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OFF THE SHELF

Recession, You Look Familiar

By DEVIN LEONARD

AFTER the financial markets melted down last year, there was some great political theater in Washington. Alan Greenspan, the former Federal Reserve chairman, told the House Government Oversight and Reform Committee that he couldn't believe what had happened. "We are in the once-in-a-century credit tsunami," he said.

Richard S. Fuld Jr., the last chief executive of the bankrupt Lehman Brothers, lamented that he, too, had been blindsided. No one, he assured the committee, "was prepared for this one."

Such performances were gripping, in their way. But they may take on a level of absurdity after reading "This Time Is Different: Eight Centuries of Financial Folly" (Princeton University Press) by two economics professors, Carmen M. Reinhart of the University of Maryland and Kenneth S. Rogoff of Harvard.

The authors use copious amounts of data — well, actually, numbing amounts — to make the compelling case that any well-informed person should have seen the Great Recession coming. The essence of their book is that while financial crises come in different varieties, they are not mysteriously born of undersea earthquakes, but frequently occurring events that can be spotted and even controlled if politicians and regulators know what to look for.

"Our basis message is simple: We have been here before," the authors write. "No matter how different the latest financial frenzy or crisis always appears, there are usually remarkable similarities with past experience from other countries and from history. Recognizing these analogies and precedents is an essential step toward improving our global financial system, both to reduce the risk of future crises and to better handle catastrophes when they happen."

These academics have found the same disturbing patterns in economic data from more than 66 countries: A nation's political leaders loosen regulations governing the financial system.

Banks use the new freedom to borrow money and earn juicy returns. Soon, these sovereign states are awash with money from foreign investors. But beware these torrents of outside wealth. They are accompanied by bubbles in stocks, commodities and real estate.

Often, policy makers and business leaders step forward and say that nobody should be fearful. Yes, bubbles have burst before — but now, they say, investors are safe because the old dangers no longer lurk.

As the authors note, this was said about Latin America and Africa in the 1970s, Asia in the 1990s and, of course, the United States in the last decade.

Bubbles, however, inevitably go splat. And what happens next isn't pretty. Countries like Mexico, Argentina, Brazil and Nigeria defaulted on debt in the 1980s. In the late '90s, Ms. Reinhart and Mr. Rogoff note, "Korea, Indonesia and Thailand, among others, were forced to go to the International Monetary Fund for gigantic bailout packages, but even this was not enough to stave off deep recessions and huge currency depreciations."

And, of course, we all know what happened in the United States. The authors point out that Mr. Greenspan and his successor, Ben S. Bernanke, "argued vigorously that the Federal Reserve should not pay excessive attention to housing prices, except to the extent that they might affect the central bank's primary goals of growth and price stability." Famous last words.

Some of the book's findings are obvious. Bubbles are dangerous? Gee, you don't say. But others are revelatory. Americans have every reason to be ashamed of the real estate boom. Many of us believed that we had earned the instant wealth we accrued as housing prices spiked. But people worldwide suffered when this easy money disappeared.

It turns out that the United States isn't the only nation where a banking crisis was preceded or accompanied by a real estate bubble. The authors found that over the last 100 years, this has happened in tandem with 21 major banking crises. No wonder they suggest the International Monetary Fund keep a close eye on property values.

"This Time Is Different" seems unlikely to be a best seller. The authors have chosen to present their findings rather dryly, with numbers and tables, instead of enlivening them with colorful observations and anecdotes that might seduce non-academics into digesting such complex subject matter.

"We trust that our visual, quantitative history of financial crises is no less compelling than the earlier narrative approach," the authors write.

They devote far too many pages to legalistic definitions and charts that are barely distinguishable from the ones of the page before. A little more color would have helped immensely.

Still, you have to admire them for being so dogged. They say up front that they hope to influence economy policy, and they may succeed. They make a predictable call for more oversight and advocate the creation of a new “international financial regulatory institution” to look for danger signs like rising property values so it can prod countries to dampen their overheated economies before they blow up.

That last proposal may be wishful thinking. But it is not too much to ask officials at existing regulatory agencies to do a better job. They, of all people, should read this book. It may be a bit too much for average readers, but everything they need to spot the next recession is in there.