Crisis Economics: A Crash Course in the Future of Finance

Nouriel Roubini, Stephen Mihm
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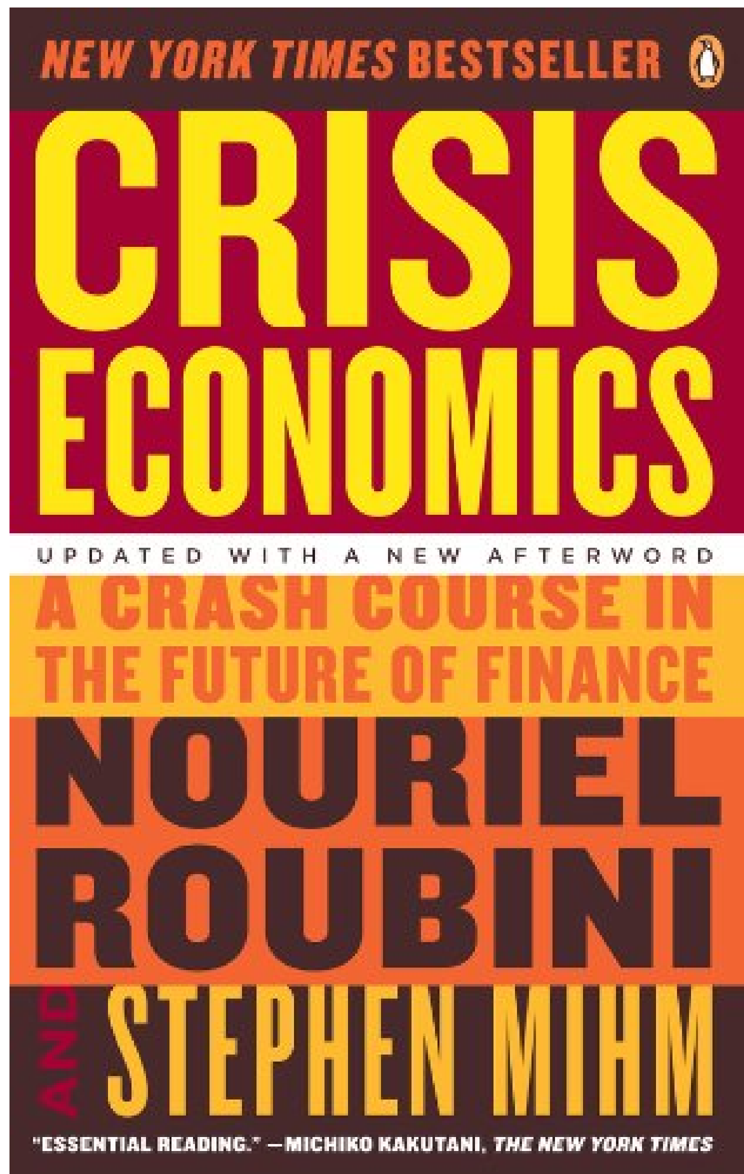

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Nouriel Roubini, Stephen Mihm : Crisis Economics: A Crash Course in the Future of Finance before purchasing it in order to gage whether or not it would be worth my time, and all praised Crisis Economics: A Crash Course in the Future of Finance:

53 of 56 people found the following review helpful. Dr. Doom Explains ItBy Omer BelskyThe economic crisis of 2008 has caught almost all observers unaware. Here and there, a few voices issued warnings, pointing out the existence of the housing bubble and the dangerous effects of the global financial imbalances and America's growing

deficits. Chief amongst these Cassandras, the man whose dire predictions proved most accurate, was Nouriel Roubini. Nicknamed "Dr. Doom" in a New York Times article written by Stephen Mihn, Roubini's reputation as a forecaster, almost a prophet, is today unmatched.Roubini's sterling reputation was the reason I chose to read "Crisis Economics", a further collaboration between Mihn and Roubini. Of the half a dozen or so books about the crisis that I have read (Richard Posner's A Failure of Capitalism: The Crisis of '08 and the Descent into Depression and The Crisis of Capitalist Democracy, Robert Shiller's The Subprime Solution: How Today's Global Financial Crisis Happened, and What to Do about It, Vince Cable's The Storm: The World Economic Crisis What It Means, etc), Roubini and Mihn offer the most wide ranging look, discussing the roots of the crisis, the government's response, and suggestions for reform. Roubini and Mihn write well, and their book is an excellent introduction for the crisis to the uninitiated. Unfortunately, "Crisis Economics" offers rather less to those of us who have spent some time on the subject. Those readers might, like me, find little new in the early chapters of the book (the ones discussing the origin of the crisis) and much to disagree with in the later chapters (the ones outlining the authors' suggested way out of it).The first half of the book described combines a run of the mill description of the crisis's formation, mixed with standard history of economic thought (from Smith to Keynes), only partially enlivened by the rather unorthodox focus on economic crisis and failure rather than success.The authors employ mostly conventional Keynesian perspective on the crisis, and so should be applauded for their discussion of the Austrian school views about it. But although they explain the Austrian position in full, they ultimately discard it with a superficial analysis that would not convince any Austrian. Later they argue that they are offering a synthesis of the Austrian and Keynesian perspectives, but no self respecting Austrian could possibly accept their call for massive government intervention, while Keynesians would find little to disagree with the notion that the problems of twisted incentives caused by the necessary intervention should be addressed, or at the very least taken into account.For me, the book only became interesting in earnest about halfway through, when the authors discussed the response to the crisis. Particularly, they emphasize the role of Fed. I knew that the Federal Reserve played a huge part in the bailouts of such players as Goldman Sachs and AIG. But Mihn and Roubini's account highlighted a fact that I was insufficiently aware of - how America's central Bank acted not only as a lender of last resort, saving the financial system from collapse, but also as an almost ordinary lender, lending money to more and more non-bank institutions in order to stop the credit freeze. It seems to me that while the Fed's action as lender of last resort was probably necessary, the active intervention in the markets more questionable. Monetary tools are effective in restraining an overheated economy (as Paul Volker did in the early 1980s), and in unleashing willing investors, but they are generally no good for promoting economic activity when there's no will for it. Ben Bernanke took very extreme actions to try to encourage economic activity and especially lending, and it is far from obvious that the relatively meager results were worth the effort.The classic Keynesian account places the onus of reigniting the economy on the government's fiscal rather than monetary powers: Crudely speaking, Keynes taught that governments should spend their way out of depressions. Oddly enough, beyond criticizing the stimulus for being a political bargain and thus far from ideal, the authors have little to say about the government's direct role in creating demand, focusing their discussion on the various ways it underwrote risks taken by other institutions.The bottom line may be that both fiscal and monetary policy focused excessively on "reigniting" markets rather than on stimulating the economy via government spending on public works and other government projects. This arguably prevented the "work" of the crisis - culling out the weak firms from the good ones - from taking place, and increased the amount of irresponsible players who gained from the bailouts.Moving forward, the authors make several proposal for reforms. Unfortunately, I think many of these proposals are extremely problematic. Take compensation - the authors point out that traders and managers in financial firms to excessive risks, because they had wrapped incentives - they would make a fortune if the gambles paid off, but would lose very little if they didn't. In the short run, the traders and the firms both did very well, but in the long run, the firms had to be bailed out, while the trader's bank accounts remained as healthy as ever. The authors therefore make a series of proposals, all meant to link the compensation of executives with the long term prospects of the firm they work in. The problem with these plans is that in the long run, the well being of the firm is likely to be determined by a host of factors, few of them in any person's control. Delaying compensation cuts the link between the employees' pays and their performance - which is, ironically, exactly what self dealing executives want (see Pay without Performance: The Unfulfilled Promise of Executive Compensation). Furthermore, in trying to align the interests of firms with those of the executives, the authors ignore the fact that part of the cost of a firms' downfall is carried by its creditors and suppliers (and as we see in this crisis, by the taxpayers). When the a cost of an activity are born by those other than the parties involved in the activity, the cost is what's known in economic terms as an externality. Negative externalities (costs), unborn by the firm, are not taken into account by it. Which means that from a social perspective, even rational, income maximizing firms are taking excessive risks.Another problematic proposal is an overhaul of America's financial regulators. The authors point out that America has a host of bodies meant to regulate finance, all of them work in an uncoordinated and inefficient way. The argue that America should reform its regulators to make them more streamlined and centralized - somewhat like Britain's Financial Services Authority. But the FSA did not seem to spare Britain the crisis. Is it really a great model for a regulating agency?The book's final chapter describes the global financial imbalances - namely the huge deficits incurred by the United States and other

rich countries, contrasted with the enormous surpluses amassed by such emerging countries as South Korea and especially China. The authors disagree with the "Global Saving Glut" hypothesis (advocated by the likes of Paul Krugman and Martin Wolf - see Fixing Global Finance (Forum on Constructive Capitalism)). They argue, in effect, that America and Americans are responsible for their choice to borrow excessively (p. 250).But whether to save or spend is a question of benefits versus costs. As long as Americans are offered amazingly cheap credit (and correspondingly, few avenues for profitable and safe long term investments), they are unlikely to stop taking advantage of it. It is natural to borrow when the costs of borrowing is low - it is unnatural to lend money for meager returns"Crisis Economics" is therefore an eloquent introduction to the financial crisis, and a thoughtful program on how to get out of it. I disagree with many of the authors' recommendations, but they are worth considering very carefully. After all, Roubini has been proven right before.2 of 2 people found the following review helpful. An Aptly Named Crash CourseBy Pete GeorgeCrisis Economics is what it says it is, a crash course- though it is as much a crash course in the future of finance as it is in the past and the present. Roubini and Mihm have come together to present a well rounded, historical view of what happens when capitalism takes a turn for the worse. The book begins by thwarting the popular notion of crises being unpredictable events called black swans in favor of the idea that all crises are, in fact, predictable events known as white swans. From here the book can be split into five different sections. The first section discusses the evolution of economic thought and how it has coincided with the assumed causation of major economic events throughout history. This gives the background foundation for the rest of the book. These historical pieces cleverly interwoven as recurring themes throughout the novel to give broader perspective on the phenomenon and serve to continuously prove the initial assertion of an economic crisis being a white swan. Continuing on, the book delves into the events and practices preceding the recent recession, continuing on to dictate in highly readable detail the exact timeline of events in 2007 and 2008 that sent the country and world into a downward spiral. This section boasts a clever analogy of the recession as a "financial hurricane," being sure to include both historical and present day perspective. Roubini and Mihm then take a chapter to analyze to global reactions to crisis. The focus is mainly on that of the recession, providing multiple theories before presenting his own while continuing with the theme of the book and including relevant historical context. Focus then shifts from identifying problems how the problems were created, to what measures were taken to prevent them. This section allows for an in depth look and the Great Depression, what went wrong and what went right, and how similar it was to the crisis of 2008. It is quite interesting to see how those in charge of steering the ship right in the 2000's had the presence of mind to step back and look to history for help. At times this section is a little too preachy. More factual information could be included and, more key characters could be introduced. Having discussed the how the situation was handled, the opportunity is paved for Roubini and Mihm to step onto the proverbial soap box and give their insight into what needs to change to prevent the next crisis from happening. They split this section up into one chapter highlighting plausible changes, many of which have been brought up in laws but not passed yet, and another chapter outlining more radical changes that could have a strong impact on reforming the financial world but would certainly be very difficult to accomplish. I believe this is the section that sets this book apart from most. Instead of simply pointing out where the problems lie, the authors take it upon themselves to provide real solutions to prevent another crisis from happening again while smoothly transitioning into a proper economy. The concluding section of the book provides a speculative perspective on the post recession United States economy and how it fits in with the global economy, specifically focusing on China. This section proves to be foreboding than forgiving, but this is with good reason. It is here where the authors finally seem to comment on the gravity of the crisis. This section could use a bit more depth into the possible global ramifications of the recession. It briefly mentions some high risk countries but does not delve into how they might continue to falter. The book itself is written in a more casual style that makes the dense subject matter extremely approachable. At times the writing is almost conversational. Reading is quick and easy and even makes the dense, complicated finance jargon seem like a breeze to understand. This, however, does not compromise the integrity of the facts or opinions presented throughout the novel. Its organization is another positive aspect. While at times the historical inserts can throw the reader off kilter, it is generally organized to take you through a crisis from start to finish. Whenever it seems as though you are being lead off the trail you find yourself having taken a shortcut to the next stop. This is a great book to give you a broad glance on everything that has to do with an economic crisis, focusing on our most recent recession. Roubini and Mihm delicately place historical and economic perspective from the first page to the last page as they navigate from the beginning of a crisis, to the middle, to the end, and to a better future. The authors do a great job in accurately providing the different viewpoints that meld together to form their opinions. At times, though, they seem a little too arrogant in their assertions without adequately evaluating rival theories. They display modern perspectives that will help their point rather that concede that someone else might be correct. I would recommend this book to anyone looking to quickly learn everything about the recession and crisis economics in general. If you are looking for thorough foray into the workings of a crisis, spending hours on analysis with thorough statistical evidence, this is not the book for you. If you just want to read every detail about the recession, this again is not the book for you. However, if you want a true crash course in crisis economics this is it. The authors have stripped down information into a basic yet detailed form that leaves you with a sense of completeness about your

newly gained knowledge0 of 0 people found the following review helpful. Relativley short guide to the Great RecessionBy xAlthough it covers some other crises, it focus on the Great Recession. If I were going to read one book on the topic this would be a solid choice.

This myth shattering book reveals the methods Nouriel Roubini used to foretell the current crisis before other economists saw it coming and shows how those methods can help us make sense of the present and prepare for the future.Renowned economist Nouriel Roubini electrified his profession and the larger financial community by predicting the current crisis well in advance of anyone else. Unlike most in his profession who treat economic disasters as freakish once-in-shy;a-lifetime events without clear cause, Roubini, after decades of careful research around the world, realized that they were both probable and predictable. Armed with an unconventional blend of historical analysis and global economics, Roubini has forced politicians, policy makers, investors, and market watchers to face a long-neglected truth: financial systems are inherently fragile and prone to collapse. Drawing on the parallels from many countries and centuries, Nouriel Roubini and Stephen Mihm, a professor of economic history and a New York Times Magazine writer, show that financial cataclysms are as old and as ubiquitous as capitalism itself. The last two decades alone have witnessed comparable crises in countries as diverse as Mexico, Thailand, Brazil, Pakistan, and Argentina. All of these crises-not to mention the more sweeping cataclysms such as the Great Depression-have much in common with the current downturn. Bringing lessons of earlier episodes to bear on our present predicament, Roubini and Mihm show how we can recognize and grapple with the inherent instability of the global financial system, understand its pressure points, learn from previous episodes of "irrational exuberance," pinpoint the course of global contagion, and plan for our immediate future. Perhaps most important, the authors-considering theories, statistics, and mathematical models with the skepticism that recent history warrantsmdash;explain how the world's economy can get out of the mess we're in, and stay out. In Roubini's shadow, economists and investors are increasingly realizing that they can no longer afford to consider crises the black swans of financial history. A vital and timeless book, Crisis Economics proves calamities to be not only predictable but also preventable and, with the right medicine, curable.

.com Ian Bremmer and Nouriel Roubini: Author One-to-One In this exclusive, we brought together authors Ian Bremmer and Nouriel Roubini and asked them to interview each other. Ian Bremmer is the president of Eurasia Group, the world's leading global political risk research and consulting firm. He has written for The Wall Street Journal, The Washington Post, Newsweek, Foreign Affairs, and other publications, and his books include The End of the Free Market, The J Curve, and The Fat Tail. Read on to see Ian Bremmer's questions for Nouriel Roubini, or turn the tables to see what Roubini asked Bremmer. Bremmer: You argue in your book [Crisis Economics: A Crash Course in the Future of Finance] that financial crises are not unpredictable ldquo;black swanrdquo; events but, rather, can be forecast ndash; in effect, white swans. What do you mean by that? Roubini: My friend Nassim Taleb popularized the concept of ldquo;Black Swans,rdquo; those economic and financial events that are sudden, unexpected and unpredictable. But if you look at financial crises through history ndash; and the earliest is the Tulipmania in the Netherlands in the 17th Century ndash; you see a pattern that is highly regular and predictable: An asset bubble ndash; often in real estate or in stock markets or in a new industry ndash; leads to financial euphoria, excessive risk taking, an accumulation of excessive debt and leverage. So the signposts of this phase mdash; asset boom and bubble, followed by the eventual bust and crash mdash; are highly predictable if one looks at the economic and financial indicators that show the build-up of such excesses. Thus, financial boom and bust are predictable white swan events, not unpredictable and random black swans. Financial crises have repeatedly occurred for hundreds of years and they follow quite regular pattern. That is why my book is about ldquo;crisis economicsrdquo;, a phenomenon that is becoming more of a rule than an exception. Financial crises that should have occurred once in 100 years now occur more frequently and with greater virulence than in the past; and their economic, fiscal, financial and social costs are rising. The trouble is that in the bubble phase nearly everyone, the exception being a few critical analysts, is swept in a delusional bubble mania of irrational euphoria: households, financial institutions, investors, governments, spinmeisters all of whom profit from the bubble, including Ponzi-schemers who concoct their houses of cards and financial con games. So, in each bubble there are cranks who argue that this time is different and that the bubble is driven by a fundamental brave new world of ever rising growth and profits. Then, when the boom and bubble turns into a bust and crash, a reality check occurs and financial depression sets in. Bremmer: Who is to blame the most for the recent financial crisis? Who were the culprits of the latest one? Roubini: The list of culprits is very long. The Fed kept interest rates too low for too long in the earlier part the past decade and fed mdash; pun intended mdash; the housing and credit bubble. Bankers and investors on Wall Street and in financial institutions were greedy, arrogant and reckless in their risk taking and build-up of leverage because they were compensated based on short term profits. As a result, they generated toxic loans ndash; subprime mortgages and other mortgages and loans ndash; that borrowers could not afford and then packaged these mortgages and loans into toxic securities ndash; the entire alphabet soup of structured finance products, so-called ldquo;SIVsrdquo; like MBSs ndash; Mortgage-Backed Securities, or CDOs ndash;

Collateralized Debt Obligations -- and even CDOs of CDOs. These were new, complex, exotic, non-transparent, non-traded, marked-to-model rather than market-to-market and mis-rated by the rating agencies. Indeed, the rating agencies were also culprits as they had massive conflicts of interest: they made most of their profits from mis-rating these new instruments and being paid handsomely by the issuers. Also, the regulators and supervisors were asleep at the wheel as the ideology in Washington for the last decade was one of laissez faire ldquo;Wild Westrdquo; capitalism with little prudential regulation and supervision of banks and other financial institutions. Bremmer: In the book you express concern that following the massive leveraging of the private sector there is now a massive re-leveraging of the public sector that will put the economic recovery at risk. Why such worries? Roubini: The Great Recession of 2008-2009 was triggered by excessive debt accumulation and leverage on the part of households, financial institutions and even the corporate sector in many advanced economies. While there is much talk about de-leveraging as the crisis wanes, the reality is that private-sector debt ratios have stabilized at very high levels. By contrast, as a consequence of fiscal stimulus and socialization of part of the private sectorrsquo;s losses, there is now a massive re-leveraging of the public sector. Deficits in excess of 10% of GDP can be found in many advanced economies, including Americarsquo;s, and debt-to-GDP ratios are expected to rise sharply ndash; in some cases doubling in the next few years. Such balance-sheet crises have historically led to economic recoveries that are slow, anemic, and below-trend for many years. Sovereign-debt problems are another strong possibility, given the massive re-leveraging of the public sector. In countries that cannot issue debt in their own currency (traditionally emerging-market economies), or that issue debt in their own currency but cannot independently print money (as in the eurozone), unsustainable fiscal deficits often lead to a credit crisis, a sovereign default, or other coercive form of public-debt restructuring. In countries that borrow in their own currency and can monetize the public debt, a sovereign debt crisis is unlikely, but monetization of fiscal deficits can eventually lead to high inflation. And inflation is ndash; like default ndash; a capital levy on holders of public debt, as it reduces the real value of nominal liabilities at fixed interest rates. Thus, the recent problems faced by Greece are only the tip of a sovereign-debt iceberg in many advanced economies (and a smaller number of emerging markets). Bond-market vigilantes already have taken aim at Greece, Spain, Portugal, the United Kingdom, Ireland, and Iceland, pushing government bond yields higher. Eventually they may take aim at other countries ndash; even Japan and the United States ndash; where fiscal policy is on an unsustainable path. Bremmer: Should we then worry about the risk of a collapse of the European Monetary Union--the so-called ldquo;eurozone?rdquo; Roubini: This is a serious and rising risk. The dilemma for Greece and the other fiscally challenge countries dubbed the PIIGS mdash; thatrsquo;s Portugal, Italy, Ireland, Greece, Spain mdash; is that, whereas fiscal consolidation is necessary to prevent an unsustainable increase in the spread on sovereign bonds, the short-run effects of raising taxes and cutting government spending tend to cause economic contraction. This, too, complicates the public-debt dynamics and impedes the restoration of public-debt sustainability. Indeed, this was the trap faced by Argentina in 1998-2001, when needed fiscal contraction exacerbated recession and eventually led to default. In countries like the eurozone members, a loss of external competitiveness, caused by tight monetary policy and a strong currency, erosion of long-term comparative advantage relative to emerging markets, and wage growth in excess of productivity growth, impose further constraints on the resumption of growth. If growth does not recover, the fiscal problems will worsen while making it more politically difficult to enact the painful reforms needed to restore competitiveness. A vicious circle of public-finance deficits, current-account gaps, worsening external-debt dynamics, and stagnating growth can then set in. Eventually, this can lead to default on euro-zone membersrsquo; public and foreign debt, as well as exit from the monetary union by fragile economies unable to adjust and reform fast enough. Provision of liquidity by an international lender of last resort ndash; the European Central Bank, the IMF, or even a new European Monetary Fund ndash; could prevent an illiquidity problem from turning into an insolvency problem. But if a country is effectively insolvent rather than just illiquid, such ldquo;bailoutsrdquo; cannot prevent eventual default and devaluation (or exit from a monetary union) because the international lender of last resort eventually will stop financing an unsustainable debt dynamic, as occurred Argentina (and in Russia in 1998). Thus, the weakest links of the EMU ndash; countries such as Greece may be eventually be forced to default and to exit the monetary union to regain their competitiveness and growth through a depreciation of their new national currency. Bremmer: So how can we properly deal with the fallout of financial crises? How to properly reduce private and public debts? Roubini: Cleaning up high private-sector debt and lowering public-debt ratios by growth alone is particularly hard if a balance-sheet crisis leads to an anemic recovery. And reducing debt ratios by saving more leads to the paradox of thrift: too fast an increase in savings deepens the recession and makes debt ratios even worse. At the end of the day, resolving private-sector leverage problems by fully socializing private losses and re-leveraging the public sector is risky. At best, taxes will eventually be raised and spending cut, with a negative effect on growth; at worst, the outcome may be direct capital levies (default) or indirect ones (the inflation tax if large budget deficits are sharply monetized). Unsustainable private-debt problems must be resolved by defaults, debt reductions, and conversion of debt into equity. If, instead, private debts are excessively socialized, the advanced economies will face a grim future: serious sustainability problems with their public, private, and foreign debt, together with crippled prospects for economic growth. Bremmer: In the book you propose radical reforms of the system of regulation and supervision of banks and other financial

institutions and criticize the more cosmetic reforms now considered by the US Congress and in other countries. Why the need for radical reform? Roubini: If reforms will be cosmetic we will not prevent future asset and credit bubbles and we will experience new and more virulent crises. The currently proposed reforms of ldquo;too-big-to-failrdquo; financial institutions are not sufficient: imposing higher capital levies on these firms and have a resolution regime for an orderly shutdown of large systemically important insolvent firms will not work. If a financial firm is too-big-to-fail it is just too big: it should be broken up to make it less systemically important. And in the heat of the next crisis using a resolution regime to close down too-big-to-fail firms will be very hard; thus, the temptation to bail them out again will be dominant. Also, the modest Volcker Rule ndash; that may not even be passed by Congress because of the banking lobbies power ndash; does not go far enough. It correctly points out that banking institutions that have access to insured deposits and to the lender of last resort support of the Fed should not be allowed to engage into risky activities such as prop trading, hedge funds and private investments. But more needs to be done: we need to go back to the more radical separation between commercial and investment banking that the Glass Steagall Act had imposed. Repealing this Act was a mistake that led to excessive risk taking and leverage by both banks and non-bank financial institutions. Finally, the government should regulate much more tightly toxic and dangerous over-the-counter derivative instruments; and compensation of bankers and traders should be subject to radical ldquo;clawbacksrdquo;: bonuses should not be paid outright but go into a fund and clawed back if the initial investments/trades turned out to be risky and money losing over time. Bremmer: Have we learned the lessons from the last financial crisis or are we planting the seeds of the next one? Roubini: I fear that we have not learned those lessons and that part of the policy response is now creating a new global asset bubble that will cause a bigger financial crisis in the next few years. For one thing, there is a lot of talk about better regulation an supervision of the financial system but the financial industry is back to business as usual ndash; rebuilding leverage, engaging in prop trading and other risk behavior, compensating bankers and traders with indecent bonuses - and is lobbying against better regulation and supervision. Governments are talking about reforms but almost no one has implemented them. In the meanwhile interest rates remain close to zero in most advanced economies and they are also very low in many overheating emerging markets. Also dollar funded carry trades are feeding asset bubbles globally. Thus, part of the sharp rise in risky asset prices since March 2009 is driven by a wall of liquidity chasing assets that are becoming overpriced: US and global equities, credit, oil and commodity prices, emerging markets asset prices. And if this bubble eventually gets out of hand the eventual bust could lead to another and bigger global financial crisis in the next two or three years. (Photo of Nouriel Roubini copy; RGE Monitor)