

## *The Economy in Perspective*

*Two thumbs up* ... Judging by the pandemonium breaking loose in financial markets and the headline coverage it is receiving, one would think the world as we knew it had come to an end. Well, in a way it has, because the world as we knew it had come to be regarded as one of infallible progress and unbounded prosperity. The world as we knew it had become an economic utopia, the promised land where debtors never default, recessions no longer happen, and nations can expand output at high rates forever. World economic prowess had become a tale of epic proportions, a story never before told, a fasten-your-seat-belt blockbuster.

There is little question that profound scientific, industrial, and political forces are at work around the globe, creating the elements of large-scale drama. The silicon chip is to today's economy what the combustion engine and electric motor were to previous epochs. With Europe uniting, the Soviet Union disintegrating, Southeast Asia transforming, and China emerging, it is undeniable that the future of human civilization around the globe offers many intriguing plot lines. Among these, of course, is the happy prospect of unprecedented global prosperity.

Now *here* is a heartwarming script if ever there was one, and very marketable too. After decades of Cold War espionage thrillers, atrocity chillers, and New Age terrorist dramas, the time had come for a feel-good story. What could appeal more to the "me generation" than a plot that makes this global rags-to-riches tale come true within our lifetime, before our very eyes? Not only that, but how about making the world safe for democracy by transforming the whole world into a democracy? What an image: Developing nations tumbling to free-market economics as easily as we once imagined them falling like dominos to Communism!

The economic world as it had come to be imagined made for good box office, but its run has ended. The world economy as it actually exists is a far less predictable and comfortable place than that dreamy celluloid depiction. What made that show such a hit was people's very human tendency to fantasize about life, confounding what

we wish reality to be with reality itself, forgetting that movies regularly rely on stunt doubles and special effects. Economic booms and busts arise mostly from human fallibility, which creates scenes that cannot simply be re-shot when the action disappoints the director's vision.

Monetary policymakers, like everyone else, would prefer light-hearted scripts and happy endings. But while others have license to suspend disbelief and reach for the popcorn as the lights dim, policymakers do not. They can't get so comfortable in their seats that they forget to be skeptical about what they are viewing. Americans sometimes regard this skepticism warily, as one might look askance at the fellow who doesn't cheer with the rest of the audience. And, yes, central bankers can become so self-conscious about not enjoying the show that they lose their objectivity and succumb to human error, too.

The Federal Reserve has not been following the script consistently throughout this economic expansion. Early on, the Fed fostered monetary conditions that were initially thought to be too easy for an inflation fighter. During 1994, according to those in the mainstream, it tightened too much and too quickly. Yet, the expansion unfolded and inflation did not accelerate. According to conventional wisdom, the Fed should have tightened policy throughout 1996 to head off inflationary pressures. But the Fed did not follow conventional wisdom, the expansion's tempo quickened, and the expected pressures failed to materialize. When the Chairman of the Federal Reserve Board spoke of irrational exuberance in the stock market, he was "shushed" for talking too loudly just as the action was reaching fever pitch.

Right now, according to the script, the Federal Reserve should be easing monetary policy aggressively to combat a global economic Armageddon. The next scene calls for our central-bank action heroes to bring law and order to Russia, reinvigorate Asia, and protect Latin America, all without letting the U.S. economy miss a beat. That's a tall order for any movie star. Come to think of it, though, people have gotten used to seeing a few villains left standing when the picture ends; they know that a sequel is already on the way.