The Lost Lesson of the Financial Crisis
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LONDON – Ten years ago this month, the French bank BNP Paribas decided to limit investors’ access to the money they had deposited in three funds. It was the first loud signal of the financial stress that would, a year later, send the global economy into a tailspin. Yet the massive economic and financial dislocations that would come to a boil in late 2008 and continue through early 2009 – which brought the world to the brink of a devastating multi-year depression – took policymakers in advanced economies completely by surprise. They had clearly not paid enough attention to the lessons of crises in the emerging world.

Anyone who has experienced or studied developing-country financial crises will be painfully aware of their defining features. For starters, as the late Rüdiger Dornbusch argued, financial crises can take a long time to develop, but once they erupt, they tend to spread rapidly, widely, violently, and (seemingly) indiscriminately.

In this process of cascading failures, overall financial conditions quickly flip from feast to famine. Private credit factories that seemed indestructible are brought to their knees, and central banks and governments are confronted with tough, inherently uncertain policy choices. Moreover, policymakers also have to account for the risk of a “sudden stop” to economic activity, which can devastate employment, trade, and investment.

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