The Global Meltdown, Continued

JOSEPH STIGLITZ ▪ GARY BECKER, ROGER MYERSON AND MYRON SCHOLES

Though another Great Depression seems to have been averted for the moment, great geo-economic shifts are in the works as a result of the global meltdown emanating from Wall Street. Four Nobel laureates in economics take a look at where we are headed.

STIGLITZ | Without question, it is a recognition of the reality of a genuinely multipolar world that requires moving to a genuinely multilateral system of governance. The powershift began already several years ago, under the Bush administration, when the dollar became very volatile and started declining. That is when China shifted from having almost 100 percent of its reserves in dollars to 75 percent. Some countries went completely out of the dollar. The dollar, for all intents and purposes, lost its special reserve status and people starting talking about a portfolio, or basket, approach as a store of wealth instead of the dollar.

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The Free-Market Economy Is Fundametally Healthy

At the Milken Global Conference in April, three Noble Laureates in Economics sat down to discuss the global recession. **GARY BECKER,** *awarded the Nobel Prize in 1992, is a professor of economics and sociology at the University of Chicago.* **ROGER MYERSON,** *also a professor of economics at the University of Chicago, was awarded the Nobel Prize in 2007.* **MYRON SCHOLES**, *chairman of Platinum Asset Management, was awarded the Nobel Prize in 1997.*

GARY BECKER | One of the depressing things about much of the economic commentary today is the insistent comparisons of this crisis to the Great Depression. There is no comparison.

Of 80 million homes in America today, 27 million do not have mortgages because they are fully owned. Forty-six million mortgage holders are paying on time. Only 5-6 million homeowners are behind in their payments. In the 1930s, 50 percent of homes were in serious delinquency.

In 1929, the unemployment rate was 3 percent. Four years later, it was 25 percent. The average unemployment rate throughout the 1930s was 17 percent.

Today, we started with 4.5 percent unemployment last year and now have 8.5 percent. We may go to 11 or 12. But it is hard to believe that, in the absence of foolish policies out of Washington, we will go beyond that. GDP has fallen 1-2 percent and may fall 2 percent more. It dropped nearly 20 percent in the Great Depression.

Yes, we are in a serious recession, but we should not react to it as if we are in a depression. The free-market system has great strengths. We shouldn't do anything to harm it with over-regulation or statist policies.

The patient is fundamentally healthy. And just like a human patient, the free-market economy has great recuperative power.

Even if you factor in a recession that entails a 5 percent drop in world GDP—more serious than this one, which has entailed a 2 percent drop so far—the per capita growth of the world economy over the past 20 years has been around 2.5 percent. That is unprecedented in world history. Hundreds of millions of people have been lifted out of poverty.

Of course, we must attack the weaknesses that have led to the current crisis. For example, we need binding capital-to-debt leverage ratios for banks and investment institutions that are not discretionary because, as often as not, the regulators themselves get swept up in the optimism of an upward market just like anyone else.

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ROGER MYERSON | Thankfully, this global economic recession is also not comparable to the years of the Great Depression in its geopolitical ramifications. There is certainly lots of suffering, but there are no signs, as some are concerned, it will result in the rise of militant political movements to power, like we saw with the Nazis in the wake of the German depression. In my view, the linkage between economic depression and the rise of militant powers doesn't really exist.

German fascism was more the result of the folly of international relations—namely the reparations policies of the World War I victors against Germany. We learned a lesson from that. The most comparable situation in our time was Russia in the 1990s. Because of the huge economic downturn after the end of communism, we saw the rise of radical, aggressive nationalists. There was a very real fear they might come to power. The difference was that in the 1920s and 1930s the international community sought to extract a punitive tribute from a vanquished power. Nobody was trying to do that with the former Soviet Union.

Unlike Germany, which couldn't afford the demand to pay up to 8 percent of its

GDP in reparations, post-Soviet Russia was not punished. Instead, it was offered the incentive of security and, ultimately, prosperity if it joined the global system and played by the rules. Militant powers arise in the world when people feel threatened as a nation, not because of economic suffering.

MYRON SCHOLES | Our current situation has some commonality with the Great Depression in that we have the same twin problem—a process of deleveraging and risk reduction combined with deflation and the fall in asset prices. That means we have to be able to hold asset prices steady because if asset prices continue to fall, there must be additional deleveraging of debt to stay solvent. We see this in housing, where mortgages go upside down because, when house prices fall so sharply, the amount borrowed exceeds the value of the house.

Along with the financial crisis, we also have a fall-off in consumption as people hold on to their cash in the face of an uncertain future, creating a downward cascade like during the Depression. It is not yet clear how far this will go.

It is also important to consider how we got here. Recently, Alan Greenspan said he had made a mistake in presuming that the self-interest of organizations, specifically banks, was such that they were best capable of protecting their own shareholders. I think he was a bit too fast in saying that banks and other financial entities had not taken sufficient account of their own risk.

Everyone was taking into account their own leveraging but not that of the whole system. The feedback loops worked to reinforce behavior instead of sound the warning signal.

Once we have a chance to study this crisis in more detail, I suspect we will find that many financial controls and risk-management procedures were in place in particular firms. In fact, each institution may have been myopically working to protect itself.

The problem we have had is assessing the aggregated risks for the whole system as a result of what each of the banks was taking separately. Because of this lack of coordination, we were not aware that the totality of risk was greater than each individual risk. Everyone was taking into account its own leveraging but not that of the whole system. The feedback loops worked to reinforce behavior instead of sound the warning signal.

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