

credit rating firms ... on whose ratings the Wall Street investors relied when buying mortgage-backed securities, had much history to draw on in assessing the risks of these kinds of securities.” Other critics will insist that while Sowell alludes to borrowers who were irresponsible, unsophisticated, or greedy, he assigns far too little weight to their behaviors for his account to be considered a balanced cause-and-effect story. Will future analysts eventually sort out and more accurately allocate blame for what happened? Housing’s boom and bust at the outset of the twenty-first century may never be fully understood, and Sowell’s account may or may not have struck the right balance in assigning responsibility, but the author’s attempt at explaining this most unfortunate episode in our history is surely laudable, and worth reading.

Freefall: America, Free Markets, and the Sinking of the World Economy. Joseph E. Stiglitz. 297 pages, New York: W.W. Norton & Company, 2010.

Reviewed by: Charles C. Carter

This is the best “crisis” book yet, even better than Paul Krugman’s. There’s everything here and it’s up-to-date and authoritative. And Stiglitz confirms I was right in giving Tett’s book a seal of approval, since he also gives Tett a seal of approval in his acknowledgments. (Gillian Tett’s book *Fool’s Gold* was the subject of my book review for this journal in volume 18, no. 1.) There are no graphs or tables, unlike the Shiller, Krugman, Baker, and Downs’ books, just text. Stiglitz’s style takes the reader from politics to macroeconomics to recommendations for crisis resolution in a free-flowing manner that makes for easy reading, though the book is thoroughly footnoted.

This is the first “crisis” book author I’ve read who has been a political insider (as well as a Nobel Prize winner): a member of President Clinton’s Council of Economic Advisers, chief economist at the World Bank, and chairman of the UN General Assembly on Reforms of the International Monetary and Financial System. But he does not mince words. He is in perfect agreement with Paul Krugman regarding what the U.S. government should have done and should be doing: a sizable stimulus program (much more than was allotted) should have been instituted immediately.

Stiglitz asks and answers all the tough questions. 1) Was the crisis foreseeable? Yes, Robert Shiller, Nouriel Roubini, Stiglitz himself, and others (all those who shared the view that markets were not self-correcting), saw it coming. 2) Is the financial system being properly reformed? No, the financial system shows signs of being very resistive to reform. 3) Has the Obama Administration taken a course of action much different than George W. Bush’s? No, Stiglitz says Obama just “muddled through.” 4) What were some of the main causes for the financial crisis? Repeal of Glass-Steagall, failure to regulate such things as credit default swaps, and the overriding view that markets regulated themselves (as put forth by Alan Greenspan) all contributed to the crisis. 5) What should be done to get the United States (and the world) on the right course? Remedy the fundamental flaws in the capitalist system.

Left, Right, and Center

Though he labels himself a centrist (page 37), Stiglitz is known generally as an outspoken liberal when it comes to politics. He was fired by the World Bank for criticizing its policies. Certainly he speaks his mind on everything covered in this book. Sometimes this is harsh stuff. The first sentence of Chapter 1 (page 1) reads: “The only surprise about the economic crisis of 2008 was that it came as a surprise to so many.”

A few notable quotes in the first two chapters, “Chapter 1 The Making of a Crisis” and “Chapter 2 Freefall and its Aftermath,” reflect the tone of the book:

“The sad truth is that in America’s financial markets, innovations were directed at circumventing regulations, accounting standards, and taxation (rather than economic growth)” page 8.

“There was no point of putting someone in a home for a few months and then tossing him out after having stripped him of his life savings. But that was what the banks were doing” page 11.

“Bankers, who had in large part precipitated the problem, took advantage of the panic that resulted to redistribute wealth—to take from the public purse to enrich their own” page 41.

“(T)he banks held a gun to the heads of the American people: ‘If you don’t give us more money, you will suffer.’ There were no alternatives, so they said. If you impose constraints—if you stop us from paying dividends or bonuses, or if you hold our executives accountable (as the government did in the case of GM), we will never be able to raise capital in the future” page 50.

Chapters 3 and 4 are titled “A Flawed Response” and “The Mortgage Scam,” respectively. Chapter 5 is titled “The Great American Robbery,” in which the author laments the special treatment given the financial industry. Bailouts included stock dividends, bonuses for executives, and the “whole nine yards,” when the crisis was the investment firms’ fault. And Lehman Brothers, Bear Stearns, and others, as investment banks, had no depositors’ insurance or anything set aside to meet needs of a crisis situation.

Chapter 6 is titled “Avarice Triumphs Over Prudence,” which recounts the history of deregulation since the Reagan administration. Here Stiglitz discusses the Gramm-Leach-Bliley Act of 1999, which repealed the Glass-Steagall Act of 1933, and the increased lack of transparency in financial markets. Instead of there being market incentives for transparency, as there should be, market incentives furthered lack of transparency, until the crisis hit. Sarbanes-Oxley (2002), passed just after the Enron debacle, and mark-to-market accounting, a practice meant to increase transparency, were and are constantly under attack by the financial services lobby.

The Housing Bubble

Chapter 4, “The Mortgage Scam,” is devoted to the housing bubble and how it burst. As we know now, badly underwritten mortgages were made, the problems were not

rectified, and, through further mishaps, these were packaged and sold to investors whose investments dropped precipitously when the mortgages defaulted and housing values plummeted. Different authors have stressed different main causes. Krugman stressed “the demise of the shadow banking system;” Shiller stressed “the bubble mentality.”

Stiglitz gives the reader a broad view of what took place and why, a view that keeps with the main idea of his book: reform of financial institutions. For Stiglitz the primary cause was a financial system based on the wrong incentives, a system that does not create incentives for doing those things that would enhance production and provide stability. It is this premise that forms the basis for later chapters in the book that discuss, broadly, reforms of economics and a movement toward global prosperity.

Waxing Philosophical

The last several chapters, Chapters 7 through 10, titled “A New Capitalist Order,” “From Global Recovery to Global Prosperity,” “Reforming Economics,” and “Toward a New Society,” respectively, go beyond the immediate problems with the U.S. economy. Here we can read some of Stiglitz’s international views on capitalism and we can surmise why these views got him fired as chief economist at the World Bank.

One theme running through the entire book is that income inequality in the U.S. has increased over the past decades and that that has had a deleterious effect on our economy. Stiglitz goes so far as to call this class warfare and blames the many processes that undermine transparency in the system. He discusses this theme on the international level. The class warfare theme comes across as especially vivid in his discussions of developing countries. He recounts that, when associated with the world bank, he saw first-hand how money went to a country’s upper-classes with little regard for economic development.

Included in these last chapters is his plan for a new, multilateral system of international trade and trade balances. The topic necessarily involves discussions running far afield from Republican versus Democrat politics in Washington and events such as the repeal of Glass-Steagall. Here he recounts topics discussed and views of developed and developing countries expounded at the G-7 and G-20 conferences.

Chapter 9 contains a wonderful discussion of the history of economic thought, from Adam Smith to Kenneth Arrow and Milton Friedman and beyond. Of all economists alive today, Stiglitz is among the most qualified to wax philosophical on the topics of international economics and macroeconomic theory.

Conclusion

This is a must read.

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