crisis is mostly about an excessive budget deficit.[23]

Most financial crises do not seem to have their roots in newfangled financial institutions and newfangled financial instruments. So I am in less of a hurry to condemn the innovation as the cause of the crisis than many.

In terms of understanding the crisis, I think the sets of ideas around the principal/agent problem and the sets of ideas around bank runs and multiple equilibrium phenomenon have been very powerful. I think of the discipline of the efficient market hypothesis not as a description of how to think about asset prices, but as a question to ask oneself – does one's view of the world that one's expressing imply that there's an effortless obvious profit opportunity? And if one does, then maybe one should think about the view of the world one just expressed. I think that is actually a useful and important idea, to take a contemporary application. I'm struck by the number of people who think – I'm exaggerating slightly – the day quantitative easing ends, there's going to be a major jump in the bond market because the federal government's no longer going to be buying there. [24] Whereas some acquaintance with efficient market type notions would lead one to be rather skeptical of that idea to one's benefit.

So I think all of these things have increased our understanding of how the market operates. And I think one does have to be struck – and there are many different ways to interpret this – but there has been a market outside the academic world in large scale for those who have been involved in developing these various modes of financial thinking. There has not been a comparable market for those who have been developing some of the newer ideas in, for example, the new classical macroeconomics. That says something about their practicality, perhaps.

WOLF: Let- I'm going to be provocative again. So let's (laughter) – one of the points…

SUMMERS: I've learned over time, Martin, that trying to be provocative can be problematic. But go right ahead. (laughter) Better you be provocative than that you get me to be provocative. (laughter)

WOLF: The difference is that it's my profession. (laughter)

Anyway, the question I had is you just said, which I think is very powerful, we understand bits of this system, but we don't really understand very well – we don't know how to control the whole financial – the financial system as a whole. We know, we've had a very long experience of that, and been reminded of this over the last 30 years, that when the financial system goes wrong, very large crises can ensue. Very costly ones.

You rightly observed that by those standards the US economic crisis, by these standards of the last years was even relatively mild. But by some estimates there have been 125 banking crises. And some of them have cost, just in fiscal costs, 50% of GPD, that's going to be the average figures, leaving aside the macroeconomics.

Wouldn't a reasonable non-economist conclude from that one, here we have this fantastically dangerous engine which we don't fully understand, therefore the obvious conclusion is that you just cannot risk deregulating it? It has to be under government control very tightly all the time. How would you tell a layperson that that's not a reasonable response?

SUMMERS: Well, in some ways it probably is a reasonable response. And the last time – this is an overstatement – but this was why Harry Dexter White was a communist.[25] This is why there were very large numbers of thoughtful people who were communists in the 1930s, because they looked and they saw that just letting the market rip had ended in disaster. And they convinced themselves that having, not just the financial system, but the processes of production be controlled and planned as they were in the Soviet Union, that had not suffered a similar unemployment problem[26] would produce a better outcome. And that did not prove to be conspicuously successful.

So I think the question one has to ask is, there are going to be decisions that are going to be made by people, and the people are going to have incentives, and they're going to follow their incentives. And you want to get an outcome that is stable. And you have to ask, what is meant by saying that you're going to have the financial system completely regulated and controlled by government?

In some sense we had that system in the Soviet Union and it collapsed . We had that system with respect to exchange rates in the 1950s and 1960s.[27] We didn't move away from the Bretton Woods system because a bunch of economists got in a room and convinced everybody that fixed exchange rates were a bad idea, capital mobility was a good idea, and so we needed to shift monetary systems from a system that was working well.

We shifted from the Bretton Woods system because the Bretton Woods system collapsed, because the internal contradictions within it, even as people tried to paper it over, didn't work.[28]

Now if you ask, "in general has the world had too much leverage, or has the world had too little leverage?," I think the case is overwhelming that it has had too little, too much, excuse me. (laughter) I think the case is overwhelming that it has had too much leverage. That the externality associated with taking on increased leverage has been under-internalized, that capital requirements in various ways should be systematically increased.

There are a lot of ways to lend money in a modern economy with integrated production. And so controlling leverage is a complicated thing and it takes a lot of thought as to how best to do it. But it is absolutely right. And every time I've spoken to a financial audience for the last two years, I've gone through some version of saying that we had the 1987 stock market crash,[29] the S&L crisis, Mexico,[30] Asia,[31] Russia,[32] LTCM,[33] the internet bubble,[34] Enron,[35] and now this. One crisis every three years from a system that is supposed to minimize, diversify and spread risk has in fact been a source of risk that's led hundreds of thousands of people each time to lose jobs through no fault of their own.

So I think it's absolutely right to be deeply worried about the outcomes that are produced. I think it is less right to assume that anger and dissatisfaction with the financial system constitutes a policy or constitutes – provides a very clear blueprint as to the directions and the ways in which it is best reformed to promote stability.

For my money, the best judgments that we have right now, and obviously there are ways it could be improved, are those embodied in Dodd-Frank. If you are big enough that – big enough and systemic enough that your failure is a major event, you are big enough and systemic enough that it should be one institution that's competent with technical things, whose job it is to regulate you.[36] There needs to be procedures for resolving and managing the failure of any kind of financial institution. Not simply banks.

There needs to be a systematic and across the board effort to make levels of leverage lower and levels of capital higher so as to make the system safe from the greed and cupidity that will eventually happen. I think these kinds of principals we know. But if you say the financial institutions with which the US government was most heavily involved were Fannie Mae and Freddie Mack, which arguably were the site of the greatest degree of irresponsibility, it is alarming.[37]

It was commonly argued in the 1960s and 1970s that a great thing about socialism and communism was that if the government ran the factories then the externality of pollution would be completely internalized.[38] And that if you could just have the government run the factories, then the externality would be well managed and you'd avoid having the kind of degradation that you had when people ran them purely for profit.

That didn't prove to be a good theory of public ownership. And so I think one has to think very hard about alternatives. I think the type of approaches that the world's groping towards, while very imperfect, are in the right direction.

WOLF: Just one final question in this area. We've had a debate in our pages which is very much interested me between Alan Greenspan and Barney Frank. Alan Greenspan has said it's a complete waste of time, because regulation will always fail. And Barney Frank said – responded by saying, well, do you really think that after this crisis you can do nothing? And it seemed to me Barney Frank has a pretty powerful argument.

But let me just –

SUMMERS: I agree with you.

WOLF: Let's follow up –

SUMMERS: That's why I talked about the different- talked about the particular steps that I just talked about.

WOLF: Let 's talk specific – let us imagine – we have this – you build the Dodd-Frank act, 1 suppose, we've had bars on all the rest of us. Let us suppose in the current, very concentrated financial system, we've had a wave – financial institutions usually get into problems at the same time. We know that's one of the features of the system.

Wouldn't you, in fact, in this country and all the other countries, have to rescue all the big financial institutions again? Do you feel confident that that structure of too big to fail, and everything going with it, has actually in any deep way changed?

SUMMERS: I don't think any country, any modern industrialized country is likely to allow a complete implosion of its financial system. I don't think that's very likely. I don't think you're ever going to see that.

I don't think that's got anything much to do with whether you have a lot of big banks or you have a larger number of small banks each doing what the big banks were. I don't think that's fundamentally about whether you have banks or whether you have money market mutual funds, or whether you have lending taking place through the capital markets and you have a – you have potential collapses.

So I think that there is a sense in which poorly run institutions need to be punished, will be punished, are better able to be punished after this. Once every fifty-year disasters, I think are likely to be met with policy, I hope, will be met with policy responses.

The heyday of the line of thought you're advocating was-

WOLF: I'm asking a question.

SUMMERS: The heyday of the line of thought that is implicit in your question (laughter) was the 20 hours surrounding Lehman's demise. And it didn't work very well. Lehman, to remind you, was less than 2% of the U.S. financial system and would not have been too big to fail on anybody's theory of too big to fail.[39] It didn't violate any of the scope restrictions that anybody has suggested.

So I think we do have to reckon with the fact that there are these systematic connections that we will need to address very hard: questions about monetary policy in the formation of bubbles; questions of exploring multiple instruments that address levels of interest rates and levels of leverage. But it is no more realistic for governments to say that in the presence of systemic failure, financial failure, they're not going to take extraordinary steps, than it is to say that in the presence of kidnapping they're never ever going to pay ransom.

WOLF: Now I've intended to ask a question at this stage, but I've run out of time. And the question was going to be should there be a second Bretton Woods, but I actually suspect that I know the answer. But if any of you wants to ask this question, you 're welcome to do so. (laughter)

I'm going to turn this over to the audience. I'm going to get about three questions. They should be questions, not long speeches or diatribes. That's for other occasions over the weekend. And you would just say who you are, address your question. I'll take three together and we'll go from there.

COLANDER: Dave Colander, Middlebury College. Wondering in terms of the training of economists, how could that training be changed to better sort of fit, sort of the example that you're suggesting? In other words, there are two types of economics? One would be scientific.

WOLF: We've got it. OK. Another one, someone in the back. Is there anybody near in the back who can stand up?

SINGH: My name is Ajit Singh from Cambridge. I have a question from both-

F: Louder.

SINGH: I have Parkinson's Disease, so I'm a little bit – my voice is a bit weak.

The question which I have is that the – if you look at the results of the financial system, which up to now you find that the world economy was expanding at a faster rate than ever before during the last ten years. The rate of growth of developing countries has been faster than developed countries.

The question is whether in light of these facts, which are faster expansion of the developing countries versus developed countries, the incredible performance of India and China, in light of these facts, would you say that there is something to be said for the previous accountings of the previous financial system, that it's not a total write off?

The reason I say this is because if these facts are not appreciated, then you're likely to run the risk of reforming the financial system in a way that doesn't take into account the needs of the developing countries.

WOLF: I think we get it. Let's go to the question – I think the question really here is – I get it anyway, I hope I do, that there's a real danger of throwing away babies and bathwater, coming back to that. We've had enormous success, and have had enormous success in the world economy over the last 10, 15 years, particularly in developing countries. Has the financial sector played – financial markets played an important role in this? To what do you attribute that? And is there a danger as we reform that we lose some of this? That's my understanding of this question.

SUMMERS: I think there are two parts to that question. I'm probably more sympathetic to financial innovation than the average person in this room. But I would not want to make the argument that financial innovation has been an important – financial innovation in terms of derivatives and in terms of the development of all of that has been an important contributor to China and India's success.

I think there's a different question, which may have been what the very thoughtful questioner had in mind. Which is to what extent did the managed export-oriented exchange rate contribute to enjoying a period of remarkable growth, and whether international monetary reform, that in the name of symmetry, reduced the ability of developing countries to, at an early stage of the convergence process, use a depressed real exchange rate, as a tool of industrialization, be in some way problematic?[40] And I think that's a very – I think that is a very fair and legitimate question.

I think you do need to recognize that it is going to be harder for countries with over a billion people to operate on that basis as they enter their third decade of 10% growth than it may have been for Europe or Japan to operate on that basis in the 1950s and 1960s, just given the political imperatives in the industrialized world. But I think it's a very real and legitimate issue that does need to be considered.

My own suspicion is that there may turn out, over the intermediate run, to be a little less in this whole debate than many people think, because I think that China is reaping the consequence of its exchange rate management in terms of higher inflation rather more rapidly than many people would have expected a year ago. And therefore, China is finding itself with less ability to control its real exchange rate than many might have expected some time ago. But I think it's a very legitimate issue.

WOLF: On the training point.

SUMMERS: I think that – I think there's a very fine sort of judgment that teachers always have to make – which is to what extent they teach students what they're interested in and what they find most exciting and what they experience as the cutting edge of their research and to what extent they need to present a broad range of perspectives to students.

For my taste, PhD instruction in economics is a bit tilted towards the former at the expense of the latter. And that's why a lot of stuff that I was taught when I was in graduate school, and that I found enormously useful over the last several years, has passed out of the curriculum. And I think with some real cost.

But I'm also sort of aware that when I was 30, I didn't have all that much time for what the old guys thought the new generation of students needed to learn. And now I'm one of the old guys, so I sort of have some hesitation about pushing my views with excessive vigor. (laughter)

WOLF: This is uncharacteristic modesty. (laughter)

SUMMERS: Maturity we call it. (laughter)

WOLF: Yes, I know the feeling. It's what happens when you hit 60.

Anybody- I would like – somebody right in the back there, yes, please. Could you say who you are?

SMITH: Eve Smith. One of your closing remarks regarded the fact that we in advanced economies, and to an increased extent in developing economies, accept the notion that we don't let financial systems fail. And in fact I would go – the evidence suggests it goes further than that. In the crisis, substantial support has been extended to financial systems beyond that of any other private sector actors. For example, military contractors don't even – don't get the same support that financial sector actors do.

My question, then, is what is the case for not treating financial sector actors as utilities?

WOLF: OK, that's a good- we'll get to that. One more question, and I think we've still got seven minutes, I'm told according to this wonderful clock in front of me. Gentleman there. Yes, you, please. Could you stand up and then no doubt a microphone will arrive. Or not. (laughter) Yes, a microphone will arrive. Thanks.

KATZ: Thank you. Louis Katz from the World Bank. I'd like to ask another exchange rate question. Given the experience of the last 12 years or so, if you had to think about another rescue of an emerging market that had external prices, would you give the same kind of advice with – as regards what to do with the exchange rate as was done in the 1990s? Or would you have more sympathy for propping up the exchange rate as was done 15 years ago?

SUMMERS: As was done where?

KATZ: In the emerging markets crisis that took place in the 1990s, like in Asia and Russia and others.

WOLF: Collapse exchange rate or prop them up? I think that was the potential question. Looking at the Euro crisis I think this is a no-brainer. (laughter) I will be – I shouldn't – I'm not supposed to answer.

So the first question is should we regard the financial sector as simply a humble utility and regulate and presumably pay its executives accordingly? Or (laughter) should we continue to support it as though it was a utility and pay it as though it was a...

SUMMERS: Let me take both questions and let me take them, if I could Martin, in the opposite order.

Look, this is a question that I've been asked a lot, and I don't think it's fair as I'm not objective. The question is usually – is frequently put, that it was the United States and the IMF that urged austerity on Thailand, Korea and Indonesia and then when the United States had a financial crisis it urged the opposite of austerity.[41] Isn't that hypocritical and doesn't it prove that you were wrong then?

My reaction to that has always been that the medicine depends on the disease. And that it is very different to have the disease, which is that no one from the rest of the world wants to lend you any money anymore, and therefore your currency is collapsing than to have the disease the asset prices in your country are collapsing. And people are bringing money back to your country because they think their money is safer there. And that the crisis that was much more analogous to the U.S. crisis than the crisis in Thailand, Korea or Indonesia was the crisis that Japan had in the early 1990s.[42] And for better or for worse the American advice with respect to that crisis was strongly expansionary fiscal policy, and was strongly expansionary monetary policy.[43] And so I think that approach is consistent.

And I think the idea that when your currency is in the process of collapsing that somehow printing more of it, or selling more financial instruments in it, is somehow going to be availing with respect the currency, I thought at the time was somewhat implausible, and I think right now is somewhat implausible.

Now that's not to defend every action the IMF took with respect to fiscal policy in the '90s. I think there were some very important excesses in the beginning of some of the programs.

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