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A Prozac Economy Has Its Costs

By DAVID WESSEL

A tantalizing question arises in profound debates about the nature of the human mind: If Van Gogh or Mozart had been on Prozac, would they have been spared the agony of depression or would the world have been denied their great art?

The financial crisis and ensuing deep recession raise an analogous question. Do we face a choice: A dynamic, volatile economy with painful episodes like the recent one to get faster long-run growth in living standards versus a more stable economy with fewer crises but also slower growth over time?

If we could find the economic equivalent of Prozac -- a cocktail of "financial stability" overseers, tighter restraints on banks, wise government rule to prevent market excesses -- would it bring a calmer prosperity or a less prosperous calm?

In a sense, this is a new chapter in a long-running debate between Europe and the U.S. "In the past 20 years, a very extensive political system was built on preserving stability in Europe," Andrzej Rapaczynski , a Columbia University law professor said at a conference last weekend in Berlin convened by Columbia's Center on Capitalism and Society. "It fell under attack by the American risk-loving system. There is now a certain feeling that the world has been victimized by the U.S.," he observed. As a result, he suggested, "a correction of a fundamental ideological kind is under way." It seems to prize stability over risk even at the cost of less innovation.

All this provokes (at least) three responses.

One says: It's a false choice. Peter Kramer , a psychiatrist and author, decries those who see treating depression as somehow different than treating syphilis or epilepsy, both of which once were associated with bursts of creativity. Depression is an illness to be conquered, he insists. Some economists look at the economy the same way. We shouldn't tolerate the panics and depressions that plagued earlier generations, they say. "We want high prosperity but we want it without crisis because crises hurt prosperity," Edmund Phelps , the Nobel laureate, said in Berlin.

Stephen Roach, the Morgan Stanley economist, argued that the boom was a mirage, false prosperity driven by excessive leverage. Surrendering such euphoria denies us nothing in terms of long-run economic growth, only the pain of deep depression. The ups of the 2000s were smaller than the downs; it was a lost decade.

A second says: This is a bad choice. Overemphasizing stability in the wake of the crisis will mean less wealth for the next generation. Standing not far from where the Berlin Wall once towered, German entrepreneur Peter Jungen said, "Without the dynamic growth since the fall of the Wall, we probably wouldn't be where we are today. Would we be happier?" His answer: No! Capitalism, he said, means lurching from crisis to crisis and getting stronger over time. "We need more capitalism than we have," he insisted.

A third says: This tension must be managed, not denied. "We can acknowledge capitalism is not stable, and deal with it," said New York University economist Roman Frydman . "We no longer have to defend capitalism against communism." He argues not for aiming at "stability," but instead at what's been dubbed in other contexts "bounded instability" or the "edge of chaos." Accept the ups and down, but strive to avoid the very highest peaks and very deepest troughs, he said. "Markets ultimately self-correct. They just do it too late."

Until a few years ago, the U.S. implicitly accepted the view that stability was overrated. The Asian financial crisis was their problem, not ours. The tech-stock bubble of the late 1990s burst, but did no lasting harm. Bankruptcies, layoffs and worthless stock options were the price of entrepreneurial risk-taking that also produced the likes of Google. And all that Wall Street financial innovation, well, it seemed to make people rich without making anyone else poor.

That view is now being challenged. The painful recession has provoked discussion inside the U.S. Federal Reserve, which once shrugged off bubbles in stocks and house prices, about when and how to pre-empt bubbles before they burst. A similar reconsideration lurks behind the debates in Washington and other capitals about what financial innovation should be banned, how much bankers should be restrained, when government should interfere with markets.

Fundamentally, this is not a technical question, but a bigger one. "The regulation we are going to get will be much more a matter of politics than economics," said Mr. Rapaczynski. "Economists are prone to forget this. They believe in markets and believe in philosopher-kings with economists as the philosophers."

If we could be sure that economic and financial stability can coincide or even produce faster growth over time, the choice would be easy. We can't be sure. So ultimately, this is going to be a political -- in the best sense of the word -- decision. If we're lucky, the political system and central banks will devise ways to get more stability without stifling innovation and dynamism. We might not be lucky.

Clumsy, ill-conceived and hot-headed efforts advertised as avoiding a repeat of the current crisis could yield neither more stability nor more growth. That would be unwelcome.

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