

Too Big to Forget

A research conference at the Minneapolis Fed honors the legacy of former President Gary Stern

Gary Stern was a tolerant boss. That, perhaps, was the overarching theme of the April 23-24 conference held at the Minneapolis Fed to honor the former bank president and author, with Ron Feldman, of the prescient 2004 book *Too Big to Fail*.

More specifically, the theme was that Stern's tolerance and patience made the Minneapolis Fed a great incubator of economic research during his 24-year tenure as president. Good research takes time and doesn't benefit from bureaucratic interference. Academics can be testy, and if you pester them about their output, they might pack up and head to a more hands-off environment. There are few places outside a university where academic freedom flourishes, and an organization like the Federal Reserve probably doesn't seem that it would be such a place.

But as a Ph.D. economist himself, Stern recognized that creating such an atmosphere was essential for allowing his research staff and consultants to generate ideas that would inform good policymaking. He also knew it was important to nurture the partnership between the Minneapolis Fed's research department and the economics department at the University of Minnesota that first developed in the 1970s.

To thank Stern for his own contributions to economic thought and for nurturing the work of other economists, alumni of that partnership gathered at the Minneapolis Fed to present recent research on macroeconomics, finance and monetary policy. "It's a strange gift to somebody to make him sit through two days of research," said Thomas Sargent, professor at New York University and a member of the University of Minnesota faculty and Minneapolis Fed adviser in the 1970s and '80s; Sargent himself was instrumental in developing modern macroeconomics.

Sargent's joke drew big laughs from the crowd, many of whom came a long way to Minnesota on a cold, rainy weekend precisely to sit through research presentations. Since much of Stern's career was devoted to ideas, the conference was hardly a

white elephant for him or other attendees, especially because most of the presentations related to ideas in his work, topics which happen to be very much in the public eye since the financial crisis.

For example, Saturday's first presentation, by University of Minnesota professor and Minneapolis Fed consultant V. V. Chari, was of a model of bank bailouts Chari developed with Patrick Kehoe of the Minneapolis Fed and Princeton University. In this model, the government would prefer not to bail out failing financial institutions, but will do so when actually confronted with a failure. This inconsistency creates a "moral hazard" problem in which banks take on more risk than they would if the government could truly commit to and follow a no-bailout policy. Chari and Kehoe argued that this dilemma implies a role for regulation beforehand. The paper essentially formalizes some of the ideas in Stern and Feldman's book.

Though presentation topics ranged from Social Security and retirement finance to changes in productivity in cement manufacturing, the macroeconomic effect of financial crises was the major focus. The Minneapolis Fed's Warren Weber gave a historical account of pre-Civil War bank insurance systems and their effects on moral hazard. Other presenters on bank crises included John Boyd of the University of Minnesota, who discussed how to measure crises accurately, Cristina Arellano of the Minneapolis Fed on the effect of financial crises on firm growth rates and Urban Jermann of the University of Pennsylvania on macroeconomic models with financial shocks.

Naturally, the event wasn't all research. At the end of the first day, a party featured a roast of Stern and a dinner with speeches by both Stern and current Minneapolis Fed President Narayana Kocherlakota. To see the full agenda as well as draft papers and slides, visit minneapolisfed.org/research/events/2010_04-23/index.cfm.

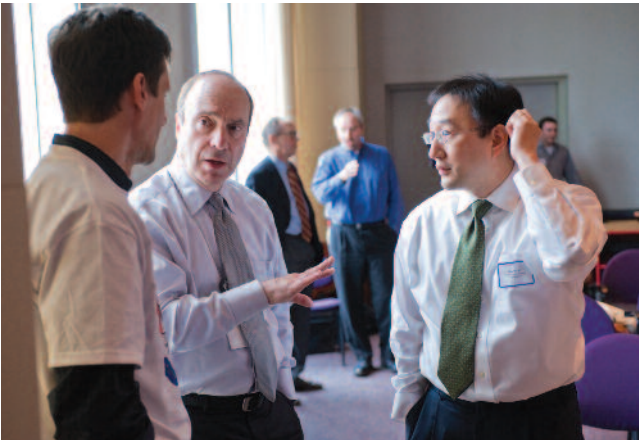
—Joe Mahon



Gary Stern



Robert Lucas,
University of Chicago



Andrew Atkeson, UCLA; Arthur Rolnick, Minneapolis Fed;
Kei-Mu Yi, Philadelphia Fed



Neil Wallace, Pennsylvania State University;
Thomas Sargent, New York University



Edward Green, Pennsylvania State University



Robert Litterman,
Goldman Sachs Group



Ellen McGrattan, Minneapolis Fed;
Edward Prescott, Arizona State University



Warren Weber, Minneapolis Fed