

**Paul Krugman - New York Times Blog**

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### **The Russians Are Coming! The Russians Are Coming!**

How big a deal is the Russian factor in Cyprus's crisis? Pretty big, it seems. Over at FT Alphaville, Izabella Kaminska reports on estimates of 19 billion euros in Russian nationals' deposits in Cyprus banks, which is more than the country's GDP. Without being an expert here, I wonder whether this is an understatement; given what we think we know about the nature of much of this Russian money, is all of it really being declared as Russian?

Let me make a broader point: we've now seen three island nations around Europe become huge international banking hubs relative to their GDPs, then get into crisis because their domestic economies don't have the resources to bail out those metastasized banking systems if something goes wrong. This strongly suggests, to me at least, that we have a fundamental problem with the whole architecture (to use the preferred fancy word) of international finance.

As long as you haven't bought into the Barney-Frank-did-it school of thought, you realize that the global crisis of 2008 was in a fundamental sense made possible by the erosion of effective bank regulation. As Gary Gorton (pdf) has documented, we had a 70-year "quiet period" after the Great Depression in which advanced countries had very few major financial flare-ups; Gorton argues, and most of us agree, that the key to this quietness was a constrained, regulated financial system that also limited the opportunities for excessive non-bank leverage.

But this regulation in turn depended, to an important extent, on limited international capital flows; otherwise regulations made in Washington or elsewhere would have been bypassed via havens like, well, Cyprus. And once capital controls began to be lifted in the 1970s we entered an era of ever-bigger financial crises, starting in Latin America, then moving to Asia, and finally striking the whole world.

So what are we going to do about this? Cyprus, as a euro-zone country, should really be part of a euro-wide safety net buttressed by appropriate regulation; it's insane to imagine that the euro can be run indefinitely with merely national deposit insurance. But euro-area deposit insurance doesn't seem to be in the cards — and anyway, there are plenty of other potential Cypruses out there.

All of which raises the question, is the era of free capital movement just a bubble, fated to end one of these years, maybe soon?