Column: Lessons From The Economic Crisis

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In times when almost everyone believes that the world is flat, it would be more than contrarian not to worry about the financial disarray that is depleting Americas resources and confidence. When the world is interconnected, doesnt it follow that the richest countrys struggle will lead to an inferno everywhere else? Not quite. As economics professor Kenneth S. Rogoff recently put it in his op-ed for The Financial Times: It is almost as if the more the U.S. messes up, the more the world loves it.

Eswar Prasad, a Cornell economist, and his coauthors have found that many countries have decoupled from the global economy in the past 20 years. Their prosperity now depends much more on the situation of countries like them, not on the global market as a whole. Business cycles in the last two decades tended to have an impact on groups of countries but not on the entire world.

There is a controversy among historians regarding the origin of syphilis. Apparently, it is plausible that it was Columbus who brought it to Europe from the Americas. What some economists have argued is that Wall Streets present disease is not as transferable as one might think.

It used to be taken for granted that the worlds affluence depended on Americas financial health. On Black Monday in 1987, stock markets around the world crashed as if by coordination. Plausibly, the U.S. crisis has so far been, in medical terms, subacute, but credible signs of exacerbation might soon depress the mood of even the darkest pessimists. Sept. 29, 2008 is already featured in databases listing the most significant days in the stock markets history.

Legislation that will allow the Treasury to use $700 billion to help institutions in distress is also potent proof of the crisis gravity. Betting on the decline of selected financial firms stocks, known in finance as short-selling, is now banned in the United States and Britain. According to South China Morning Post, Chinese banks were recently told to suspend lending to U.S. financial institutions. The weak dollar caused import prices to surge by 20 percent from last year, which should have helped local enterprises; it has provided an advantage to some businesses but it also increased prices for most American consumers.

Not surprisingly, current events are almost impossible to judge rationally from the headlines. Bill Isaac, former chairman of the Federal Deposit Insurance Corporation, recently described them as a senseless destruction in the U.S. financial system and a well-known executive exclaimed on the pages of The Financial Times that Greenspans sins return to haunt us. Finger-pointing, whining and semi-fake expressions of compassion with homeowners are all mixed in print and the airwaves with serious analysis. A surefire recipe for confusion has thus emerged. Although many seem to enjoy suggesting that the present state is disastrous or worse, certainly not all have jumped on the bandwagon.

Economics professor Benjamin M. Friedman, for example, noted that had economists seen the future in early 2007, they almost certainly would have forecast a steeper downturn, with many more layoffs. That is a striking insight. It is unpopular to say that the U.S. economy is resilient when firms are failing, but what story is told by the facts? Unemployment now exceeds 6 percent in the United States but it declined by 159,000 in September. In France, for example, the unemployment rate was nine percent (or more) in nine out of the last 12 years. As the U.S. outlook worsens, it is worth remembering how other, comparable countries are performing.

Western Europe shares many characteristics with the United States, so its upcoming path will be a challenging one. But when it comes to poor countries, they are more likely to lose sleepover the rising food and other commodity prices than to suffer directly because of the evaporation of some companies in America. In fact, when Americas consumption slows down, the upward pressure on prices of scarce commodities will dwindle. Foreign countries will surely welcome appropriate restructuring of the U.S. economy (American shoppers make growth much easier in a number of countries), but they are not standing on the edge of an abyss; the world is different from two decades ago.

Although The New York Times quoted one trader as saying that you felt like the world was unraveling and another as claiming that it felt like there was no ground beneath your feet last week, bankruptcies are sometimes as inevitable as they are necessary. They ensure that when one segment of the economy grows out of proportion as the financial sector did, it will eventually shrink. That certainly does not imply the process is painless, but it is also not apocalyptic, as some market participants insist, with a healthy dose of melodrama.