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# How globalization's losers win

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The modern economy is built not only on hard work and technological progress, but on itself. Unfortunately, the economy's amazing ability to create a lot from a little goes alongside a terrifying capacity to self-destruct from the smallest catalyst. These capacities can be illustrated by the three different "multipliers" in economics. And thinking about these multipliers is the key to understanding a paradox of the current recession: some of the countries that are least developed are having the least difficult time weathering the crisis.

The money multiplier illustrates how cash and other liabilities of the Federal Reserve get expanded through all commercial banking activities to become a much larger amount of bank deposits. The money multiplier is higher when banks lend more of their reserves, and when firms and individuals deposit more of their money in financial institutions.

The employment multiplier describes the additional jobs or welfare generated from an important industry, often in the export sector. For example, if a manufacturing firm comes to town, it will require lawyers, doctors, storekeepers, and barbers, not to mention suppliers.

Finally, the fiscal multiplier predicts the net impact of a deficit-financed government stimulus effected through additional government spending or tax cuts.

The fiscal multiplier is higher when government expenditures end up in firms' or individuals' pockets, and when they in turn spend a large percentage of that on goods and services produced in the economy.

All three of these multipliers sound super. Who wouldn't want to magically create money, or jobs, or income? Well, the downside is that when the money multiplier is decreased, or when the initial employment or fiscal stimulus is negative rather than positive, a lot of wealth or jobs can be lost.

In this crisis we have seen a lot of "unwinding": of wealth, and of jobs, particularly in export-led economies. The simple tool of the multiplier illustrates this. In response to the credit crisis, banks stopped lending, hedge funds de-levered, firms hoarded cash, and individuals pulled their money out of bank accounts and money market funds. So even as the Federal Reserve attempted to inject liquidity into the U.S. banking system, the fact was that the money multiplier had dramatically shrunk. With the supply of credit diminished, debts became harder to service, and asset prices fell. As a result, a whole lot of wealth was quickly erased from the economy.

Meanwhile, with reduced demand from the United States and Europe, the export-led economies of East Asia got slammed: in the last quarter of 2008, according to The Economist, Japan's GDP fell at an annualized rate of 10%, Singapore's at 17%, and South Korea's at 21%. The employment multiplier has magnified the economic impact of these initial lost export jobs, leading to a much larger fall in global demand.

With lending down, and demand down, we are left with the government to fill in the gap, to try to wind back up the economy through the fiscal multiplier. Unfortunately, we don't know just how big that multiplier is, because it is different for every situation. Only time (and a lot of statistical analysis) will tell.

But in those parts of the world that are less economically sophisticated, the crisis is creating fewer disruptions. In Sub-Saharan Africa, the IMF is still forecasting economic growth of 3.5% for 2009. That's faster than everywhere outside China, India, and the Middle East.

Why might that be? For one, the money multiplier in sub-Saharan Africa is already quite low, and therefore cannot fall much further. There is very little lending there relative to developed countries, and even less leverage. On a recent trip to a less-developed country in Africa, I spoke to major businessmen who were only able to get loans equal to 5 or 10 percent of their net worth. These firms were largely self-financing, and invested out of retained earnings. In addition, African economies are not a sizeable part of the global supply chain -- except in commodities, which, admittedly, have taken a beating. Thus, the net effect on lost export jobs will be limited. The employment multiplier, however high, is being multiplied by a very small number of export jobs.

Strangely, where the least-developed economies are most vulnerable is where the rest of the world is trying to ramp up: through the fiscal multiplier. Many poor countries depend on foreign aid for a large fraction of their government spending; aid regularly makes up 10-30 percent of their GDP. So if the budgetary crunch in rich countries results in reduced foreign aid, poor countries would experience the equivalent of a fiscal contraction, with their GDP falling by the lost aid times the fiscal multiplier.

As the world has grown more integrated and financially sophisticated, it has also been multiplied, getting more wound up in itself. In an ironic twist, the countries that have failed to gain from globalization also look to suffer the least from this particular recession, which is one characterized by wholesale unwinding. That is, of course, unless the fiscal stimuli in the integrated world come at the expense of its regular cash injections abroad.