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# Boom, Bust. Repeat.

*Financial meltdowns typically follow real-estate bubbles, rising indebtedness and gaping deficits.*

By [EDWARD CHANCELLOR](#)

The great 19th-century British journalist Walter Bagehot claimed that during each speculative upturn merchants and bankers "fancy the prosperity they see will last always, that it is only the beginning of a greater prosperity." A boom in U.S. stocks in the early 1900s was remembered by Alexander Dana Noyes, the financial editor of the New York Times in the 1920s, as "the first of such speculative demonstrations in history which based its ideas and conduct on the assumption that we were living in a New Era; that old rules and principles and precedents of finance were obsolete; that things could be done safely to-day which had been dangerous and impossible in the past." This mode of wishful thinking has continued up to the present day.

Instead of providing salutary warnings, economists have more often played the role of academic shills during each successive New Era. Irving Fisher of Yale, in September 1929, notoriously opined that stocks had reached a "permanently high plateau," justifying this view with the claim that Prohibition had enhanced worker productivity and that businesses were employing new "scientific" management practices. More recently, just a few short years ago, Federal Reserve Chairman Ben Bernanke and a number of other academic economists hailed the "Great Moderation," arguing that rising institutional debt levels were tolerable, thanks to better monetary policy and better risk-reducing financial innovations. During the boom years, Mr. Bernanke pronounced that rising house prices were a sign of improved economic fundamentals rather than speculative excess.

It turns out that the Great Moderation was, in fact, a great snare—a time of intemperate borrowing and risk-taking that would eventually destroy wealth rather than create it. Yet we didn't need to experience the greatest financial crisis since the 1930s to arrive at this conclusion. As Carmen Reinhart and Kenneth Rogoff show in "This Time Is Different," financial catastrophe is invariably preceded by periods of prosperity and New Era rationalizations.

Messrs. Reinhart and Rogoff have compiled an impressive database, which covers eight centuries of government debt defaults from around the world. They have also collected statistics on inflation rates from every country where information is available and on banking crises and international capital flows over the past couple of centuries. This lengthy historical study gives what they call a "panoramic view" of the unending cycle of boom and bust, showing how claims that "this time is different" are invariably proven wrong.

The Great Moderation of the early 2000s had much in common with the 1920s. Both periods were characterized by quiescent inflation. International capital flows surged. Defaults on both national and private-sector debt fell off. The business cycle appeared tamed. But then came the wildness that precedes a crisis: Messrs. Reinhart and Rogoff demonstrate that financial meltdowns typically follow real-estate bubbles, rising indebtedness and gaping current-account deficits. Before 2007, the economies that are suffering most today, from tiny Iceland to the mighty U.S., shared these maladies.

"This Time Is Different" doesn't simply explain what went wrong in our most recent crisis. The book also provides a roadmap of how things are likely to pan out in the years to come. Real-estate bubbles invariably give way to banking crises. Losses in the financial sector are followed by the sharp deterioration in government finances amid bailouts and decreased tax revenue. The decline in economic output that follows the bust is sharp, but the recovery tends to be slow and protracted. The situation is especially dire when the crisis is geographically widespread.

Messrs. Reinhart and Rogoff are content to furnish the historical data on the cycles of boom and bust. As economists, professors at the University of Maryland and Harvard respectively, they recognize the challenge to their discipline created by the recent financial collapse. But they offer frustratingly little economic theory to accompany their findings. There is nothing here on the role played by loose monetary policy in fueling speculative manias, although this subject has been addressed by earlier generations of economists, most notably the Austrian School, of which Ludwig von Mises and F.A. Hayek are the best known representatives.

Nor is there any mention of the work of the late Hyman Minsky, whose "financial instability hypothesis"—suggesting that periods of stability encourage excessive risk-taking—explains why New Eras contain the seeds of their own destruction. The authors also ignore the role played by international exchange-rate regimes, from the gold-exchange standard of the 1920s to the U.S.-dollar standard today, in fostering global economic crises.

Despite these limitations, "This Time Is Different" is an important addition to the literature of financial history. It also issues a worrying economic forecast. Currently the markets are discounting a rapid and sustained recovery from the global economic meltdown. Around the world, governments are borrowing very large sums at very low rates—assuming that stimulus spending will generate future taxes to pay off the current debt binge. But Messrs. Reinhart and Rogoff's work points in a rather different direction: toward the potential for future national debt crises and rising inflation. Of course, this time may be different. But don't bet on it.

**Mr. Chancellor is the author of "Devil Take the Hindmost: A History of Financial Speculation."**

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