EDITORIAL DESK

A Crisis Without A Reform

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At this time last year it seemed as if the global economy was hanging by a thread. Russia was defaulting on its debt, the first emerging market to do so since the Asian crisis had begun. The world's largest hedge fund, Long-Term Capital Management, was hemorrhaging badly and would soon require a $3.5 billion bailout. And the Federal Reserve was preparing to lower interest rates to keep the world financial system from imploding.

What a difference a year makes.

Or does it? Yes, the American economy is still booming, Europe is gaining some steam, and even several emerging markets like South Korea and Mexico seem to be on the mend. It would be easy to conclude that what President Clinton, in a speech last fall, called the worst financial crisis in 50 years was vastly overblown. It's a short jump from that to believing that whatever big problems existed have been more or less fixed. But this line of reasoning would be seriously flawed.

The fact is that although millions of people in emerging markets have suffered horribly -- losing their jobs, going bankrupt, sinking into poverty -- the crisis wasn't long enough or deep enough to result in the kinds of corrective measures that would result in a less risky global economy. Indeed, little of a fundamental nature has changed, and in some respects the environment is more fragile today.

Let's review why this August looks so much better than a year ago. The Fed's exquisitely timed interest rate reductions last summer and fall were, collectively, the turning point in the crisis. But we had a lot of luck, too. The Asian crisis hit when our economy was in exceptionally good shape, breaking records for price stability and job creation in the midst of a long consumer-led boom that was simply too powerful to derail. And Wall Street trusted Alan Greenspan, Robert Rubin and Lawrence Summers, Mr. Rubin's deputy and eventual successor as Treasury Secretary.

We were also lucky that foreign money returned to Asia with lightning speed. This was in marked contrast to the 10 years it took for bankers to resume lending to Latin America during the debt crisis of the 1980's. Finally, the International Monetary Fund played a role with its austerity packages, but in reality, soon after most emerging nations agreed to belt-tightening, they started to return to their old free-spending ways.

None of these developments were accompanied by fundamental reforms. The cries for "a new financial architecture" were forgotten even before there was any echo. "Crony capitalism" in emerging nations is alive and well. While leaders of these countries understand the need for sound banking regulation -- the lack of which was a cause of the crisis -- it will take many years to reach Western standards. The same goes for bankruptcy laws and other necessary foundations for modern capitalism.

There have been no big changes on the global level, either, and last year's debates have lost their intensity. Should short-term speculations by foreign investors in emerging markets be controlled? Should private lenders be obligated to help bail out the countries to which they lent too much?

Last winter, I interviewed 20 top officials on Wall Street and in Washington to get their views on what caused the financial debacle and how to deal with it. They didn't agree on much, except on one point: we are in for a series of financial crises over the next several years. Why? The global system is no stronger than its weakest links. And there are plenty of them, from Japan, with its sky-high debts, to the tension-ridden emerging countries that are trying to move from closed to open societies. The executives pointed to widening regulatory gaps as the movement of money outpaced governments' ability to supervise the system.

No one I interviewed would even dare guess when and how the next crisis will arise. But the most worrisome set of circumstances relates to the United States, which for the last few years has been single-handedly supporting the world economy. Perhaps recent tremors in many public Internet-related companies -- 40 percent of which were trading below their initial offering price earlier this month -- are telling us something about the sustainability of our soaring market. Or, could it be that the recent downward pressure on the dollar -- stemming from our soaring trade deficits, or the fact that American investors are moving big money to Europe and elsewhere -- is a sign that something is amiss? There is also the bond market, where prices have been dropping and rates moving up.

Most important, a weak dollar and a tightening labor market may cause the Fed to increase interest rates for a second time this summer when it meets on Tuesday, or perhaps at its next meeting this fall. If this trend continues, it could spook the market rather than steady it, and stifle consumer confidence. A receding tide could expose many problems that have been camouflaged by our sustained growth, like enormous consumer debt or the continued growth of risky, unregulated hedge funds.

There are also some glaring weak spots abroad. For the past few years China helpfully kept its currency steady, becoming a big island of stability among emerging markets. But now it is flirting with devaluation, a move that could jeopardize the fragile recoveries of its neighbors by undercutting the prices of their exports. Argentina, until recently a pillar of strength in South America, is projecting negative growth of 3.5 percent this year. These are not huge economies. But remember that the last crisis began in Thailand.

The point is not to add up everything that could go wrong, but to recognize that globalization implies that everyone and everything is more closely connected than ever before, but on a foundation that is still shaky.

Of course, like last year at this time, our luck may hold. But it's like playing Russian roulette with some additional bullets loaded in the chamber.

Drawing (Brian Cronin)