This webinar was given by Sir Paul Tucker, chair of the Systemic Risk Council, and M-RCBG Director Lawrence H. Summers on Friday, February 19, 2021 as part of M-RCBG's weekly Business & Government Seminar Series.

Sir Paul Tucker:

So, welcome, everybody. This is Paul Tucker. I'm a research fellow at the Harvard Kennedy School, and I have with me Larry Summers, the co-director of Mossavar-Rahmani Center for Business and Government and, of course, former treasury secretary, top economist. We're going to talk about what issues the pandemic has revealed about macroeconomic policy and financial stability policy.

Sir Paul Tucker:

But before we do so, let me just say two things. First of all, it's a measure of how extraordinary this year is, but a kind of small measure that my diary for today says "Fly to Boston," which was something that I put in a year ago. A more serious thing to say, and I know Larry will join with me in this, is a few days ago we lost our colleague, Bob Glauber, who I first met at the tail end of 1987 when he was writing the Brady Report on the 1987 stock market crash, and I was writing a rather similar report for Hong Kong.

Sir Paul Tucker:

Bob finished his report in 60 days, and it must be one of the highest quality public reports written about anything in such a short period. It was really quite a remarkable piece of work, and I can't tell you, as a much younger man, how grateful I was that a somewhat older man had written his essay in around twice or three times the speed that I and my colleagues were capable of doing. So, we kind of miss him. I gave a lecture at the Kennedy School in his name a few years ago, and I was proud then to do so, and I'm proud now to have had that opportunity.

Sir Paul Tucker:

So, Larry, there's an extraordinary thing going on in macrofinancial policy, and I thought we might have a discussion under three headings. First, literally macroeconomic policy. Secondly, although it's initially going to sound abstruse for people watching, debt management and cash management policy. And then finally, financial stability policy. I think we're at a most extraordinary moment in lots of ways. The debate and actions to put more weight on fiscal policy are quite unlike the calls in 2010, 2011 that austerity was basically a bad idea. That was something about the mix of fiscal and monetary policy.

Sir Paul Tucker:

But the first time I heard anybody seriously argue that it wasn't just a question of maybe you could get better, closer to optimal policy through a slightly different mix, but actually you would need fiscal policy to address a slump was in a lecture you gave in London in 2012, I think it was, which was before, I think, you were framing it in terms of a secular stagnation.

Sir Paul Tucker:

By 2015, '16, a different group of people, comprising largely retired former top central bankers, were kind of saying in public, "Actually, regular monetary policy, is more or less out of our mode, in terms of stimulating aggregate demand." Axel Weber and I did that together at an event in the fringes of the annual IMF meetings in I think the autumn of 2016, maybe 2015.

Sir Paul Tucker:

And then, during that period, your analysis of secular stagnation of Olivier Blanchard's discussions of shifting the emphasis of macro policy got more and more attention. But big picture, nothing much happened. Nothing changed. This was a debate rather than a shift in policy. And it was kind of rather like, I now think, Milton Friedman writing those papers in the mid to late 1960s, including most famously the 1968 paper about monetary policy. And that not really getting traction until after the collapse of Bretton Woods and inflation expectations becoming deanchored.

Sir Paul Tucker:

So this time, all of the arguments about shifting the weight onto fiscal policy have been circulating around, but nothing much happened until COVID arrived and then fiscal relief was needed. And I'm deliberately using the word relief rather than stimulus. And that seems potentially to have changed everything in ways that could be good and could be bad.

Sir Paul Tucker:

You, of course, as everybody watching knows, had ignited a very important debate about the Biden-Yellen package. And I took three points away from what you said in public in your debate with Paul Krugman last Friday, which is, first of all, this package is very large relative to any reasonable judgment or estimate of the amount of slack in the American economy.

Sir Paul Tucker:

Secondly, that it isn't really aimed at improving the underlying dynamism of the economy. It doesn't address the supply side. And thirdly that the politics of the package, which you have tried to stay out of, Paul got into a bit more, are very interesting, because, on the one hand, there is a possibility that having had this package, it will be harder to get future packages which do address the supply side.

Sir Paul Tucker:

On the other hand, you can argue, "Well, for the Democrat administration, this is a shrewd way of addressing the hazard of the midterm elections, which are not so far away. And that's what I wanted to start posing a question, which is that last justification of the size of the package, that this is politically shrewd absolutely says to a central banker, and the sort of former central banker who has favored a shift from monetary policy to fiscal policy, "Ah! Here we see the specter again of fiscal excess."

Sir Paul Tucker:

Except my approach to that has been over the last few years, "Well, don't worry. Last time we had fiscal excess in the 60s and 70s and inflation got out of control, we haven't really got independent central banks," whereas now we do have independent central banks, although I'm going to frame that as a question in a second, and therefore, the way I put it in the UK is, "Policy has been the wrong way around. Rather than asking monetary policy to do things it probably can't do, instead we should rely on fiscal stimulus with the independent central bankers coming in as a check if inflation expectations start to get out of hand."

Sir Paul Tucker:

Now, that whole approach relies on the independent central bank being truly independent and caring about price stability. So, I was worried when I heard one regional president of the Federal Reserve say recently, "Let's not get too captivated by the fears about price stability that we forget about all those people who are sidelined who don't have the jobs they deserve."

Sir Paul Tucker:

Now, Mary Daly, who I don't really know very well, is a very decent person and made a very moving video earlier this year about issues of social justice, and so the point isn't ad feminam at all, but it's in a model where the independent central bank is meant to be a check on fiscal excess. I wonder if it wouldn't be better if the Federal Reserve and the Bank of England and the ECB didn't sound as thought they were at least cheering on using monetary policy as an adjunct of political policy, rather than as some kind of constitutional check.

Sir Paul Tucker:

And so, the question I have, and this I thought didn't get the attention it deserved in your debate with Paul, the big issue isn't in terms of macro policy. The big issue isn't whether this package is so great that it generates excess demand and drives inflation, perhaps even materially above the target of roughly 2%, it's whether inflation expectations become de-anchored in a meaningful way requiring a much more aggressive [inaudible 00:09:40] central banking response. And my question is do you think the central banks have still got that in them or are we at risk of them having to do more in the long run because they didn't do enough in the medium run?

Lawrence H. Summers:

So, Paul, you raised a lot of questions and let me associate myself with your thoughts about Bob Glauber, who we'll all miss very much and let me just say several things connected to the concerns you very thoughtfully raised. First, economics is a quantitative subject and all the arguments are quantitative. And so anybody who thinks they can resolve these arguments simply by saying we've learned that more spending is necessary or some such is behind participation in a relevant debate. Very broadly I feel like someone who's been a minimum wage advocate, has felt that the minimum wage act needs to be increased has argued vigorously for years that the minimum wage needs to be increased and then, all of a sudden, policymakers are proposing to raise it to $23 for the next two years. And, on the one hand, one is gratified that one's call has been heard. On the other hand, one didn't dream that it would be increased so much and sees substantial risks from an excessive increase in the minimum wage.

Lawrence H. Summers:

To just remind briefly on the numbers, the lost labor income relative to an optimistic pre-COVID baseline is about $20 billion a month. The proposed stimulus this year is in excess of $150 billion a month. The estimate of the fiscal impulse this year relative to the GDP gap is in the range of six times as large as was engaged in in 2009. I think the argument that it would have been better if more had been done in 2009 is correct. The argument that it should have been six times as large is not one that had ever previously been made.

Lawrence H. Summers:

I think central bankers were, for the most part, right to emphasize the limits of their instrument and to call for assistance from fiscal policy and I welcome that call when it came from Ben Bernanke, when it came from Janet Yellen, when it came from Jay Powell. I think at a moment when we're looking at fiscal policy that is with this year's total stimulus package five times the estimated GDP gap on top of a substantial savings overhang on top of the loosest financial conditions in history, on top of the most rapid central bank growth in history for central bankers to suggest that their primary concern is with avoiding deflation at a moment when the Atlanta Fed's nowcast is for nine and a half percent growth in the first quarter seems to me to be taking very substantial risks.

Lawrence H. Summers:

We are in wartime territory in terms of fiscal policy, wartime territory in terms of monetary actions in support of that fiscal policy, but on consensus forecasts not in wartime territory in terms of the need to mobilize production or in terms of the threat posed by COVID once we get to the end of the first half of this year. It could all work out splendidly. That is certainly a very real possibility and no one knows, but it seems to me the risks that it will lead to increasing inflation.

Lawrence H. Summers:

The risks that it will lead to a complete euphoria in financial markets with low real interest rates and rapid promotion of aggregate demand that will not continue indefinitely. The risks that it will force, once inflation starts to rise, some kind of fiscal monetary collision that will be problematic, the risks that when the United States is engaged in this experiment on a far larger scale than the rest of the world, it will have adverse consequences for the dollar at a time when we are a substantial debtor nation. It seems to me that the risks might be appropriate to run if there was a large income gap caused by COVID that needed to be filled.

Lawrence H. Summers:

The risks might be appropriate to run if what was being financed was a set of fundamental investments that were going to expand the economy's capacity and enable it to repay debt on a far greater scale but to run these risks in support of a program of pervasive transfer payments that may create the expectation of the need for those transfer payments to continue, the need to finance something so extraordinary in order to provide the victims with unemployment insurance, with incomes 120% of their income when they were employed, that seems to me to be a bizarre set of policy choices and an even more bizarre set of policy choices for central bankers to be cheering on. And so, I am very concerned that we are repeating the mistakes of the 1960s, the rate of inflation as measured by the core CPI had risen to 6% by 1969.

Lawrence H. Summers:

It is not the case that, coming out of a period of anchored expectations, inflation stays low forever or that inflation at what is generally regarded as unacceptably high levels is only a consequence of supply shocks. I think we are taking very substantial risks and I do not see what commensurate benefit, except possibly for a political benefit from transfer payments and the idea that there will be an enduring political benefit from providing people with temporary transfer payments that will then be cut off. I'm not a politician but the argument does not strike me as compelling and if the transfer payments continue, I think that will have a set of costs and if the transfer payments are cut off, I think that will have a set of costs.

Lawrence H. Summers:

So, I am very concerned about the path we are on and would like to see a sense that there is concern about these risks and I must say I find it troubling that the IMF, whose role in the system is in some sense to be cautionary on these kinds of matters in the same way that it's the role of others in the system to arouse our social conscience, seems to have redefined its role as cheering on these trends.

Lawrence H. Summers:

I very much hope that they are right. I very much recognize that mine is, at this point, among economic observers not a consensus opinion and am aware that things may well work out the best and for the best and certainly very, very much hope that they do work out the best, but I am someone who has been dismissive of inflation fears, has been confidently of the view that we need more expansionary fiscal policy for almost all of the last decade, who has warned against the tyranny of Phillips curve thinking for the better part of 25 years and I now see us as in a territory unlike anything that we've seen before and have concerns. And I hope that my concerns will prove to be wrong as those who've had concerns about inflation proved to be wrong in the 90s and the naughts.

Sir Paul Tucker:

I think what's really interesting about this is that one can break it down into two components. But the first is is it reasonable for the fiscal policy maker who is elected to take a bunch of risks and secondly and separately, is it sensible for the central bank and the IMF to act as a cheerleader? And my view on these things is that if these are risks that the elected fiscal policymaker wants to take given the social problems in society, the kind of increases in certain types of inequality, the difficulty that some groups in society find in getting decent jobs and getting a fair share, I think that's an important political judgment and it's why we have a democracy. And they've decided to do that.

Sir Paul Tucker:

But the way we have organized our institutions is that just as in the kind of core of politics we have checks and balances between the executive and the legislature and the judiciary. In macroeconomic policy, we have a check and balance between a political elected policymaker who one hopes will pursue social justice, my god, on the one hand. And on the other hand, we have central banks that are insulated from day-to-day politics precisely so that they can, in the famous expression, take away the punch bowl if it threatens to get out of control.

Sir Paul Tucker:

And so, although as individuals and citizens, I can understand why central bankers might go home thinking, "Thank goodness they're doing this," I'm concerned if that's the kind of attitude that they live in their professional lives. So, in a sense we insulate central bankers from politics precisely so as to take them away from all of these judgments and instead so that they can ensure that the recovery is smooth and doesn't have to be brought to a shuddering halt by engineering a really horrible recession, not a recession that happens by accident because of the pandemic, but a recession that is engineered to bring things back under control. And I'm saying this partly because it needs to be said that the losers in such an engineered, deep recession are precisely the people that are elected politicians are rightly keen to help.

Sir Paul Tucker:

But this goes to, so I'm kind of worried about, if you like, the body language of the central bankers. When asked about this, they just need to say, "Well, it's happening. That's a fine thing, and we'll build it into our projections for growth and inflation and we're going to be watching medium to long-run inflation expectations. And so, along as those remain anchored, things can remain on an even keel." And I think that one doesn't actually need to say very much as a central banker at all.

Sir Paul Tucker:

But I think this leads us into something else which is slightly more technical and you and I have touched on before in different sessions, which is the peculiarity or in the way that the current regime doesn't cater adequately for, I'm going to assert the fiscal policymaker doing monetary policy and the central banker doing government debt management.

Sir Paul Tucker:

Now, what I mean by that is this, that as many people watching will know, over the past few weeks, the US Treasury have decided to run down a balance of approximately one and a half trillion dollars with the Federal Reserve, which arose out of the Treasury issuing more debt than they needed to during the last year, more than they spent, and putting the excess cash on deposit with the Fed and then I'm going to be running that cash down and spending it and that may be perfectly sensible. That of course is going to add to reserves in the system and it so is a kind of monetary policy step of a certain kind.

Sir Paul Tucker:

The mirror image of this, in terms of relations between central banks and treasuries, is that although quantitative easing is usually discussed as though it's a monetary macroeconomic stimulus instrument, it is also a means for the state as a whole, the state when you consolidate the treasury and the central bank to swap the payments on its debt from being fixed rate obligations to floating rate obligations where the rate of interest the treasury pays on its debt and this is true for the British Treasury as it is for the US Treasury, the interest rate they pay on their debt varies with the central bank's policy rate.

Sir Paul Tucker:

A long time ago, I was the UK's debt manager in the mid 1990s and when, much later, central bank started doing QE, we in the Bank of England, Vernon King and I and Charlie Bean, were acutely conscious of the connection with debt management and asked Gordon Brown's government, we asked Gordon Brown to make a public commitment that they would not lengthen the maturity of their debt to exploit the way that we were going to bring down [inaudible 00:27:15] and whether that was well-judged or ill-judged as a macroeconomic policy, it was perfectly sensible coordination between treasury and the central bank trying to make policy coherent and, as you wrote with some others at the time, the US didn't do that.

Sir Paul Tucker:

I now have a concern which I'm not sure you share that QE is kind of a perverse debt management policy at this stage of the economy's journey. Long-term interest rates are around zero negative in real terms at some maturities and yet the US Treasury and the UK Treasury are on a course where the interest rate they pay on their debt will be the average Federal Reserve or Bank of England interest rate over the next 15 or 20 or 30 years.

Sir Paul Tucker:

So, if they think that the interest rate is going to average zero over that period, they have a very pessimistic outlook for the economy, indeed, a very pessimistic outlook. If you think that the economy is going to recover tolerably well and the normal interest rate is going to average, say, two and a half or three, it is going to prove a lot more expensive to service the debt if it is held in the Federal Bank of England, hands over that period.

Sir Paul Tucker:

And, of course, if the Bank of England or feds sell it before it matures, then presumably they will be selling it at a loss as yields rise, as the economy recovers.

Sir Paul Tucker:

And what this says to me is that, although quantitative easing as a monetary policy measure and debt management jelled together reasonably well back in 2009, 2010, it is not obvious to me that the machinery has existed for finance ministers and central bank governors to reach a coherent view on whether it still makes sense and the sharpest way of putting it and I'm not sure I quite believe this, but this is what I won with table it for discussion at a serious policy meeting, it would be that, while quantitative easing probably isn't doing very much to stimulate the economy and it may be a very costly debt management measure to switch, to swap fixed-rate debt into floating-rate debt. Have we been on the wrong course over the past two to three years on autopilot after the initiatives of those people a decade or so, again? I just think we need, in the US, this tends to be described as an accord, but it is as if we need a new kind of richer accord for making fiscal policy, monetary policy, debt management policy, and even cash management policy coherent and effective together.

Lawrence H. Summers:

Let me say two and a half things, if I could, Paul. First, with respect to your first set of remarks about the role of central banks and checking fiscal excess, I think it's important to emphasize that you laid out the framework you believe is appropriate, that I've got considerable sympathy with that framework, that it is broadly the framework that's conceived by UK law and it is broadly the framework that is conceived by EU law, but it is not actually a framework that is conceived by US law. US law and the framework within which the US central bank operates puts equal weight on a full employment objective and on an inflation objective.

Lawrence H. Summers:

The US Congress has repeatedly rejected legislative proposals to enshrine inflation targeting to embody in the law what is many economists understanding that monetary policy can, over the long term, affect the rate of inflation but not the rate of unemployment.

Lawrence H. Summers:

And so, while I think that the central bank has not been entirely prudent in its statements and I would have a rather different and more concerned view in their shoes, it's important to recognize that insofar as they are fulfilling a constitutional mandate of their constitution, it is rather different than the one you have in England or the one you would probably recommend, but it is their job presumably to operate within that mandate.

Lawrence H. Summers:

I think you raise a very difficult set of questions with respect to debt management, to perhaps frame the issue differently for our audience that has thought less about it than you have. Many years ago during the Thatcher times, the British government decided that issuing 9% or more 30-year bonds was a signal that it lacked confidence, that it would succeed in bringing down interest rates and bringing down inflation and therefore it issued more short-term debt and therefore it began to issue indexed bonds as a way of signaling its confidence.

Lawrence H. Summers:

And so the idea was that the nature of the debt management choices that the polity made signaled the confident commitment of its officials and the question you're raising today is isn't it odd to be turning away opportunities to issue long-term debt for 10 years at rates below 1% or to turn away opportunities to issue 30-year debt at rates of 2%.

Lawrence H. Summers:

Doesn't that suggest a tremendous degree of pessimism about the resumption of some kind of normality in the economy and should we really be that pessimistic, and if so, how do we take the measure of that, and if not, why are we engaged in the process of purchasing such large quantities of long-term debt? I think that's the question you're raising and I think where you're surely right, I believe surely, very likely right is in saying that there probably ought to be some common policy that's forged by the nation's financial authorities rather than the treasury's doing one thing with one story and the fed's doing another thing with another story.

Lawrence H. Summers:

You asserted that you didn't think that QE was having much of an effect and you might be right. I have in general been inclined to agree with you, but there are many, many, many in the markets who believe that if the Fed was not supporting the 10-year auctions to a substantial extent by purchasing longer-term debt, that you would start to see a yield curve that would be rising very rapidly and steepening very rapidly, reflecting the kind of concerns that I expressed about inflation. I'm inclined to think that if that is the case, it would be better to observe that that was market sentiment and to act on it rather than to suppress this.

Lawrence H. Summers:

So, I share your concern that somehow either QE is inconsequential, except it's sending and not changing any rates and is signaling a debt management policy that's only appropriate on a very dire scenario, or it is consequentially protecting the yield curve in which case it's suppressing discovery of quite ominous market sentiments. And so I am inclined to share your degree of concern about the QE policies and I would rather see if a decision has been made to undertake long-term very expansionary fiscal policy that it be financed in an ultimate sense with longer-term borrowing rather than with a shorter term borrowing, but I am not entirely convinced that a sense that the Fed was going to withdraw from the market would not be quite consequential indeed. What I think is difficult to know is I am really quite confident that if it were to be announced tomorrow that QE would be substantially scaled back. I would expect a taper tantrum event of very considerable magnitude. Whether that is a fundamental thing or is a short-run feature of market dynamics is something I would be much less confident about.

Sir Paul Tucker:

Yeah. I think that's exactly the point. One of the hazards in this and I think this is a hazard in terms of the economics and economic policy, but also in terms of the broader politics which is this. Central bank policymakers ought to be concerned about a correction in the yield curve or volatility in financial markets insofar as that would deliver a negative shock to spending in the economy that would set back the recovery, and cause people to lose their jobs, cause businesses to fail, macroeconomic outcome. It should not concern them greatly if it is just volatility in Wall Street and the City of London.

Sir Paul Tucker:

I was still in office when the taper tantrum happened and I was asked about it by some of my then colleagues. And I said, "Well, I don't know. I think when Eddie George was the governor of the bank and I was running the open market desk, which I'd done some years before, and if we'd made a mistake like that, I think he'd have called me up and said, 'Anybody bankrupt,'" meaning the street, and I'd had said, "No. As far as we can tell. They're just very angry." And he'd have said, "Well, not our final stay but nevermind," because the volatility of the markets as they affect Wall Street and the City of London just cannot be the biggest thing in the Fed's or the Bank of England or the ECB's reaction function.

Sir Paul Tucker:

And I think this will take us on to where I want to end up about shadow banking, but how to disentangle a kind of supersonic Fed put from prudent concern about a correction in bond markets and capital markets arresting recovery and harming the real economy seems to me likely to have become one of the tests that central bankers simply won't be able to dodge over the next few years.

Sir Paul Tucker:

So, let's go onto that in the final kind of session, which is that, as you know, the group that I chaired, the Systemic Risk Council, a group of former top central bankers and regulators and academics and others before COVID, were we were really concerned that the issue of shadow banking had been left unaddressed, the hazard being that, as you re-regulate banking, then inevitably in a dynamic market economy, features of banking migrate from what are banks in law to vehicles and funds that, in some cases, are wholly sound and in other cases actually just replicate the inherent fragility of banking leverage and liquidity mismatches, investments in opaque or liquid credit assets, but beyond the regulatory perimeter and without the safety net and the checks around the safety net.

Sir Paul Tucker:

Now, that was getting kind of nowhere as an issue. I think there are some policymakers who, behind the scenes, have been trying to pursue it, but it was getting nowhere fast. And then last March, as the markets finally grasped that the pandemic was a pandemic, we saw extraordinary market interventions in both New York and London, which, in part, many people believe were designed to hold up asset prices and avert distress in the financial system, but not in the banking system, which does have a lot more equity and quite a lot more liquidity, but in the penumbra.

Sir Paul Tucker:

And I would say that this can't be dodged, even this ridiculous episode in the US equity markets over the past month or so. GameStop, which is partly to do with overlevered retail investors, partly to do with overlevered short sellers. It wasn't a systemic event of any kind, but we should be alert to the signals that it sends and one of the signals it sent was that it's very easy to get a lot of leverage, whoever you are. It's very easy to build a liquidity mismatch in your vehicle or fund or dealer, whoever you are.

Sir Paul Tucker:

And the reason this bothers me is not just that I happen to care about financial stability. It's also more broadly that I feel very strongly that the Western world absolutely cannot afford another financial crisis. The only people applauding if there's another financial crisis will be in Beijing because it would be a gift in the geopolitical game that is going to play out through the remainder of our lives and well beyond, I think.

Sir Paul Tucker:

And so, what I want to pitch to you is not a well-framed policy, but do you agree that there's something here that people ought to be attentive to, that Congress and the new administration, Secretary Yellen ought to be kind of onto this and the FCC should be onto this, taking stability seriously, and do you think it can be done in a way that doesn't choke off the vitally important role that capital markets play in allocating resources.

Lawrence H. Summers:

So, I am fundamentally a macroeconomist not a financial services economist, and so I express views with more confidence about macroeconomic questions that I do about financial services regulation questions and I'm more prepared to accept your views on those. I think there is a classic kind of mistake which is to focus on, I think, the logic of the pre-2008 regime driven by people like Paul Volcker was deeply and profoundly misguided. It was that there were certain kinds of institutions that, quote, "Had access to the payment system and were banks," that needed to be heavily regulated and basically were the beneficiaries of the safety net and that there were other kinds of institutions that were not the beneficiaries of the safety net and were not heavily regulated.

Lawrence H. Summers:

And then it turned out that those other institutions were capable of bringing down the whole system, so they had to be beneficiaries of a safety net. And so the paradigm proved not to work. And so, I think there's always a danger that if you overregulate a component of the system, what you will do is have a beautiful, small object that will be kind of irrelevant and safe, while the risks migrate to somebody else, to someplace else. And therefore I think you are entirely right to be placing emphasis on the question of regulating the shadow banking system, and so that broad impulse strikes me as right.

Lawrence H. Summers:

Whether and how possible it is to fully regulate every aspect of leverage-taking everywhere in the system, I think it's a complicated question and I have a concern that it may not prove ultimately possible and I am quite uncertain as to how I think in reaction to the recent events with Reddit and GameStop. One view is that it's a terrible thing that we need a set of rules to ensure that nothing like this happens again. The other is that it was a rather salutary experience for all involved that is going to lead to more caution-taking in the future and is, in some ways, going to be self-correcting and I think there are elements of truth in both of those views.

Lawrence H. Summers:

I also take seriously and I think this is a problem that has perhaps been under-considered. These questions around maintaining safety. My late father was a professor of economics who would have regarded himself as upper middle class, so I suppose that he was probably a little bit more affluent than that, but he used to ask me how come Bob Summers is not allowed to invest in anything that Bob Ruben would choose to invest in?

Lawrence H. Summers:

And that was because in the name of protecting him and in the name of a kind of stability, he was not allowed to invest in most of the things that the most sophisticated and affluent individuals chose to invest in. That kind of claim has considerable force and we saw that very much in this Reddit thing and so the question of how we define leverage is very complicated.

Lawrence H. Summers:

So, take a dilemma here. How should one regard options? One view is that options are a fantastic instrument, because if you let people invest in options, they can't lose more money than they put up by the construction of the instrument, unlike a short sale, for example. And so options are an investment that encourages prudence.

Lawrence H. Summers:

Another is that options can have embedded within them great leverage that others who write options then choose to edge them in ways that create lots of positive feedback and the possibility of cascades. And so allowing unlimited option trading can be quite problematic for that reason even though, in approximate sense, the instruments are safe.

Lawrence H. Summers:

So, I think the issue is a very, very difficult one. I think one needs to decide. Another manifestation of this is we don't want imprudent borrowing and we don't want people encouraged to borrow imprudently. Should we allow families to buy homes in circumstances only where there's only a 0.1% chance that they will ultimately not be able to pay their mortgage and be foreclosed? 1%? 5%? 10%, when the opportunity to buy a home is something that's very fundamental and has very positive benefits. So, I find these areas very, very, very difficult.

Lawrence H. Summers:

In general, I do think there is a deep problem which exists in our society in many different spheres, take a very different sphere, nuclear power. Why would you become knowledgeable about nuclear power unless you kind of believed in it? And so, why would you go spend your life studying nuclear engineering, so you understood nuclear reactors, unless you wanted to run nuclear reactors or teach people about nuclear reactors or consult the people who did nuclear reactors? If you thought nuclear reactors were just deeply dangerous, you wouldn't devote your life to study nuclear reactors.

Lawrence H. Summers:

But society wants people who are not co-opted making nuclear reactor policy and it also wants people who know something about nuclear reactors to make the policy and so it's a hard problem and I think the same problem exists to important extents with respect to financial policy, but I do think that we have had a bit too much of a tendency to defer to the experts of the inmates as we've regulated the asylum, and I do think that we have almost certainly made more errors of insufficient regulation then of excessive regulation over time but I think we have to be, as that example of Bob Rubin and Bob Summers suggests, rather careful in thinking about the ways in which we may actually, when we think we're benefiting the outsiders or protecting the outsiders, we may in fact be conferring substantial benefits on the insiders.

Lawrence H. Summers:

The simplest example is do we want to make credit more universally available in the American economy or do we want to make it less universally available in the American economy? And I think people who think that they have a moral principle that makes the answer to that question obvious to them in either direction are probably thinking a bit simplistically.

Sir Paul Tucker:

I agree with that. I also think that we need to separate the kind of questions that you posed about your father and then just from questions about the basic resilience of the system. So, another analogy, one that's very topical is it would be a good thing if Texas currently had power and energy being delivered to homes. That is a kind of basic, very ... It's turned out that the energy system there wasn't very resilient at all and somehow in the financial sphere, we need to find a way of separating questions about whether the system breaks from questions where people of different political persuasions are going to have different judgments about how free should you be to kind of mess up your life through your personal mistakes, how much should you be protected from the incompetent and sometimes sharp practice of people in the industry?

Sir Paul Tucker:

I agree very much, by the way, about needing to broaden this debate beyond that side. It's something I felt more strongly since I left office and started chairing the Systemic Risk Council is that compared with, say, environmental policy, where there are two very active lobbies on both sides, the Systemic Risk Council was created by Sheila Bair and Paul Volcker and others and that now involving me and a bunch of people essentially because there are very few voices outside of the authorities in favor of stability.

Sir Paul Tucker:

One brief compound question. A few questions came in from the audience. I want to bundle two together just for a kind of quick response from you before we close. One question I was concerned, "We're looking at a Japan-type situation for the American economy over the next half decade, decade or so."

Sir Paul Tucker:

And then related to that, "Can American manufacturing kind of recover, can the kind of policies that are being put in place or contemplated or any set of policies increase the share of manufacturing in the American economy without," this is my addition, "Without kind of some considerable costs elsewhere in the economy?" There isn't remotely time to go into that, but I was struck that two of the questions that came through were very much about the real economy and about the industrial base of the American economy.

Lawrence H. Summers:

I think the long run trend is that manufacturing is like agriculture. We get more and more productive at doing it. We can produce all that we need with a smaller and smaller share of the workforce. That's the long-run trend. China has a substantially smaller share of its population engaged in manufacturing and employment than it did 25 years ago and it's had the most remarkable gains in competitiveness the world has ever seen. Germany is a massive exporter and an industrial power within Europe and its share in manufacturing of employment is far lower than it was in 1990.

Lawrence H. Summers:

So, I think the suggestion that somehow some manufacturing renaissance is going to be a major go-forward job creator for a growing labor force is not plausible and is frankly irresponsible when put forward. That doesn't mean there aren't strong cases for a variety of kinds of investment in manufacturing on grounds of national security, on grounds of competitiveness, on grounds of technological leadership. I'm not answering those arguments but to hold out the prospect that some kind of manufacturing support can cause manufacturing to be a major source of net job creation is, I think, not realistic as a go-forward policy. And your first question, Paul, was about ...

Sir Paul Tucker:

Japan, could the US become like Japan, kind of secular stagnation on kind of turbo or whatever the opposite of a turbo charge is?

Lawrence H. Summers:

Look. I think that we're in a very uncertain place because of this current 15% of GDP that were injected as fiscal stimulus, but I think that the concern that savings absorption, I think the long run macroeconomic problem is the absorbing of all of the saving in a productive way because the private markets left to their own devices are not finding sufficient profit opportunity at substantial risk-adjusted returns to absorb all the saving globally, and that is, in some sense, the most fundamental macroeconomic challenge for the next generation. And the fact that we have decided to hype up household incomes in an unsustainable and extraordinary way for the next year should not blind us to that more profound challenge.

Sir Paul Tucker:

Thank you very much. This has been great fun. I hope it was of some use to the people that have been good enough to tune in. I mean, in a sentence, where we are is that just about everything is changing and the kind of policy frameworks that have served the world tolerably well over the past 40 or 50 years are going to get rethought and they're not going to get rethought in a systematic way and then applied. People are going to do things and then corrections are going to be made afterwards. That's the lesson of the 60s and 70s. I thought that lesson had been learned, but I don't think it has particularly and I think that's the nature of politics and we're embarked on an extraordinary period. It's been great talking to you and, as I say, thank you to everybody for tuning in.

Lawrence H. Summers:

Paul? Paul, could I just say one thing-

Sir Paul Tucker:

Yeah, yeah.

Lawrence H. Summers:

... as we finish? There was a question on the chat that expressed a feeling that I know many people have that the kinds of analytic conversations that you and I have just had seem remote and divorced from the urgency of a large number of people who are suffering. And if they seem that way, that's something that I very much regret. I went into economics and I think very many of the people of my generation who went into economics went into it because we thought that it was a way on large scale of making the world better for people and particularly for people who were disadvantaged and avoiding the kinds of catastrophic losses that were associated with recessions, that were associated with periods of stagnation. And what I would just caution is that you can't repeal laws of arithmetic, that you have to think very carefully about consequences. And the judgments that I make may be wrong. I'm never sure that any judgment is right.

Lawrence H. Summers:

I do think it's worth remembering that the excesses of the 1960s and 1970s and they were excesses of a variety of kinds, of which inflation was just one manifestation, did lead to a 30 to 40-year romance with hardcore conservatism, beginning with the Reagan and Thatcher years, that were catastrophic for the groups in society that we all care most about. And I would ask those who find things they hear to be hard-hearted or unreasonable or unsympathetic to at least recognize that there is the aspect of the way in which the argument is offered that is designed to support approaches that will be sustainable on an enduring basis and will avoid that kind of tragic backlash and not to agree with positions that you find unsympathetic or that you find unreasonable or that you find harsh, but to be open to the possibility that those who offer them have the same objectives and the same goals that you do. That's something that I would ask you to consider.

Sir Paul Tucker:

Thank you, Larry. Thank you for that. I agree with you that people go into public policy for those kind of reasons. This debate isn't going to go away, but you I are about to talk about it again at the Kennedy School, I hope, where we're all physically there and can see the audience and hear the questions and hear the challenge. Thanks to everybody for tuning in. Stay safe and well. Bye-bye.