Financial Fiasco

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Financial Fiasco: How America's Infatuation with Homeownership and Easy Money Created the Economic Crisis
By Johan Norberg
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The financial meltdown of 2008 delighted the enemies of laisser faire. Westminster and Washington have resounded to speeches claiming that the collapse of **Lehman Brothers** justifies any amount of fresh regulation.

Johan Norberg of the Cato Institute has written a book to refute this leftish gloating. *Financial Fiasco: How America's Infatuation with Homeownership and Easy Money Created the Economic Crisis* is more subtle than its brazen title suggests. It describes the wide-ranging causes of a "perfect financial storm" but with one underlying theme: the role of government in creating the conditions for the boom, and counterproductively intervening against the subsequent crash.

Norberg blames former US Federal Reserve chairman Alan Greenspan's low interest rates and the ballooning surpluses of east Asia for providing the monetary fuel for the boom. But his main focus is where the money went – to an insane housing market, full of perverse incentives and deluded or deceitful participants, and beset by dangerous government meddling. Two examples of particularly egregious policymaking stand out: the very existence of Fannie Mae and Freddie Mac, sluicing politically targeted streams of capital towards low earners; and the deeply flawed and privately motivated ratings agencies, granted a distorting role in US regulation. Widespread political support for the resultant bubble kept sceptical voices from being heard. After reading this book, only a naive reader could argue that extra regulation can fix a boom.

But this is far from proving that the crisis was simply caused by a state-induced obsession with homeownership. The chiefs of Wall Street are not meekly led wherever the government commands. The author's largely anecdotal style prevents him from teasing out the issue with concrete figures. In particular, he fails to address how subprime lending, for all its lunacy, made up just 13 per cent of US mortgage lending. Often he seems ready to recognise that this bubble was a worldwide phenomenon, taking different forms wherever the easy money flowed; in fact, he writes about how "pyramid schemes involving various assets will often start spontaneously". It was not just for places with a Community Reinvestment Act, as Dubai's recent collapse has shown. But this recognition sits uneasily with the idea that US housing was behind it all, and remains relatively unexplored.

The anti-government line becomes less convincing when the book criticises how governments tried to prevent systemic collapse after Lehman went bust. Up to that point, it paints a terrifying picture of the abyss faced last autumn, of businessmen scared witless and companies everywhere struggling to get funding. This jars when held against the accusation that Fed chairman Ben Bernanke and Hank Paulson, then US Treasury secretary, resorted to scaremongering to get $700bn from Congress. While bungled, the troubled asset relief programme was neither a Machiavellian plot to take over the economy nor disproportionate to the perils faced. In the end, it was what was needed.

At other points the author quite arbitrarily highlights the role of the state in events with many contributory causes. The British are blamed for the collapse of both Lehman and Kaupthing, as if a "private sector" solution of cobbled-together financial conglomerates might have been sustainable. In a short book of 150 pages, Norberg does not explore the counterfactual. The Barclays-Lehman behemoth that Alistair Darling, UK chancellor of the exchequer, refused to underwrite might well have created an even larger bust down the line.

The weakest arguments are reserved for macroeconomics. Norberg casually uses scepticism about the New Deal and its institutional creations to produce a timeless warning against government intervention. It is not very convincing.

Ultimately, Austrian-style economics like this fails to appreciate the real damage caused by demand slumps. Blind faith that economic destruction will smoothly sort winners from losers leads its adherents into a knee-jerk condemnation of any government intervention. This ignores the evidence all around us. Indiscriminate financial meltdown brings arbitrary destruction upon countless businesses that are innocent of the "sin" of subprime lending. This lack of balance is a pity, because *Financial Fiasco* is good descriptive history and a welcome addition to the literature. All it needs is to recognise that government, very occasionally, offers the best way to protect the economic liberty so precious to the author.

The writer is chief economist of CentreForum, a liberal think-tank more to distribute to others.