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Five Surprises of the Great Recession

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SUMMARY

- The Great Recession included five major surprises: (1) the severity of the global trade and output collapse, (2) the United States suffered a milder than expected recession, (3) Europe saw the onset of a severe sovereign debt crisis, (4) China grew at an extraordinary rate even though it's greatly dependent on exports, and (5) Latin America showed remarkable resilience.
- Each of the five surprises teaches policy makers critical lessons ranging from the need to rein in unbridled risk-taking in the financial sector, to the importance of a vigorous response from the private sector to crises, to the importance of quickly re-establishing sound macroeconomic fundamentals. Beyond the generally applied lessons, the surprises also hold lessons for specific regions, notably the need for reforms to strengthen the institutional mechanisms underpinning the Euro area.
- While governments reacted quickly and appropriately with stimulus measures and bank rescues to prevent a descent into depression, they unfortunately have not acted forcefully enough on the lessons emerging from the five surprises. In particular, leaders have failed to enact the structural and regulatory reforms needed to protect the world against the next crisis.

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The Great Recession was the mother of all surprises. Late in 2008, the "Great Moderation"—the supposed end to economic volatility worldwide—suddenly morphed into the deepest global recession since the 1930s.

At least four other big surprises followed, which provided a stark demonstration of the limitations of our understanding of financial crises: the United States, despite having been at the epicenter of the crisis, experienced a relatively shallow recession; Europe, which initially appeared to be an innocent bystander, went through a more severe downturn than any region and remains mired in a sovereign debt crisis; China, despite being heavily export-dependent, grew at an extraordinary rate throughout the crisis; and Latin America, which had previously suffered disproportionately from global recessions, showed remarkable resilience.

Surprises are a terrible thing to waste: examining them can yield valuable policy lessons. In this brief we explore the five surprises of the Great Recession and identify the policy lessons they teach. We also examine the extent to which the reforms enacted to date reflect these lessons. While governments reacted quickly with stimulus and bank rescue measures to prevent a descent into depression, they have been much more timid in enacting the politically tougher structural reforms needed to protect against the next crisis.

FIRST SURPRISE: GLOBAL COLLAPSE

With the benefit of hindsight, one can clearly see that the Great Recession conformed to a familiar pattern. Just like the Great Depression and the oil shocks and deep recessions of the 1970s, the 2008 crisis came on the heels of a long period of euphoria. The run-up to this crisis did exhibit several new twists, including toxic securities and derivatives (collateralized debt obligations, credit default swaps, and so forth), and the sheer size of government-directed housing credit in the United States, but most of the failures that were building up during the boom had been seen before. Households, firms, and governments rapidly accumulated debt, asset and housing prices boomed and overshot, banks overextended themselves, excessive risks were taken, and regulatory and macroeconomic policy failed on many fronts (Reinhart and Rogoff).

The real surprise was the speed and global reach of the trade and output collapse. The crisis marked the first contraction in world GDP since the Great Depression, and the shock was global: All countries saw growth decelerate sharply in 2009, and 91 countries saw GDP fall (figure 1). World trade went into free fall: Its volume decline, 12.8 percent in 2009, was about as bad as that of the worst year of the Great Depression.

We can explain the recession's depth and global reach as the result of the interaction of two forces. First, the credit crunch spread suddenly and violently from the United States, home to the world's largest financial market and reserve currency, through an integrated global financial system. In October 2008, the TED spread—an indicator of the perceived credit risk of banks lending to other banks, as measured by the difference between the three-month London Interbank Overnight Rate and the interest rate for three-month U.S. Treasury Bills—spiked at more than 400 basis points, compared to 94 basis points a year earlier. According to the International Monetary Fund, the United States, the United Kingdom, and the Euro area saw bank credit contract by nearly 3 percent on average in the fourth quarter of 2008 from a year before, compared to average growth of more than 8 percent (year on year) in the preceding 20 quarters.

The second force was the collapse in the demand for durable goods—itself a result of tighter credit and vanishing confidence—and its multiplier effect on trade. As credit disappeared and panic spread, any purchase that could be delayed, such as a house, car, or appliance, was delayed. The demand for consumer durables fell four to six times more than the demand for non-durables and services (Bems, Johnson, and Yi). This had a multiplier effect on global trade, which is largely composed of the inputs that feed into durable goods and that may be re-exported multiple times in the form of intermediate products.

Prior to the Great Recession, economists had been confident that an outright decline in world GDP could not happen. A more open and integrated world economy meant, so the thinking went, that the sources of demand were diversified such that an adverse shock in any one country or region would be offset by continued demand growth in the others, and creditworthy countries could borrow to finance spending despite the shock. Furthermore, with manufactures and commodities declining in importance relative to services, demand had supposedly become less cyclical, and automatic stabilizers in advanced countries would help cushion the shock.

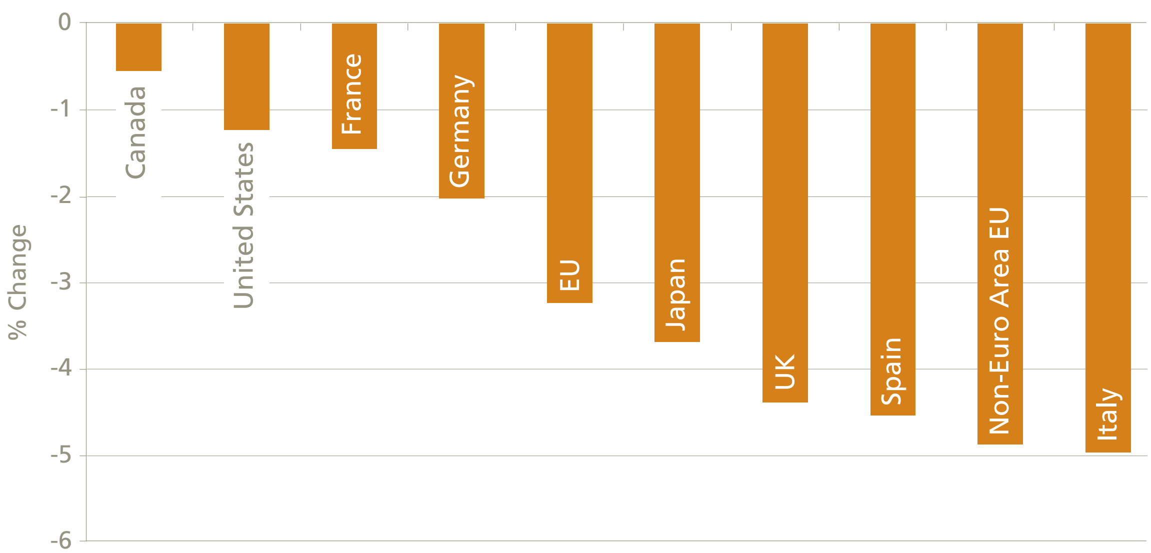
The Great Recession demonstrated exactly the opposite of this thinking: The financial and trade linkages that were supposed to contain a shock originating in one region instead acted as giant conveyor belts that carried the shock worldwide and thus magnified its effects. This showed that the major financial centers, and not just volatile emerging markets, are vulnerable. It also illustrated how the loss of confidence in a major financial center can have immediate repercussions on credit and real economic activity worldwide. No country is safe.

While governments reacted quickly to the crisis with stimulus and bank rescue measures, they have been much more timid in enacting the structural reforms needed to protect against the next crisis.

Fortunately, governments quickly enacted stimulus measures and bank rescue, and as confidence began to return the interacting forces of credit and durable goods worked in reverse. The TED spread fell back to pre-crisis

FIGURE 1

GDP GROWTH Q2 2008–Q2 2010



Sources: BEA, Eurostat, ESRI, Statistics Canada levels by the summer of 2009 and, though credit has still not resumed its prior growth, it has stopped its sharp decline. In 2010, trade rose 23 percent (year on year) through May, and inventory restocking in OECD countries has added 1.5 to 2 percentage points to GDP growth in each of the last three quarters, following a loss of 0.5 percent during the downturn.

The suddenness and global reach of the Great Recession underscored the need to reform the way finance is conducted, not just in the less developed periphery, which had been the focus of scrutiny in the recent past, but in the major financial centers as well. They have prompted a radical rethinking of the policies and regulations designed to limit risk-taking in financial markets and the banking systems of the industrial countries.

SECOND SURPRISE: THE UNITED STATES SUFFERS A MILDER DOWNTURN

The need for financial reform is clearest in the United States, home to the world's largest capital market and the birthplace of the crisis. It was in America that the largest housing and asset price bubbles occurred. There, several hundred billion dollars were extended in subprime mortgages, repackaged into complex and opaque securities, and insured against. And there the world's largest insurance company and three of the five largest investment banks collapsed, initiating a string of bank and corporate failures.

Yet the United States saw its own economic output decline less during the crisis, and recover more in the upturn, than did most other advanced countries. To be sure, the crisis hit the United States hard; the country suffered its longest postwar recession. But from its peak in the second quarter of 2008 to the second quarter of 2010, U.S. GDP contracted less than that of any other G7 country except Canada.

Though fiscal stimulus was slightly stronger and monetary policy a little looser in the United States than they were in other economies, the policy responses were broadly similar and thus cannot account for such a large disparity in outcomes. Some of the factors that do help explain the relative mildness of the U.S. downturn are the result of economic structure, but others reflect policy choices.

Compared to other advanced economies, the United States is much less dependent on the sectors that were hit hardest by the crisis (figure 2). Manufactures, which suffered more than services when consumers and firms cut back on durable goods and investment, account for a much lower share of GDP in the United States than in Germany, Japan, or Italy. Similarly, construction, which contracted more than any other sector because of the U.S. housing bubble, accounts for only a modest share of U.S. GDP by international standards.

Compared to Europe and Japan, the United States is also less dependent on bank lending. In April 2010, Euro area monetary financial institution (MFI) assets (including central banks, resident credit institutions, and other resident financial institutions that receive deposits and grant credit/invest in securities, as well as money market funds) were nearly 3.5 times as large as Euro area GDP, while the assets of FDIC-insured institutions amounted to only 90 percent of U.S. GDP in March 2010. Furthermore, compared to U.S. banks, European banks are more dependent on less reliable wholesale funding than on customer deposits.

Perhaps most important, the private sector reacted faster and more aggressively in the United States than it did in other advanced economies. In the United States, the private sector seized the opportunity to restructure, shed unneeded workers and capacity, and utilize labor-saving technological innovations. For example, in the U.S. auto industry, whose vigorous, government supported restructuring was well publicized, capacity utilization rose from 41.5 percent in March 2009 to 52.8 percent in February 2010, and, according to the *Economist,* overcapacity will fall from 6 million vehicles in 2009 to 3.4 million vehicles in 2010, compared to a fall from 10.4 million to 7 million in Europe, where not one carmaker had been shut down or sold as of September 2009. Similarly, in construction, U.S. employers shed 16 percent of workers (quarter on quarter) in the second quarter of 2009—more than two times the cuts in the Euro area. Furthermore, banks quickly took repossession of homes whose mortgages were in default, and U.S. banks restructured faster and recognized (marked-to-market) their losses faster than European banks (IMF, April GFSR).

This decisive private-sector response meant sharply increased unemployment in the United States, but it also resulted in a quicker reestablishment of confidence in banks and firms. Overall labor productivity rose by 3.5 percent in the United States in 2009, compared to a decline of 2.5 percent in the European Union over the same period. Profits also returned more quickly in the United States: The net value added of U.S. non-financial corporate profits returned to growth (2.2 percent, year on year) in the fourth quarter of 2009, while that in the Euro area continued to contract (-13.2 percent, year on year) over the same period.

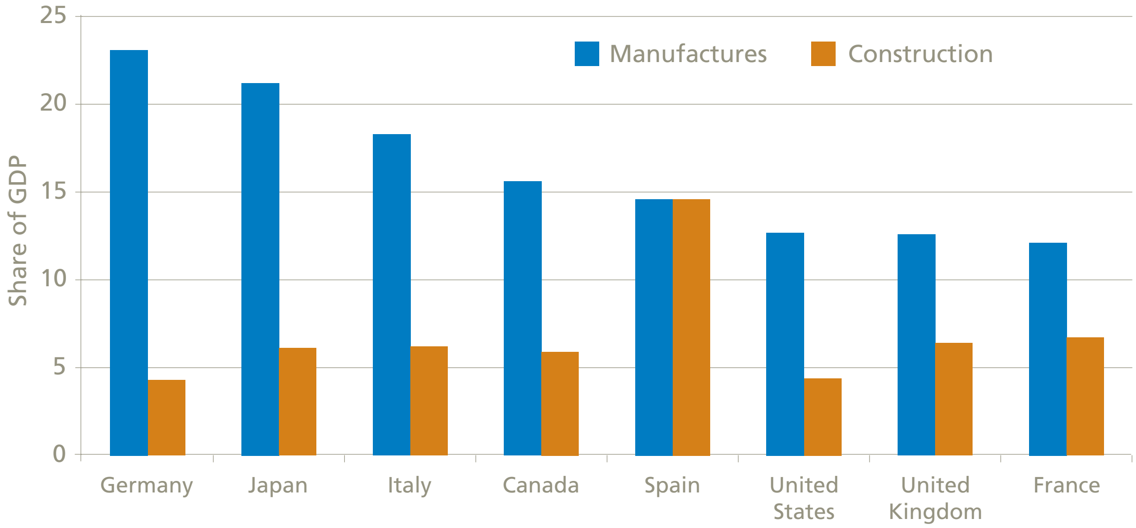
As a result, when demand began to return, U.S. firms were in a better position to invest, although they remain reluctant to add jobs. In the United States, gross domestic investment returned to growth in the third quarter of 2009, while it continued to contract in the Euro area until the second quarter of this year.

The United States thus remained the safe haven. Ironically, even though the crisis originated in the United States, capital flowed to it from abroad, alleviating its credit crunch. The costs of borrowing in the United States declined relative to other advanced countries. The safe-haven effect was also visible in the dollar, which appreciated 13.6 percent during the panic from September 2008 to March 2009 but returned to pre-crisis levels by November 2009 as confidence returned.

The U.S. reliance on services, the country's more diversified financial system, the flexibility of its corporate sector and labor markets, and its safe haven status helped it navigate the crisis. But questions about its low household

FIGURE 2

MANUFACTURES AND CONSTRUCTION



Sources: OECD, World Bank. Data for Spain, Italy, Germany, and France is for 2008; 2007 for United States, UK, and Japan; 2005 for Canada savings and its fiscal sustainability, which had long predated the crisis, have become increasingly pressing.

Observers have paid much attention to the U.S. government's successful response to the crisis, which may have averted a descent into depression. However, most of them have neglected the importance of the vigorous private sector reaction to the crisis. This is a lesson for advanced countries that were hit hard by the crisis but whose private-sector response was sluggish—a group that includes Japan and many countries in Europe.

THIRD SURPRISE: EURO COMPLACENCY BECOMES EURO FUNK

Though Europe initially appeared to be an innocent bystander, the Great Recession quickly implicated it, exposing vulnerabilities similar to—but in many cases worse than—those in the United States. In a few countries such as Ireland and Spain, housing bubbles even larger than the one in the United States had inflated and burst, and banks were taking excessive risks. As we argued above, compared to the United States, Europe depended more on banks, manufactures, and construction, and its private sector was slower to respond, all of which help explain the deeper downturn. But the crisis also exposed a set of vulnerabilities entirely unique to Europe and to its Euro area in particular—namely, a secular loss of competitiveness and fiscal vulnerability in Greece and other countries that had adopted the single currency a decade earlier. In hindsight, Europe had a loaded gun aimed at it from the outset of the crisis, even if the trigger happened to have been pulled from across the Atlantic.

The Greek disease affected a significant number of countries, including large Euro area economies like Italy and Spain, as well as smaller members like Ireland and Portugal. Newly acceding non-Euro area countries whose exchange rates are officially tied to the euro, such as those in the Baltics and Bulgaria, and countries whose ability to devalue is impaired by large foreign currency liabilities, such as Hungary and Romania, were also infected. Together, these countries account for about one-third of European Union GDP.

The disease manifested itself somewhat differently across these countries. In some, such as Greece, Spain, and Ireland, the economy grew too rapidly on the back of consumer and housing booms, ample credit, and immigration surges, and ran unsustainable current account deficits. In others, such as Italy and Portugal, the economy depended too much on sluggish domestic (non-tradable) activities. In most, government spending expanded too rapidly amid unsustainable fiscal revenues. The surge in government indebtedness was particularly large in Ireland, mostly due to the massive banking crisis and bailout there.

The market punished all of these disparate countries in similar ways, however, by demanding much higher yields on their government debt. Remedies will be painful across the board. To restore competitiveness and put their fiscal accounts in order, they will have to face a deflationary adjustment over many years, during which they will remain vulnerable to a variety of internal and external shocks.

The recent European experience shows that the macroeconomic policy and sovereign debt of the world's richest countries are now subject to just as much market scrutiny as are those of developing countries. No country is exempt.

However, the most important lesson for Europe to draw from its experience is that even within a monetary union, divergences between countries in competitiveness and external balances matter greatly. Even when the source of the external imbalance originates in the private sector, the cost of correcting it can eventually spill over into the public sector and threaten fiscal sustainability. The problems such divergences entail are compounded in the absence of pooled fiscal resources and other conditions necessary to adapt to shocks within a monetary union—most importantly flexible labor markets and international labor mobility. Though labor can move freely within the European Union, in practice intra-European migration is small.

FOURTH SURPRISE: CHINA'S GRAVITY-DEFYING ACT

In contrast to the dismal European experience, China's growth rate in 2009—9.1 percent—came as an enormous favorable surprise. This figure is noteworthy not only because it occurred in the midst of a global contraction, but also because China is heavily dependent on exports, which were hit hardest by the crisis, and particularly on exports of manufactures, which, as discussed above, fared the worst. In China, exports account for 36.6 percent of GDP—more than two times their share in Japan and close to three times their share in the United States and the Euro area (excluding intra-Euro area trade).

Reflecting the global contraction in trade, China's export values fell by nearly 16 percent in 2009, and net exports went from contributing 2.5 percentage points to GDP growth in 2007 to subtracting 3.8 percentage points in 2009.

Government-engineered credit expansion and investment more than compensated for this drag, however. Only seven weeks after the Lehman collapse, Beijing announced a four trillion RMB stimulus program. The program initially took the form of two sets of orders issued by the central government: one to local authorities to invest in infrastructure and other projects, and another to state-owned banks to sharply increase lending. As a result, investment accounted for more than 90 percent of China's GDP growth in 2009, and domestic credit expanded by about 9.6 trillion RMB that year.

China's ability to respond so quickly and aggressively was due in part to a level of government control not available—and not desired—in other countries. However, it would not have been possible had China's pre-crisis fundamentals not been so solid.

In contrast to the United States, no sector of the economy in China appears to have been overleveraged. As a result, stimulus spending translated quickly into increased demand.

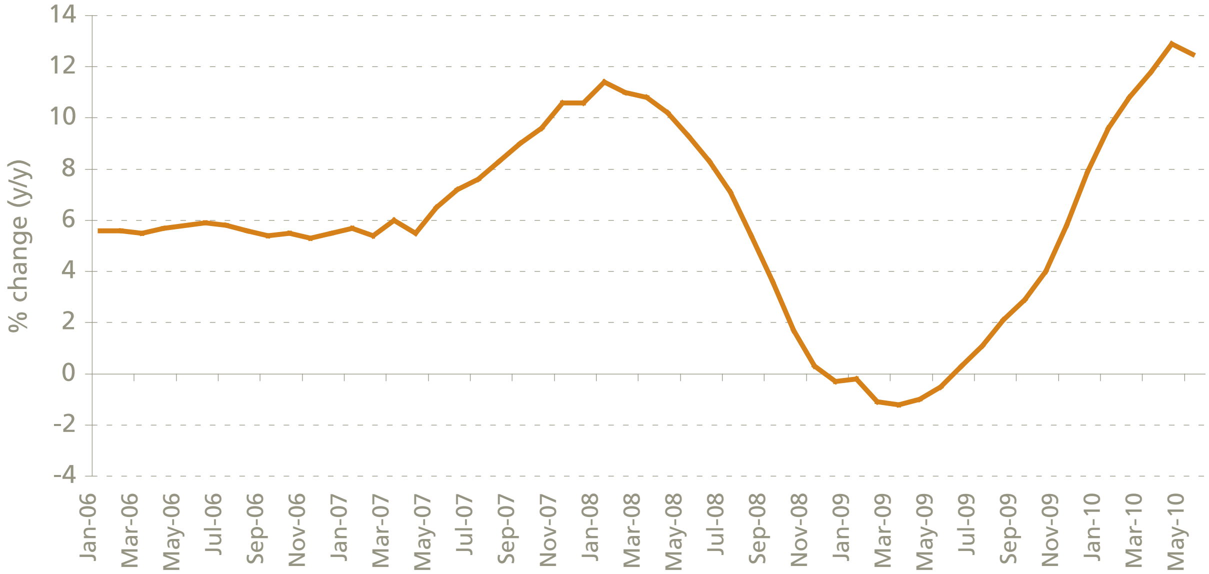
Before the crisis, China's official government debt stood at less than 20 percent, and after a decade of reform China's banking system was also in good shape. And in contrast to the United States, no sector of the economy in China appears to have been overleveraged. As a result, stimulus spending translated quickly into increased demand.

Government intervention has not been without cost, however—far from it. Local government debt, which is not included in tabulations of the national debt level, amounted to 20–30 percent of GDP in 2009, implying that total debt levels are actually close to 40–50 percent of GDP. The ability to repay that debt depends on the health of property markets—a fact that places local governments at odds with a national government aiming to calm soaring real estate prices (figure 3). Furthermore, just as the government's decisive action has enabled China's remarkable growth to continue, a policy misstep in unwinding the stimulus carries great risks.

China's unique mix of government control and market-driven economy and its exceptional balance-sheet strength at the outset of the crisis mean that the applicability of its experience to other countries is limited. However, the episode holds an important

FIGURE 3

HOUSE PRICES IN 70 MAJOR CITIES IN CHINA



Source: Bloomberg

lesson for China: remaining too dependent on export markets rather than domestic demand in a continent-sized economy with a population of 1.3 billion people is itself a sign of large imbalances and high intrinsic risk. In part because China is so dependent on export markets, its policy makers feel compelled to stabilize its exchange rate through excessive and costly reserve accumulation. And in part because China wishes to retain its freedom in domestic macroeconomic policy, its capital markets remain characterized by interest rate repression, heavily distorted and isolated from the mainstream. Correcting these distortions and imbalances will require a complex set of reforms (Dadush).

Among the needed reforms that will help China reorient its economy toward domestic demand is a more flexible and gradually appreciated exchange rate. Pressure to liberalize two-way capital flows will build as China develops and integrates into global markets. Eventually, as has been the case in other large economies, monetary policy should be dedicated largely to stabilizing domestic demand instead of maintaining a currency peg.

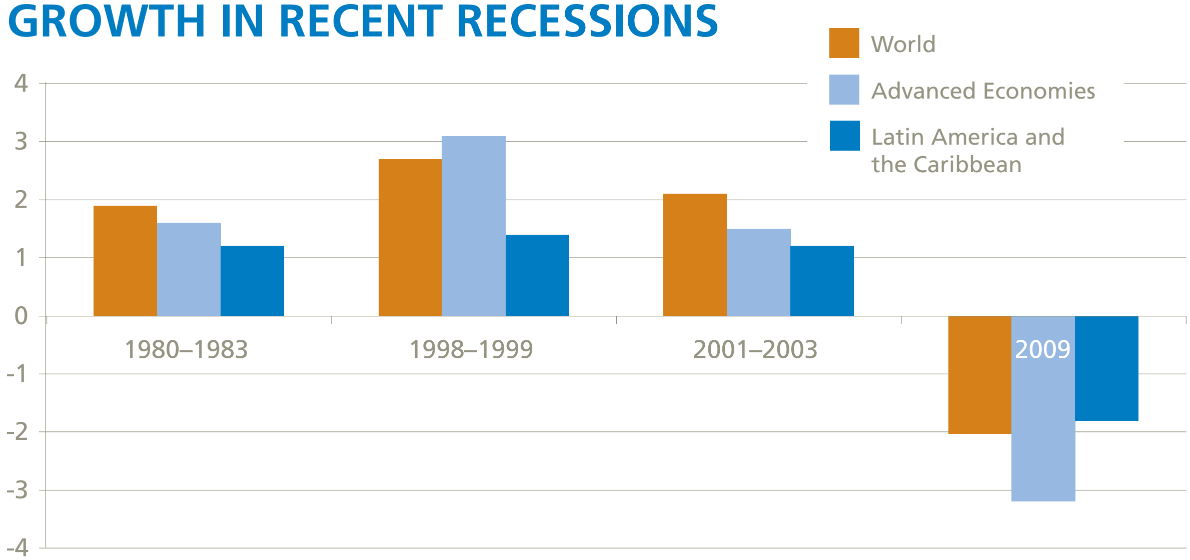
FIFTH SURPRISE: LATIN AMERICA'S RESILIENCE

During the Great Recession, Latin America and the Caribbean (LAC) contracted less than the advanced economies during a worldwide recession—the first time in three decades that such an outcome has occurred (figure 4). South America did particularly well relative both to other regions and to itself in previous crises.

As in most other developing regions (including Sub-Saharan Africa, the poorest and most vulnerable region), an improved pre-crisis national balance sheet helped Latin America weather the crisis, as did better macroeconomic management. In the past, the region had to confront global downturns with high initial external debt, current account and fiscal deficits, modest reserves, pegged or heavily managed currencies, vulnerable banks, and heavy dependence on foreign debt financing. This time, however, the LAC region, helped by a long commodity price boom, had lowered its debt from 36.7 percent of GDP in 2000 to 20.5 percent in 2008, decreased its reliance on short-term maturities, and built up foreign reserves. The region's current account turned

FIGURE 4

WORLD AND REGIONAL GDP GROWTH IN RECENT RECESSIONS



Note: Prior to the current recession, the IMF informally defined global recessions as periods when annual growth fell below 3 percent. This chart covers the four most recent periods that fit that definition.

Source: IMF

to surplus in 2003 for the first time in the last thirty years and remained positive through 2007. Its banking sectors were more tightly regulated and less inclined to take risks: For example, they had little or no exposure to U.S. toxic assets.

Better crisis management was also essential to the LAC region's success. Flexible exchange rates worked as a shock absorber and afforded more room for expansionary monetary policy. Brazil, Mexico, Colombia, Chile, and Peru were able to lower policy rates in 2009 rather than having to raise them as they had in the past. Excluding Mexico (which contracted sharply due to its strong dependence on the United States), GDP in those countries fell by an average of only 0.2 percent in 2009. In contrast, the average contraction in Venezuela, Ecuador, and El Salvador, which maintained pegged exchange rates, was about 2 percent. For the first time, countercyclical fiscal policy was used by several countries, most notably Peru and Chile.

In addition, the global credit crunch impacted Latin America less directly than it did other developing regions. From September 2008 to June 2009, foreign banks' outstanding claims in the LAC region actually increased slightly, while their claims in emerging Asia, emerging Europe, and Africa and the Middle East contracted by nearly 8 percent and more than 4 percent and 3 percent, respectively. According to the IMF, the credit contraction in the LAC region was limited by the fact that foreign banks conduct much of their lending there through local affiliates and in the local currency, which provided added insulation from international shocks.

Notwithstanding this resilience as compared to past global recessions, the LAC region still failed to keep up with other emerging markets during the crisis. In 2009, it contracted by 1.8 percent, compared to growth of 6.9 percent in developing Asia (a region that includes China) and 2.4 percent in the Middle East and North Africa. Of emerging markets, only Central and Eastern Europe, which contracted by 3.6 percent, did worse.

The LAC region still suffers from a serious competitiveness deficit. Across the region, political instability, violence, and limited rule of law remain notable weaknesses compared to other regions, especially after controlling for the region's relatively high per capita income.

Lack of export diversification in both partners and goods remains the region's other major weakness. Within the region, countries with more diversified export structures, notably Colombia and Brazil, did better than those that are more heavily concentrated on the export of primary commodities. The region sends 46 percent of its export goods to the United States (the numbers are much higher for Mexico, which was hit badly by the recession). Developing Asia, in contrast, trades increasingly with China and other fast growing countries in Asia, sending only 20 percent of its exports to the United States.

The experience of Latin America shows that even in the presence of severe structural and competitive handicaps, sound macroeconomic fundamentals can greatly mitigate the effect of shocks.

The experience of Latin America shows that, even in the presence of severe structural and competitive handicaps, sound macroeconomic fundamentals can greatly mitigate the effect of shocks. Their importance cannot be overstated.

A TIMID RESPONSE

The fact that the Great Recession delivered so many surprises underscores the limitations of our knowledge of how financial crises arise, evolve, and are dealt with. Our ignorance clearly calls for modesty in forecasting crises, caution and flexibility in setting policy to deal with them, and further research.

The five surprises discussed above teach us many lessons, but a handful stand out more clearly than the others. First, globalization can amplify shocks in an extremely violent fashion, especially if the shocks originate in the great financial centers and are transmitted through financial channels. Second, decisive policy action is important in the face of a crisis, but so is a decisive private-sector response. Third, external balances and competitiveness matter, even within a monetary union (the Euro area)—all the more so when labor markets are inflexible. Fourth, large economies (China) should nurture their domestic markets so as not to become excessively dependent on foreign demand. Finally, the benefits of sound macroeconomic management are, if anything, greater than we once thought. But are these lessons being heeded?

To limit their vulnerability to future crises, countries must have sound macroeconomic fundamentals, but a regular feature of financial crises is a large deterioration in precisely these areas. And in this case the increase of vulnerability and the depletion of arsenals for future crisis response in industrial countries have been remarkable: Public debt/GDP ratios are about 20 percent higher than pre-crisis averages and continue to rise rapidly, central bank balance sheets have exploded, and policy interest rates are near zero. In contrast, developing countries have been much less affected: Debt levels remain near reasonable, pre-crisis levels; foreign currency reserves are rising, and with output returning to trend levels several central banks have already tightened monetary policy.

The deterioration of macroeconomic fundamentals in industrial countries due to the crisis is not an excuse for inaction, however. Rather, it makes action more urgent. In all the advanced countries, but especially in countries where stimulus policies (rightly) persist, there is a need for medium-term fiscal consolidation programs. Thus legislation to reform pensions and healthcare, improve the efficiency and targeting of benefit programs, and rationalize defense and other spending must proceed, even if it is only implemented once the crisis has abated. These measures will have the added effect of increasing investor confidence. Unfortunately, with only a few exceptions there is no indication that politicians in advanced countries are willing to grasp the nettle.

The reforms that advanced countries have taken in the financial sector have been similarly disappointing. Banking systems are slowly returning to health, but they remain fragile. Steps toward improving capital and liquidity adequacy and tightening regulations have been taken at both national and international levels through the Basel III Accord, but many of these reforms will be implemented over time periods as long as a decade. In any event, they are widely viewed as inadequate, partly because the banking industry pulls a great deal of political weight and partly because of a largely unjustified fear of putting additional strain on banks as they restructure and deleverage. Areas that still need urgent attention include the "too big to fail" problem and the inclusion of the non-commercial-bank financial sector in the regulatory net (IMF, October GFSR).

There has also been only limited progress on narrowing the competitiveness gaps in Europe, which must include increasing the flexibility of labor markets and focusing on product markets. Across much of Europe but especially in the countries most vulnerable to a sovereign debt crisis, the structural reforms envisaged ten years ago by the Lisbon Agenda are all but officially recognized to have failed. The sovereign debt crisis is forcing the hardest-hit countries, such as Greece, Ireland, and the Baltic states, to enact far-reaching austerity measures and other reforms designed to reduce the competiveness gap with core European countries. In other large, vulnerable countries in the Euro area, like Italy, and in the rest of the continent, reform proposals are still far too modest and hesitant.

Judging in light of these lessons, many of the largest developing countries appear to be in better shape than the advanced countries, though this is mainly because the crisis had a milder and shorter-lived effect on them—not because of accelerated reforms. Indeed, there is a serious risk that their success during the crisis will breed complacency. China has announced greater currency flexibility, but the actual appreciation it has allowed has so far been minuscule. The Chinese government appears serious in its declared intent to rebalance the economy in favor of domestic demand at the expense of exports and toward its underdeveloped inland regions, but it remains to be seen how far these reforms will go.

As the world economy recovers, unemployment declines, and the memories of the disaster fade, the political will to bring about change is more likely to subside than grow.

Thus nearly everywhere the lessons of the financial crisis have yet to be effectively applied. Governments were quick to react to the crisis with stimulus and bank rescues, but they have been hesitant to undertake the politically tougher, long-term reforms needed to protect us from future crises.

Indeed, as the world economy recovers, unemployment declines, and the memories of the disaster fade, the political will to bring about change is more likely to subside than grow. In several large countries—including the politically paralyzed trio of the United States, Japan, and Italy—big changes appear especially unlikely. Perhaps the best we can hope for is that partial and incomplete reforms combined with self-imposed changes in the behavior of firms, unions, banks, and households will prevent a repeat crisis in the near future. But history is full of proof that memories are all too often short. ■

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FIVE SURPRISES OF THE GREAT RECESSION