

NOURIEL ROUBINI, STEPHEN MIHM

Crisis Economics: A Crash Course in the Future of Finance

Publica, Publishing House 2010

Many years ago, professor Nouriel Roubini got the Dr. Doom nickname. He was one of the few economists warning that the entire world economy was on the verge of a major recession, unseen since the Great Depression. As immediate cause, he identified the speculations spreading in the United States that finally led to the bankruptcy of the investment banks. In 2007, his predictions came true. Suddenly, Roubini's voice started to be heard.

In the "crash course in the future of finance", written together with journalist and history professor Stephen Mihm, Roubini explains the origins of the crisis, analyses the anti-crisis measures adopted in time and their flaws, proposes immediate and long term remedies and evaluates the perspectives of the world economy.

In the beginning, the authors demonstrate that financial crises must not be seen as rare events. They are older than capitalism and have first occurred in China in 1072.

Next, a summary of ideas of the main economics schools referring to the crises issues is presented. Many contemporary economists (among whom Alan Greenspan) see the market economy as a self-regulatory entity that stabilises at full labour force occupancy and a low inflation when left free. Marx, on the other side, considered capitalism as being fundamentally instable. It was going to crash as consequence of the continuous cost reduction by the owners, reduction that was leading to overproduction and an insufficient occupancy and finally, to a revolution of the working class. Keynes asserts that in case of salary reduction and workers dismissal, deflation would occur and the demand will crash. The Keynesian solution consists in the creation of demand by the government. Milton Friedman and the other representatives of the Chicago school explained the Great Depression as direct consequence of a quantitative decline of the bank deposits and reserves, combined with the fail of the Federal Reserve in reducing the interest rate and saving the banks. Hyman Minsky reinterprets Keynes and claims that the financial system making capitalism possible has the potential of an unbound expansion, potentiated by the investor's burst. Challenges occur due to a loan excess that cannot be returned. Irving Fisher comes with the idea that the government needs to "reflate" a stagnant economy, flooding it with money easy to obtain (as the US did in 2007 and 2008) Finally, the Austrian school (Schumpeter among others- the author of the theory referring to the creative destruction) considers that this kind of actions only lead us towards a worse situation, assuring the survival of the banks and weak companies. The authors' opinion is that even though on the short term

they are wrong, on the long term the representatives of the Austrian school are right.

Referring to the current crisis' causes, the book identifies 4 main causes. A first would be the financial innovation. High-risk stock and shares are considered secure, because of different subterfuges. The impossibility to correctly evaluate the financial instruments by conventional measures led to the usage of complex mathematical models based on too optimistic hypothesis (for example, the fact that there will be no decrease in the real estate value). A second cause was the existence of the moral hazard. The excessive bonuses and the belief that if anything went wrong, the central banks would intervene encouraged some excessive risks. As seen previously, the central banks did intervene. The existence of a shadow banking system constituted the third cause. These institutions looking like banks, functioning like banks, but that do not obey the banking regulations were at the centre of the financial crisis. Finally, the fourth cause was the deregulation of the financial derivatives market, these bond papers (worthing over 60 trillion dollars in 2008) becoming one of the most important systemic risk sources.

The **Crisis Economics** recommends a more efficient intervention from the government, especially by the consolidation of the existent agencies and by introducing a more restrictive legislative frame that would end the regulations arbitrage (all the financial institutions should obey the same regulations). It also recommends the division of the financial conglomerates considered "too big to be allowed to fall".

Although they do not state it clearly, the authors do not seem very optimistic with regard to the implementation of these measures, the financial system seeming to go back to the habits previous to the crisis. Nonetheless, as many economists admit, "it is a shame to waste a crisis".

3 September 2010

Uță Cristian, Lecturer Ph.D.

Redactor: Mihaela N. ȘTEFAN
Tehnoredactor: Marcela OLARU
Coperta: Magdalena ILIE

Bun de tipar: 27.09.2010; Coli tipar: 15,5
Format: 16/61×86

Editura Fundației *România de Mâine*
Bulevardul Timișoara nr.58, București, Sector 6
Tel./Fax: 021/444.20.91; www.spiruharet.ro
e-mail: editurafrm@yahoo.com

