

Book reviews

MELTDOWN: A FREE-MARKET LOOK AT WHY THE STOCK MARKET COLLAPSED, THE ECONOMY TANKED AND GOVERNMENT BAILOUTS WILL MAKE THINGS WORSE

Thomas E. Woods Jr.

Washington, DC: Regnery, 194pp., ISBN: 978
1 59698 587 2, \$27.95 (hb), 2009

FINANCE: SERVANT OR DECEIVER? FINANCIALIZATION AT THE CROSSROADS

Paul H. Dembinski

Basingstoke: Palgrave Macmillan, 176pp.,
ISBN: 978 0 230 22037 9, £60.00 (hb), 2008

It is difficult to imagine two views of the financial crisis that are so different. One wonders what they would have said in a review of each other's work!

Thomas Woods produces a free-market critique of the events leading up to the financial crash. Whereas many other authors have pointed to the so-called herd-like mentality of participants in financial markets, with investment banks under-pricing risk and getting too deeply involved in subprime markets, very few of them have asked the question 'why did they do this?'. Why should rational, intelligent individuals behave like this and in the process lose so much money? Why should this

behaviour bring the financial system crashing down? Thomas Woods answers this question with much, rich detail.

He argues that government regulation created the housing bubble. If the market 'fails' and needs government to 'correct' it, then why did the government create the securitisation warehouses Fannie Mae and Freddie Mac? Why did it encourage a 'pro-ownership tax code'? And why did it pump up the money supply with artificially cheap credit? In addition to this, Woods explains the problems of implicit bailout guarantees in the banking system and puts to rights many of the myths that have grown up surrounding the Great Depression. In summary, Woods is saying that the state should have taken Ronald Reagan's advice every time it was asked to intervene in the financial sector: 'Don't just do something, stand there!' Whatever one's view of the cause of the financial crisis, it is very clear that the government did not anticipate anything that the private sector did not anticipate – in other words, whatever problems there might be from time to time within free financial markets, the state is not equipped to anticipate them and regulate in a way which will stop these problems arising. The author also sketches out how a free-market monetary system would work along Austrian lines.

My only criticism of an excellent book – which should be read by all those on all sides of the debate – is that at first it is not totally clear, when proposing his Austrian perspective on monetary reform, whether he believes that his framework would evolve out of a free market or whether it needs to be constructed by government. Gradually this becomes clear, so this is only a criticism of a small aspect of style and not of substance.

Intrinsically, I have less sympathy with Dembinski's argument, but he raises an important issue. His main proposition is that transactions have

come to dominate relationships in the banking industry. He would like a return to the old-fashioned ways of doing business. This is a serious proposition and one which deserves serious attention. He strongly criticises the neoclassical/neo-Keynesian hegemony in academic economics: here Woods and Dembinski would agree entirely.

Dembinski associates the neoclassical dominance of economics with the supposed triumph of free markets. This does not accord with the facts. The role of the state in many sectors (not least in financial services, certainly in the UK) has grown hugely in the last 40 years. That growth has partly been in the form of regulation, encouraged by the 'market failure' approach of neoclassical economics.

There is too much polemic when the author is putting his case. In one flourish, Dembinski quotes Mrs Thatcher's 'No such thing as society' comment – if this comment is worth bringing into the author's argument, at least it should be set in its proper context. The author talks about Eurodollars emerging in a regulatory vacuum. In fact, like the transaction-based banking system that the author decries, the development of Eurocurrency markets have the fingerprints of government regulators all over them – Eurocurrency markets were developed to avoid regulation; the transaction-based banking system and securitisation was very much encouraged by regulation and government bodies.

Essentially, the approach of the author is Christian Democrat. The author would like markets with a 'human face'. This is all well and good but systems of relationship banking; corporate governance systems that allow management to focus on things other than owner-value; slowing down the speed of information flows in the market; and many other things that the author would like to see all have their

downsides. Relationship banking was often elitist and discriminatory – and the cartels that facilitated it contributed to *negative* real interest rates of –15% in mid-1970s Britain: one-sixth of a saver's capital disappearing in one year. The Japanese financial crisis of the early 1990s was addressed first by trying to slow down the production of financial information as Dembinski would like but this did not work – the institutions really were bust! And there is nothing moral about managers pursuing their own objectives, rather than those of the owners of the property they are hired to manage. The 'retain and invest' approach to company profits that Dembinski proposes should be restored is anti-competitive and has the potential to starve new companies of capital. Also, to somebody who had to do his homework by candle-light, put up with 27% inflation, and walk miles because of bus strikes, the phrase 'thirty golden years' to describe the 1950s, '60s and '70s does not ring true. The reliance of the argument on assertions is perhaps summed up by one phrase in the book: 'little has been written on the subject, for obvious reasons, but there can be no doubt that built-in obsolescence is a key aspect of product design'. If there is so little research, how can there be no doubt?

But, I do have some sympathy with the author. He wants a world of better people and better financial relationships. He does not wish to build this through regulation – and, indeed, is extremely critical of prescriptive regulation in the financial sector and elsewhere. But the issues that the author tries to connect do not really connect. Perhaps that is most obvious when a proposal is brought up to increase untied budget support for underdeveloped countries: it is possible to believe that such support has been catastrophic in enriching the corrupt elites that prevent civilised development whilst also taking the view that we need more integrity in financial markets – the two issues are not obviously connected. As I have mentioned, this is a firmly Christian Democrat view of the world. Coming from a country, the UK, where, next year, the government will spend around 20% more than the citizen, I simply do not accept the 'triumph of market liberalism' assertion. So, even if many of the perspectives are interesting,

I think they start from a series of false premises. But, nevertheless, I learned a great deal from reading the book.

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