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If the ascent of modern finance began in the 1980s, with “liar’s poker” on Wall Street and the City of London’s Big Bang, it ended on September 15, 2008—the day Lehman Brothers Holdings went bankrupt. Seven years on, 9/15 supplanted 9/11 as the costliest day in Wall Street’s history.

Lehman Brothers’ demise was one of seven events that, in the space of just 19 days, signaled the end of an epoch. The first, on September 7, was the nationalization of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac). On September 14 Bank of America announced that it would buy Merrill Lynch. On September 16 a money market fund, Reserve Primary, broke the buck—that is, its net asset value dropped below \$1 per share—because of losses on the unsecured commercial paper it had bought from Lehman. That same day the Federal Reserve agreed to give AIG \$85 billion to avoid a lethal chain reaction if the insurance giant couldn’t meet its obligations on the credit default swaps

it had sold to banks. Nationalization in this case took the form of a warrant to the Federal Reserve for 79.9% of the company’s equity. On September 22 the investment bank became an extinct species when Goldman Sachs and Morgan Stanley converted themselves into bank holding companies. Finally, on September 25, Washington Mutual Bank was seized by the Office of Thrift Supervision and placed into the receivership of the Federal Deposit Insurance Corporation—marking the biggest bank failure in America’s history.

Although the crisis began nearly two years ago, September 2008 was the month American finance fell off a cliff. What will be the long-term impact on the U.S. economy and the global financial system?

From Crisis to Breakdown

Imagine the worst-case scenario: The current recession turns out to be another great depression. The one that began in August 1929 lasted 43 months, according to the U.S. National Bureau of Economic Research. However, the first

great depression, which only historians now remember, began with the Panic of 1873 and lingered for 65 months. If the U.S. economy keeps shrinking that long, there won't be a sustained recovery until after May 2013.

Fast-forward to 2013. The government-owned Citibank of America, formed by the forced merger and nationalization of the United States' two biggest banks, now dominates retail banking. The number of U.S. banks has fallen by half, from 8,534 in 2007. There are just 3,000 hedge funds all over the world—less than a third of the precrisis total. The regulatory framework that was imposed by Treasury Secretary Timothy Geithner in the previous four years has completely changed the financial landscape. With new restrictions on executive compensation, bank capitalization, and derivatives trading, retail banking has become more like a public utility. Even nonbank entities like hedge funds and insurance companies have to operate under the unsleeping eye of the new Financial Authority for the Regulation of Systemic Institutions (FARSI).

Despite FARSI's extensive powers, the U.S. government is still grappling with the fiscal legacy of the crisis. The federal debt is now around \$20 trillion—\$3 trillion higher than the Obama administration forecast in its 2009 budget. The top income tax rate is 45%. The S&P 500 is down to 418, where it was in December 1991—a decline comparable to that between 1929 and 1934. The United States, it appears, is stuck in the middle of its own lost decade, with real GDP having grown by barely 1% per annum since 2010.

We started out calling it the Subprime Crisis. It quickly became the Credit Crunch and then the Global Financial Crisis. By 2013 a new name has stuck: the Breakdown.

The breakdown of the American colossus has fundamentally altered the international economic order. China's GDP in 2013 is half that of the United States; in 2006 it was only one-fifth as big. The U.S. dollar has halved in value against the Chinese yuan following a Russo-Chinese initiative to replace the greenback as the international reserve currency with the International Monetary Fund's Special Drawing Rights (SDRs, pronounced "sadders"). Oil, for instance, is priced in SDRs.

For the newly elected U.S. president, Jeb Bush, who defeated Sarah Palin for the Republican nomination in 2012, the time has finally

come to Put America First. Treasury Secretary John Paulson says he is optimistic about his negotiations with the IMF to repay the 150 billion SDR loan negotiated by his predecessor. An investor in gold mines all over the world, Paulson is enthusiastic about the president's plan to return the United States to the gold standard. At the G4's latest meeting, the Brazilian, Russian, Indian, and Chinese foreign ministers unite to condemn Commerce Secretary Lou Dobbs's latest round of tariffs on imported apparel and automobiles.

Meanwhile, Defense Secretary Max Boot confirms that U.S. "R" (for robot) forces will continue to be deployed in the radioactive zone around Bushehr as part of Operation Iranian Freedom, launched by the new Bush administration to support Israel's recent strikes on Iran's nuclear facilities. With unemployment stuck at 12%, many Americans are excited by the military successes in Iran; the Islamic Republic inflicted several humiliations on President Obama's administration after his disastrous visit to Tehran in 2010. However, people are more nervous about the naval clashes between American and Chinese forces in the South China Sea.

If this scenario strikes you as too pessimistic, think again. From 1929 to 1933 the stock market rallied several times on the long way down to the bottom. In fact, the Dow Jones Industrial Average moved up by at least 2% on 15% of the trading days between October 1929 and December 1932; on 34 trading days it rose by more than 5%. True, post-World War II recessions, on average, have lasted only 10 months from peak to trough, but the present crisis is no average recession.

Back to the 1870s

One hopeful possibility is that this recession will be no worse than the two worst recessions since 1945: those of 1973–1975 and 1981–1982. If that's the case, a recovery should be under way by the time this article is published. But consider another scenario: Suppose this recession resembles neither the Great Depression of 1929–1933 nor the big recession of 1973–1975 but is more like the Long Deflation of the late nineteenth century. That one began after the financial panic of October 1873 and dragged on until March 1879. Although it was more protracted than the 1930s depression, the 1870s slump was less painful. In 1873, as in 2008, the

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trouble began with a monetary policy misstep. The government demonetized silver, saying that only gold could be used to back banknotes. The deflationary effects proved unpopular, particularly with indebted farmers. A technological and construction boom in the form of railroads was coming to an end. A major bank failure signaled the beginning of the panic: Philadelphia-based Jay Cooke & Company blew up. There was a sell-off on Wall Street, though it was a steady slide rather than a nosedive. From the peak in May 1872 to the trough in June 1877, stocks slowly declined by 47%. Then as now, the crisis was global, with the American crash coming just five months after collapses in Berlin and Vienna.

The contraction in output was smaller in the 1870s than in the 1930s. In fact, 1874 was the only year during that depression in which U.S. real GDP declined. By 1877 production was 12% higher than it had been in 1872. There were two reasons for this: One, grain production in the Midwest and steel production in the Northeast were both soaring. Moreover, continued growth in the number of banks ensured that money supply didn't contract. Two, the crisis didn't lead to the breakdown of globalization. Many countries raised tariffs in the late 1870s, but they didn't impose restrictions on capital flows or migration. Trade wasn't significantly impeded; indeed, it received a boost as railroad lines were further extended and oceangoing steamships became more efficient. Nor did foreign investors lose their appetite for U.S. bonds and stocks.

A long deflation like that of the 1870s? A great depression like that of the 1930s? Or a big recession like that of the 1970s? It all depends on what matters more: the burden of debt and falling asset values, or easy-money policies and fiscal stimuli.

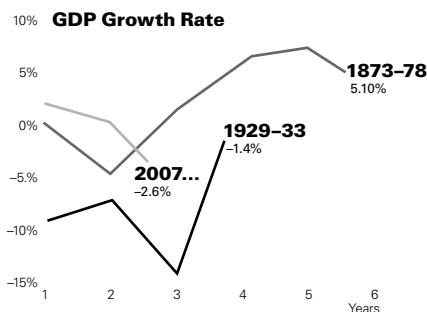
Who Will Buy the Bonds?

At the heart of this crisis are overleveraged bank balance sheets—to be precise, excessively high ratios of liabilities or assets to bank capital. For most of the eighteenth and nineteenth centuries and well into the twentieth, bank lending was held in check by rules about deposit volumes, minimum reserve requirements, and the risk of a run. Since the late twentieth century, however, banks have expanded their balance sheets by borrowing from one another or from the commercial paper market.

A hundred years ago a typical European bank's assets-to-capital ratio was 4:1; by the 1970s bankers regarded a 10:1 or 12:1 ratio as prudent. But over the past two decades such ratios have risen. Take the U.S. investment banks. From 1993 to 2002 the average leverage ratio—assets divided by equity capital—was 21 for Morgan Stanley, 24 for Goldman Sachs, 27 for Merrill Lynch, and 32 for Bear Stearns, according to Robert Lockner, of Chapman and Cutler LLP. By 2006 those figures had risen to as high as 33 for Morgan Stanley, 26 for Goldman Sachs, 32 for Merrill Lynch, and 34 for Bear Stearns. Thus in four years these four investment banks went from having assets that were, on average, 26 times their capital to assets that were 31 times their capital. They weren't the only financial institutions gearing up: Debt exploded in the U.S. financial sector from 16% of GDP in 1976 to 116% of GDP in 2007.

Common sense tells us that borrowing on such a scale is risky. When a bank has an assets-to-capital ratio of 25:1, a relatively small decline in asset values—say, 4%—can wipe out its equity. However, sophisticated measures such as risk-weighted assets divided by tier one capital, or value at risk relative to equity, concealed the banks' vulnerability by their very intricacy.

Will this financial crisis be more like the Great Depression that began in 1929 and lasted 43 months, or the one that began in 1873?



The depression of the 1870s lasted 65 months, but it was less painful.

The banks also massaged their ratios by using off-balance-sheet vehicles (see the UK Financial Services Authority's report *The Turner Review: A Regulatory Response to the Global Banking Crisis*, March 2009). The crisis exposed all those accounting tricks. For instance, in September 2008 Bank of America's leverage ratio was 73.7:1; in other words, its capital was just 1.4% of its assets. If the bank's off-balance-sheet commitments were included, its leverage ratio was a staggering 134:1, according to Bridgewater Financial Group.

The global banking regulatory framework known as Basel II—published in 2004 but not universally adopted when the financial crisis struck—draws distinctions between credit risk, operational risk, and market risk. Ironically, those norms combine liquidity risk with other kinds under the heading of residual risk. However, with banks so highly leveraged, the risk of a liquidity crisis turned out to be anything but residual. When interbank lending choked up in August 2007, the effects were disastrous. Sources of short-term finance, including commercial paper, dried up; securitization all but ceased; and a range of assets secured on subprime mortgages plummeted in value. In weeks the liquidity crisis became a solvency

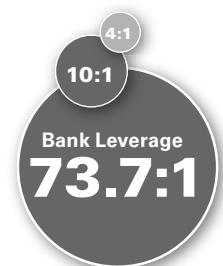
crisis, claiming Bear Stearns as its first victim.

Will the measures taken by the U.S. government restart credit creation or end up impeding a recovery? The Federal Reserve has effectively cut its minimum lending rate to zero. In conjunction with the Treasury Department and the overstretched FDIC, it has provided financial institutions with about \$10 trillion worth of loans, capital injections, and guarantees. The Federal Reserve's Term Asset-Backed Securities Loan Facility has committed up to \$1 trillion to revive the loan securitization process and to help finance the purchase of mortgage-backed securities. And the Public-Private Investment Program is supposed to create a market for old mortgages and mortgage-backed securities. (After the auction of a bundle of mortgages has established the buyer and the price, the Treasury will invest a dollar of taxpayers' money for every dollar of private capital. In addition, the FDIC will lend up to \$12 for every dollar of private capital.) Compared with these measures, the Obama administration's \$787 billion fiscal stimulus seems like small beer, especially since the spending is spread over three years. Even less significant is the paltry \$75 billion set aside under the Homeowner Affordability and Stability Plan to reduce some households' interest payments on mortgages.

Whatever their economic impact, one consequence of these new expenditures will be a huge increase in the federal government's budget deficit, which at the time of the writing of this article was expected to exceed 12% of GDP in 2009 or 44% of total outlays. Not since World War II has the gap between government expenditures and revenues been so wide. Despite its exceedingly optimistic GDP growth forecasts—1.5% in 2010, 4.2% in 2011, 4.4% in 2012, and 4.1% in 2013—the Obama administration projects that the federal debt will rise from \$10 trillion (89% of GDP) in 2009 to \$23 trillion (101% of GDP) by 2019. If those expectations are belied, and the U.S. economy grows at an average of only 1% a year over the next decade, the federal debt will soar to 146% of GDP by 2019.

The mystery is who will buy \$1.75 trillion worth of freshly printed U.S. government bonds in 2009—to say nothing of the trillions of dollars' worth to come in future years. Non-Americans own about 60% of the outstanding Treasury debt, having bought 75% of new bond issues over the past five years. But foreign de-

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In September 2008 Bank of America's leverage ratio was 73.7:1.

mand for Treasuries is falling as other nations' current account surpluses shrink. According to Deutsche Bank, China will increase its reserves by no more than \$100 billion this year, less than a quarter of last year's total, and only a fraction of that will be invested in dollar-denominated bonds.

A dramatic rise in the U.S. personal savings rate could create a domestic appetite for bonds. Although the savings rate fell below zero in 2005, it averaged 7% of GDP in the 1980s. However, a reversion to traditional American thrift would cause other headaches for policy makers desperate to rekindle consumption. A more likely scenario is that the Federal Reserve will absorb a substantial proportion of the new bonds. Indeed, the March 2009 announcement that the central bank would buy \$300 billion worth of longer-term Treasury securities over the next six months confirmed that another consequence of current fiscal policy would be the printing of dollars by the Federal Reserve.

The administration is betting that the combination of the Federal Reserve's "quantitative easing" of monetary policy and the Treasury's fiscal stimulus will bring about a recovery by 2010. But we live in a globalized world, where governments' varying monetary and fiscal stimuli are more likely to generate bond market volatility and exchange rate fluctuations than to guarantee a return to growth. It seems doubtful that the only solution to a crisis caused by excessive private leverage is the creation of more public debt. Moreover—as became apparent in Britain in March 2009, when the governor of the Bank of England essentially vetoed further fiscal stimulus by the government—monetary policy and fiscal measures can be in conflict. If large deficits push down bond prices, raising long-term interest rates, the Federal Reserve will have no option but to increase purchases of Treasuries. In the process, it could overdo monetary expansion and thereby arouse fears of future inflation, increasing the upward pressure on interest rates.

The Future of the Greenback

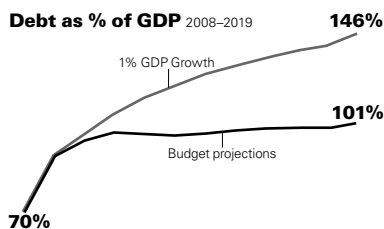
A number of politicians have claimed that today's financial crisis signals the end of U.S. power. "One thing seems probable to me," declared Germany's finance minister, Peer Steinbrück, last year. "The U.S. will lose its status as the superpower of the global financial sys-

tem." Russia's prime minister, Vladimir Putin, spoke in January 2009 of "a serious malfunction in the very system of global economic growth—namely, when one regional center endlessly prints money and reaps the benefits." Though more muted in his criticism, China's premier, Wen Jiabao, delivered a similar message when he declared, "The crisis has fully exposed the existing international financial system and governance structure defects."

Central to globalization as it has evolved over the past decade has been Chimerica—the symbiotic relationship between China and the United States. For a time, this seemed to be a marriage made in heaven. The Chinese did the exporting, the Americans the importing. The Chinese did the saving, the Americans the spending. The Chinese ran a trade surplus, the Americans a current account deficit. The Chinese intervened to keep the renminbi from appreciating; the Americans sold them around a trillion dollars' worth of dollar-denominated bonds.

The crisis has called this economic marriage into question. In March 2009 Wen Jiabao made his concerns explicit. "We have lent a

The government has projected that federal debt will rise to 101% of GDP by 2019,



but if the economy grows at just 1% a year, debt will soar to 146% of GDP.

That will arouse fears of inflation and push interest rates up.

huge amount of money to the United States,” he observed. “Of course we are concerned about the safety of our assets....I request the U.S. to maintain its good credit, to honor its promises, and to guarantee the safety of China’s assets.” Ten days later the governor of the People’s Bank of China, Zhou Xiaochuan, suggested that the IMF’s SDR replace the U.S. dollar as the world’s reserve currency. The aim, he said, would be to create a reserve currency that is “disconnected from individual nations and is able to remain stable in the long run, thus removing the inherent deficiencies caused by using credit-based national currencies.”

Has Chimerica turned out, as the term has always implied, to be a chimera? It’s tempting to think so. After all, the British pound lost its primacy among the world’s currencies after World War II because of excessive debt and slow growth. With America’s debt spiraling upward and its long-term growth rate falling, the dollar could follow the pound into the category of former reserve currencies. The U.S. would then lose the convenient ability—exploited since the 1960s—to borrow from foreigners in its own currency.

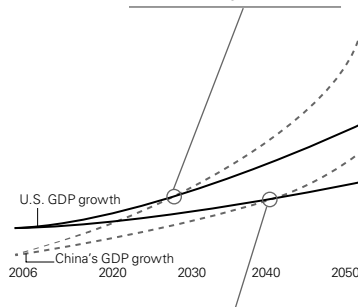
In addition, if over the next four years China maintains an average growth rate of more than 6% and the United States suffers low to zero growth, the moment when the Chinese economy overtakes America’s might come sooner than expected. Goldman Sachs, which predicted in 2001 that China’s GDP might equal that of the United States by 2040, recently brought that date forward to 2027. With China relying less on exports to the United States and caring less about pegging the renminbi to the dollar, Chimerica could quickly end in a divorce. The balance of global power would shift. No longer committed to the friendship with America that was established in 1972, China would be free to create other spheres of global influence, from the Shanghai Cooperation Organisation, of which Russia is also a member, to its nascent empire in commodity-rich Africa.

Yet there are reasons to question the notion that the crisis will undermine U.S. global economic power. For a currency whose demise economists have been predicting for the better part of a decade, the dollar is in remarkably rude health. After a period of weakening from February 2002 to March 2008, when the real trade-weighted exchange index declined by 25%, the dollar rallied as the crisis turned into a panic. Admittedly, this was the result of more than a flight to safety by global investors. Many, especially the Chinese, had been borrowing in dollars, expecting the currency to depreciate. The crisis sparked a scramble for dollar liquidity as lenders declined to roll over debt, and borrowers reacted by buying dollars to repay the debt before its value rose. The Chinese authorities’ decision in late 2008 to restore the renminbi-dollar peg also played a role in pushing up the dollar.

Nevertheless, the financial crisis has reaffirmed the dollar’s centrality to the global system. It’s possible that we will see some weakening of the currency this year. But it’s far from certain that a dollar rout will materialize. After all, there is no clear alternative to the dollar. There are practical obstacles to switching to SDRs, which exist as an accounting device used by only a few international institutions. So any weakening of the dollar will be more obvious against commodities than against other currencies.

Moreover, because the present crisis will reduce China’s rate of growth more than Amer-

Goldman Sachs recently predicted that China’s GDP might equal that of the United States by 2027.



But if China’s growth falls to 6% and America’s to 1%, that won’t happen until 2040.

ica's, it may delay the moment at which China's economy becomes bigger than the U.S. economy. If the IMF is correct, by the end of 2009 the U.S. growth rate will be 4.6 percentage points lower than the growth rate in 2007, while China's growth rate will have declined by 6.3 percentage points. If, say, the long-run growth rate of the U.S. economy falls to 1% and that of the Chinese economy declines to 6%, China won't overtake the United States until 2040.

The most important point to grasp about today's financial crisis is that it is a global crisis—and, indeed, a crisis of globalization. There hasn't been such a dramatic decline in worldwide industrial production since 1973–1974; if the present trend persists, the contraction will be even greater. Strikingly, world trade has collapsed by more than 25% in less than a quarter, which bears comparison with the early 1930s. Yet the global economy's breakdown hurts other nations more than the United States. For that reason, the dollar has a good chance of retaining its stature despite the U.S. government's prodigious monetary and fiscal laxity. America's reputation as a safe haven makes it possible for it to run bigger deficits and to print more money at lower cost than any other country on the planet.

It's unfair that a crisis so obviously American in origin has a more severe impact on the rest of the world than it has on the United States itself. But that's the world in which we live—and will continue to live.

The World in Crisis

Confounding the claim that emerging markets had decoupled themselves from the United States, the collapse of U.S. consumer confidence has combined with a financial crisis in Western Europe to cause the worst global recession since World War II. In 2009 world output may contract for the first time in 60 years, according to the IMF, by 0.5% to 1%. The United States may suffer a 2.6% decline in output in 2009, but the euro zone's GDP could shrink by 3.2% and Japan's by as much as 5.8%. Even China may see its growth rate cut in half.

The crisis has affected Japan and newly industrialized Asia the most because their economies rely so heavily on exports, which have declined sharply. Japan's exports fell by a staggering 49% in the 12 months leading up to February 2009; its industrial production de-

clined by 31%. Taiwan's exports declined by 42%, and its GDP by 32%; South Korea's exports and GDP fell by 33% and 21% respectively, and Singapore's by 21% and 17%. China's official growth figures probably overstate the extent to which it is coping with the slowdown. Its exports were down by 26% in the year to February 2009, and the fact that imports were down almost as much suggests a steep decline in industrial output.

Meanwhile, the problem of bank leverage is smaller in the United States than in Europe. At 12:1, the average leverage ratio of U.S. banks in 2008 compared favorably with the average ratios of 24:1 in Britain, 28:1 in France and Denmark, 29:1 in Switzerland, and 52:1 in Germany. The IMF says that European banks have about 75% as much exposure to toxic American assets as U.S. banks do, but European write-downs have been far less than that figure implies.

Europe's biggest problem is that its banks have greater exposure to the world's most vulnerable regions—East Asia and Eastern Europe—than U.S. banks do. Western European banks are owed roughly 54% of the total of foreign bank loans to emerging economies in Asia and no less than 70% of the \$1.8 trillion of foreign loans to Eastern Europe. Austrian banks alone have lent about \$300 billion to Eastern Europe—the equivalent of 68% of Austria's GDP. Some countries, including Hungary, have seen their currencies plummet, while in others, such as Ukraine, the default risk premium on bonds has soared. The situation increasingly resembles a 1980s Latin American debt crisis, only this time Western Europe, not the United States, must deal with it.

Governments have recently fallen in Latvia, Hungary, and the Czech Republic, but Western European leaders are divided about how to respond. The Germans, in particular, cling to the notion that they are more fiscally virtuous than the Americans, and have no desire to commit their taxpayers' money to a general Eastern European bailout. It's hard to imagine, however, that they will idly watch while a European Union member goes into default.

Because the crisis has affected some EU members more than others, Europe is suffering a crisis of divergence. Britain, Belgium, and Ireland have major banking problems, but others don't. Greece, Portugal, and Spain have been running large current account deficits,

The financial crisis has reaffirmed that the U.S. dollar is central to the global system. It may weaken, but it's far from certain that a rout will materialize. There is no clear alternative to the dollar.

but Austria, Germany, and the Netherlands are running surpluses. Monetary policy may be uniform throughout the euro zone, but there isn't a European treasury that can coordinate a fiscal stimulus. The extent of fiscal divergence is striking. For instance, Italy, Greece, and Belgium are saddled with debt-to-GDP ratios of 80% to 100%, which greatly limit their room for maneuver. These centrifugal forces are manifesting themselves in widening bond yield spreads and credit default swap spreads. It's highly unlikely that the euro zone will break up (the costs of leaving are prohibitively high), but friction will increase within Europe, especially between euro-zone members and nonmembers.

One unnerving aspect of this crisis is that it's hurting America's allies more than its rivals. Think of the hardest-hit countries: East Asian exporters and Eastern Europe's new democracies. And remember what Vladimir Putin said

in January 2009: "Let us be frank: Provoking military-political instability and other regional conflicts is also a convenient way of deflecting people's attention from mounting social and economic problems. Regrettably, further attempts of this kind cannot be ruled out." Having invaded Georgia last year, Russia has signaled its intention to test the Obama administration with several aggressive moves. It is planning to set up Black Sea bases in breakaway Abkhazia; it has signed an air defense treaty with Belarus; and it paid Kyrgyzstan to oust the United States from its Manas air base. This saber rattling is likely to continue.

America the Safe Haven

Will this financial crisis make the world more dangerous as well as poorer? The answer is almost certainly yes. Apart from the usual trouble spots—Afghanistan, Congo, Gaza, Iraq, Lebanon, Pakistan, Somalia, and Sudan—expect new outbreaks of instability in countries we thought had made it to democracy. In Asia, Thailand may be the most vulnerable. At the end of 2007 it reverted to democracy after a spell of military rule that was supposed to crack down on corruption. Within a year's time the country was in chaos, with protesters blocking Bangkok's streets and the state banning the People's Power Party. In April 2009 the capital descended into anarchy as rival yellow-shirted and red-shirted political factions battled with the military.

Expect similar scenes in other emerging markets. Trouble has already begun in Georgia and Moldova. Then there's Ukraine, where economic collapse threatens to trigger political disintegration. While President Viktor Yushchenko leans toward Europe, his ally-turned-rival Prime Minister Yulia Tymoshenko favors a Russian orientation. Their differences reflect a widening gap between the country's predominantly Ukrainian west and predominantly Russian east. Meanwhile, in Moscow, Putin talks menacingly of "ridding the Ukrainian people of all sorts of swindlers and bribe-takers." The Crimean peninsula, with its ethnic Russian majority, is the part of the "Near Abroad" (the former Soviet Union) that Putin most covets. January's wrangle over gas supplies to Western Europe may have been the first phase of a Russian bid to destabilize, if not to break up, Ukraine.

2013 Two Scenarios

If the current crisis turns out to be another great depression, the left-hand scenario may come to pass. If not, the picture may look somewhat more familiar.

U.S. PRESIDENT	
Jeb Bush	Barack Obama
U.S. ECONOMY	
The recession continues.	The recession is only a painful memory.
U.S. BANKS	
The number of banks has halved.	Many new banks have appeared.
TOP INCOME TAX RATE	
45%	35%
S&P 500 HIGH	
418	976
U.S. FEDERAL DEBT	
\$20 trillion	\$17 trillion

The world's increasing instability makes the United States seem more attractive not only as a safe haven but also as a global policeman. Many people spent the years from 2001 to 2008 complaining about U.S. interventions overseas. But if the financial crisis turns up the heat in old hot spots and creates new ones at either end of Eurasia, the world may spend the next eight years wishing for more, not fewer, U.S. interventions.

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Perhaps we should revisit 2013 against this background. The outlook for the United States appears less apocalyptic than we first feared. In this asymmetric world, where everywhere else seems more dangerous and unpredictable than America, the consequences of the crisis are less terrible than those of the Great Depression. In this better-case 2013, the recession of 2007–2009 is a receding if still painful memory. We are over the Breakdown. Those who feared that Federal Reserve Chairman Ben Bernanke's policy of quantitative easing would lead to inflation have been proved wrong: Prices have barely changed since 2009, despite the central bank's best efforts. Thankfully, there hasn't been severe deflation either.

Following the Obama administration's reluctant decision to take Bank of America and Citigroup into "conservatorship," the banks' balance-sheet problems have finally been resolved. The government has sold off toxic assets at realistic prices, and bondholders, bowing to the inevitable, have accepted equity in the new entities created when the ailing financial giants were broken up and privatized. A remarkable number of new banks have appeared, offering financial services on an altogether different basis: minimum leverage and maximum attention to client relationships. The return to the fore of long-established names like Rothschild and Lazard confirms the enduring strength of that tried-and-true formula. Meanwhile, a number of the hedge funds that survived the crisis have

morphed into institutions very like the old investment banks. Bridgewater, Paulson, Renaissance, and Shaw are the new bulge bracket names on Wall Street.

The regulatory framework proposed by Treasury Secretary Timothy Geithner in 2009 has proved surprisingly successful. Rather than focusing on executive compensation, he told the banks to abide by a new rule: Assets should never exceed capital by more than a factor of 20, and during good times the target ratio should be closer to 15:1. As predicted in the 2009 government budget, the gross federal debt has risen to 98% of GDP in 2013. But the relatively strong growth of the previous four years has reassured investors that the United States hasn't gone the way of the Latin American economies. The top income tax rate is 35%. The S&P 500 is at 976, as stocks slowly claw their way back from the nadir of October 2009. The dollar is stable at 6.8 yuan.

Following the recovery of Asian exports to the United States, talk of replacing the dollar with the SDR has fizzled out. As Luo Ping, a director-general at the China Banking Regulatory Commission, said back in February 2009: "Except for U.S. Treasuries, what can you hold? Gold? You don't hold Japanese government bonds or UK bonds. U.S. Treasuries are the safe haven...We hate you guys...but there is nothing much we can do."

In 1886, in the middle of the Long Deflation that followed the 1873 crash, Germany's Iron Chancellor, Otto von Bismarck, famously remarked, "God has a special providence for fools, drunks, and the United States of America." With just a bit of luck, that may turn out to be still true.

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