knowsquare

PREPARADO POR: ANTONIO GARCÍA SANSIGRE

5 DE OCTUBRE DE 2010

CRISIS ECONOMICS

A CRASH COURSE IN THE FUTURE OF FINANCE

RESEÑA DEL LIBRO DE
NOURIEL ROUBINI Y STEPHEN MIHM

knowsquare

Privado y Confidencial

Prohibida su Distribución sin Autorización Expresa de Know Square S.L.

© **KNOW SQUARE, S.L.** SOCIEDAD LEGALMENTE CONSTITUIDA EN ESPAÑA, CON DOMICILIO EN MADRID, PASEO DE PINTOR ROSALES 2, 6º. CIF B-85086460. REGISTRADA EN EL REGISTRO MERCANTIL DE MADRID, TOMO 24.295 FOLIO 82 SECCIÓN: 8 HOJA: 436797 INSCRIPCIÓN: 1.

"Crisis Economics – A crash course in the future of finance" (edición inglesa). Editorial: Allen Lane (Penguin). Autor: Nouriel Roubini/Stephen Mihm. 1ª edición: 2010 en EE.UU e Inglaterra. Páginas: 353. Precio: 18,45 dólares/12,51 libras.

¿Qué tiene de interesante el libro?

Nouriel Roubini se ha convertido en el nuevo gurú de la economía. Llamado profeta de la crisis, o también "Dr. Doom" por los más críticos, es un economista muy controvertido por sus pronósticos pesimistas. Desde 2005 venía alertando de la formación de una burbuja sobre un crédito demasiado fácil y el tiempo le ha dado la razón.

Es presidente de RGE Monitor (Roubini Global Economics, una consultora de análisis y coyuntura) y profesor de la Stern School of Economics de la Universidad de Nueva York.

Este libro viene a ser la culminación teórico-práctica, en forma de ensayo, de lo que ocurrió y de lo que se debe hacer para prevenir crisis en el futuro. El autor estuvo esperando a que otros autores publicasen sus versiones (Krugman, Akerloff, Rogoff, Shiller, etc.) y el resultado es el libro más actual sobre la crisis *(Nota: los recientes acontecimientos relacionados con la debilidad del euro no se recogen, aunque sí se adelanta la situación de Grecia y del resto de países del Club Med).*

Su libro estaba esperándose con avidez desde la industria editorial y va camino de convertirse, de hecho ya lo está siendo, en uno de los libros del año 2010.

Es un libro recomendado para todos aquellos interesados en economía. Por supuesto, su aproximación es algo más técnica que la de otros libros, como el de Leopoldo Abadía. Sirva como aviso para navegantes: aunque es un libro redactado de forma comprensible para el gran público, no es un libro nada sencillo, ya que requiere una base de conocimiento sobre macroeconomía y política monetaria básica.

Como anécdota, no hay ni un solo gráfico que muestre de forma visual los desequilibrios que bullían debajo de la burbuja. Son 350 páginas densas de explicación, que toca desde política monetaria, hasta política fiscal, hasta economía internacional, con énfasis en Estados Unidos. Por supuesto, España no es protagonista ni de lejos.

El libro recoge:

- Una síntesis de crisis pasadas.
- Una explicación detallada del desarrollo de la crisis de 2007.
- Un análisis de la actual situación y los riesgos que las medidas correctoras han generado.
- Una serie de recomendaciones a llevar a cabo para evitar futuras crisis.

Resumen

a) Economic theory has until today, focused on stability

Markets we supposed to be self-regulating entities, stable, solid, and dependable. By this reasoning, the entire edifice of twenty-first-century would regulate itself, keeping close to a steady, self-adjusting state of equilibrium. For decades it was the conventional wisdom. In this paradigm, not surprisingly, economic crises had little or no significant place. Indeed, if crises appeared at all, they were freak events: highly improbable, extremely unusual, and largely unpredictable. Serious academic study on crises was reserved for less developed, "troubled" countries, not economic powerhouses such as the United States.

b) Crises: the main character of economics movies

This book returns crises to the front and centre of economic inquiry. Far from being the exception, crises are the norm. Crises – unsustainable booms followed by calamitous busts – have always been with us, and with us they will always remain. In many important ways, **crises are hardwired into the capitalist genome**. The very things that give capitalism its vitality – its powers of innovation and its tolerance for risk – can also set the stage for asset and credit bubbles and eventually catastrophic meltdowns whose ill effects reverberate long afterward.

This book sets out the principles by which these economic storms can be tracked and monitored and, within reason, forecast and even avoided. What we just lived through is a taste of what is to come. Crises will figure in our future. So crises are the norm, not the exception. That's not to say that all crises are the same.

c) Economic philosophy

John Maynard Keynes once rightly observed that "the ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed, the world is ruled by little else. People in authority, are distilling their frenzy form some academic scribbler of a few years back" (dated 70 years ago). Much of our framing and understanding of the worst financial crisis in generations derives from a set of assumptions, from one ideology. But it is necessary to check ideology at the door and look at matters more dispassionately. Crises come in many colours, and what works in one situation may not word in another. So we are not devotes of any particular economist's thought. Almost every school of economics has something relevant to say about the recent crisis, and our analysis relies on a range of thinkers.

Crisis economics is the study of how and why markets fail. Much of mainstream economics, by contrast, is obsessed with showing how and why markets work – and work well. A host of economists – David Ricardo, Jean-Baptiste Say, León Walras and Alfred Marshall, reworked and refines Smiths' ideas. The consensus in the nineteenth century was that markets are fundamentally self-regulating. So if markets are in equilibrium, and their collective wisdom is always right, then the prices of assets bought and sold in the market are accurate and justified. This is based on the work of French mathematician Louis Bachelier (Théorie de la speculation, 1900), who argued that an asset's price accurately reflects all known information about it. In theory, the Great Depression should have put an end to this sort of nonsense, but postwar academic departments of economics and finance breathed new life into the old fallacy. Much of the credit goes to the economics department at the

University of Chicago. By 1970s the Efficient Market Hypothesis had become conventional wisdom, preached form academic pulpits at the University of Chicago and elsewhere.

NOTA COMENTARIO – Cómo se nota que Roubini es de Stern (Nueva York) y no de Chicago.

The most trenchant critic is Yale economist Robert Shiller. In the early 1980s, Shiller conducted research demonstrating that stock prices exhibit far more volatility than the Efficient Market Hypothesis can possibly explain. Additionally, the "feedback theory" was built upon the suggestion that investors who watch prices go up will jump on the bandwagon, sending prices still higher. Behavioural economists have added other factors, such as the "biased self-attribution", in which investors attribute their growing profits to their perspicacity.

The first economist to write about crises was John Stuart Mill ("Principles of Political Economy", 1848). Bubbles, Mill believed, begin when some external shock or accident sets speculation at work. He argued that a great extension of credit also takes place.

Marx, in The Communist Manifesto (1848), prophesied that capitalism is chaos incarnate, it will inevitably plunge into the abyss, taking the economy with it. So far Marx has not been proved right, but his larger point – that crisis is endemic to capitalism – is a good insight.

Keynes' "The General Theory of Employment, Interest and Money" (1936), casts a long shadow. Conventional wisdom believed that full employment is the natural state of things, so is unemployment rises, wages will fall, and entrepreneurs will start to hire again, lured by the prospect of increased profits, renewing the cycle. He saw it differently, as demand drops, entrepreneurs, he argued, will become more reluctant to invest, which will lead only to further wage cuts or layoffs. Likewise, ordinary consumers will save more and spend less, further dampening demand (the paradox). This creates"underemployment equilibrium", a state of suspended animation in which workers remain unemployed and factories shuttered. Keyne's solution was simple: government would step into the breach and create demand.

Friedman disavowed his views, as father of the monetarist school of economics. He thought that instability can be explained by fluctuations in the money supply. His interpretation of the Great Depression was that the collapse in the money supply ("The Great Contraction") caused aggregate demand to collapse, which reduced spending, income, prices and employment. Had the Federal Reserve prevented the waves of bank failures in the early 1930s, they argued, the Great Depression would have bet an ordinary one.

The effort to blend Keynes and Friedman was a neoclassical synthesis. Keynes' belief in the power of government was retained, but almost everything else Keynes wrote was ignored.
Not by all. Hyman Minsky built his works on Keynes. In his opinion, instability is an inherent flaw of capitalism". He also observed that financial intermediaries play a critical and growing role in modern economies, binding creditors and debtors in elaborate webs. So he categorized the debtors into three groups:

- Hedge Borrowers – they can make payments on both the interest and the principal from their current cash flow.
- Speculative borrowers – they can make payments on the interest but not on the principal.

- Ponzi borrowers – their income does not cover principal or interest. Their only option is to mortgage their finance by borrowing still further, hoping for a rise in the value of the assets they purchased with borrowed money.

So in a bubble, speculative and Ponzi borrowers grow.

The Austrian school (Carl Menger, Ludwig von Mises, Friedrich Hayek and Joseph Schumpeter, amongst others), held libertarian economic beliefs. They hold a great scepticism of government intervention in the economy. They also thought that many of the common cures for financial disasters are worse than the disease: because everyone comes to believe that in the event of a future financial crisis, a bailout will be forthcoming (moral hazard).

The Austrian approach focused on individual entrepreneurs as the unit of economic analysis. Schumpeter developed a powerful theory of entrepreneurship with his words: "creative destruction". Crises can be good because they separate the wheat from the chaff; they eliminate the zombies, the insolvents.

d) Not black swans

Crises are neither the freak events that modern economics has made them seen nor the rare "black swans". They are commonplace and relatively easy to foresee and comprehend. Call them white swans.

Bubbles are related to:

- Excessive growth in the supply of credit.
- Or a major technological innovation – the invention of railroads, or the creation of Internet –.
- Or financial innovations (such as the securitization of subprime mortgages).

But just as a fire needs oxygen, a bubble needs leverage and easy money, and when those dry up, prices begin to fall and deleveraging begins. That process began in the United States when the supply of new homes outstripped demand. The excessive number of homes built during the boom collided with diminished demand, as excessively high prices and rising mortgage rates deterred buyers from wading any further into the market. And **just as prices exceeded their fundamental value during the bubble, prices fall well below their fundamental values during the bust.**

COMENTARIO – Aunque a lo largo de todo el libro asevera la existencia de "reglas de las crisis", la realidad es algo más complicada, ya que muchas crisis no nacen sólo de una burbuja. Hay muchos otros motivos. Por ejemplo, el Reino Unido vivió una crisis muy seria en la década de los veinte porque ligó la libra esterlina al estándar del oro a un precio demasiado alto, lo que le hizo perder competitividad. No logró recuperarse hasta pasada la segunda guerra mundial. Sería más apropiado decir que su teoría es válida para aquellas crisis nacidas de burbujas.

Por otro lado, a menudo recoge comentarios y opiniones de autoridades públicas como Henry Paulson o Ben Bernanke. En ellas, suelen infravalorar los riesgos de la explosión de burbujas. Es injusto cargar contra ellos, ya que un político nunca sale airoso de una valoración económica negativa: no se puede ser honesto, ya que si lo eres, el efecto que provoca es forzar más la caída. Y si no lo eres (con objeto de influir sobre los inversores), como suele ocurrir, luego se le echa en cara haber metido la pata. Es un poco como el principio de Heisenberg, su opinión influye sobre lo observado.

e) It is not as straightforward as it seems

It has been fashionable to blame it on recently issued subprime mortgages that somehow infected an otherwise healthy global financial system. It is an absurd perspective, and we show how decades-old trends and policies created a global financial system that was subprime from top to bottom.

NOTA – Esta es la explicación ofrecida por Leopoldo Abadía que, siendo correcta, es incompleta.

f) It was a global weakness

Could it be that the rest of the world merely caught a disease that originated in the United States? Far from it: the vulnerabilities that plagued the U.S. financial system were widespread. **Only countries whose financial system suffered from similar frailties fell victim to it.**

g) How to react and the aftermath

It makes sense to follow the playbook devised by Keynes in the short term, preventing a disorderly collapse of the entire financial system via monetary easing and the creation of bulwarks: via lender-of-last-resort support, or capital injection into banks. But when it comes to medium term and long term, we must follow the Austrians playbook: cleansing, reducing the level of the debt of the different players. In the long term, it is absolutely necessary for insolvent banks, firms and households to go bankrupt and emerge anew.

All crises end, and this one was no exception. Unfortunately, the aftershocks Hill linger on for years if not decades. Deflation and depression loom large in the wake of any crisis. In the past, central bankers used monetary policy to counter crises, and now they've revived some of these approaches. At the same time, many financial crises force central bankers to innovate on the fly, as the recent crisis shows. Unfortunately, while these emergency measures may word, they can, like any untested remedy, end up poisoning the patient.

h) The Fed's reaction

Bernanke, as Fed's chairman, had studied the Great Depression, and did not want to repeat the same mistakes in 2007, so he directed a stunning series of interventions into the financial system. The Fed, in its rush to prop up the financial system, rescued both illiquid and insolvent financial institutions.
This raises a series of dangers. One of the is deflation, studied by Irving Fisher, caused by a sharp fall of aggregate demand relative to the supply of goods and the productive capacity of the economy.
Another danger is the liquidity trap, in with ordinary monetary policy does not work properly. It happens when the Fed has exhausted the power of open market operations. It arrives when the Federal Reserve has driven the Federal funds rate down to zero. And it happens when banks get money from the Fed but do not lend it, but hoard it. You can lead a horse to water, but you can't make it drink. To deal with this problem, the Fed set up a series of new liquidity facilities. The government jumped directly into the market and made loans directly.

Addressing the needs of other countries, the Fed cannot lend directly to financial institutions outside the United States, so it lent dollars to foreign central banks. By late 2008 these swap lines totalled half a trillion dollars.

Another instrument used by the Fed is called "quantitative easing", meaning direct intervention of the Fed in markets for long-term debt. By buying long-term government bonds and injecting money, the price goes up, the yield goes down, becoming less attractive to banks, who will look for other places to sink their extra money.

Central banks also acted as investors of last resort.

Once these instruments have been deployed, it is crucial a mid-long term strategy to recover from that flow of easy money. It is usually called the "exit strategy", to be executed when credit conditions improved.

i) A new architecture

A new financial architecture is needed, one that will bring new transparency and stability to financial institutions.

The crisis has shown that the devil lies in the details:

- We must cure compensation – bank managers were lured by short-term profits and do not think about the long term. Even worse, when things go south, they bet even more (it is called gambling for redemption). Shareholders should monitor it, but they do not have enough information (and sometimes they do not care). It is called the principal-agent problem. This can be solved in various ways, for instance, by compensating the traders with restricted shares in the firm, recalculating bonus pools based on long term bets, holding bonuses in escrow (a malus system), or compensating traders with the same securities they sell.
- Re-assessing the elaborate system of securitization, by obliging banks to hold part of the same asset-backed securities they sell, by standardizing the securities much more (this creates more liquid and transparent markets). The problem comes with the famous CDOs. These should be heavily regulated if not banned, because they do not transfer risk so much as mask it. So it is about the quality of the ingredients.
- Reforming ratings – The rating agencies had serious conflicts of interest. The reform should include opening up competition in the realm (there are 3 main competitors today, there should be more), or take away the semiofficial role that the rating agencies enjoy, or avoiding the conflict of interests by mandating that all institutional investors pay into a common pool that would be administered by regulators.
- Dealing with derivatives, making sure they are dealt with over the counter. Creating transparent markets for them, creating a central clearinghouse, central database registering and banning insurance companies from selling these guarantees. The new generation of derivatives should be the subject of far more ruthless scrutiny. Their existence poses a far greater danger: they do not only imperil economic growth, but they create a great danger to economic stability.
- Changing the Basel rules – reversing the procyclality of the methods by creating dynamic provisioning or contingent capital, reducing or requiring eliminating short-term borrowing, reducing the discretion of the Value At Risk model.

© Antonio García Sansigre
© Know Square S.L.