Book Review:

Freefall: America, Free Markets, and the Sinking of the World Economy. By Joseph E. Stiglitz, New York, NY: W. W. Norton & Co., October 4, 2010. Price $16.95, Paperback: 443 pages, ISBN-10: 0393338959, ISBN-13: 978-0393338959.The first edition was published as hardcover edition (361 pages) on January 18, 2010, and as a Kindle edition (361 pages), sold by Amazon Digital Services, on October 4, 2010. The paperback edition adds 44 pages of an Afterword to the hardcover/Kindle edition.

Joseph E. Stiglitz is a professor of economics at Columbia University, a Nobel prize-winning economist (2001), former Chairman of President Clinton's Council of Economic Advisors (1995-97), former Senior Vice President and Chief Economist at the World Bank (1997-2000), and the chair of a United Nations Commission on the reasons for and solutions to the financial crisis (2008). *Freefall is* an important book that has been translated into 20 different languages. This book does not require a background in economics and is of value to an average person. Stiglitz discusses the causes of the Great Recession (2008-2009); the battle of ideas that led to this financial and economic calamity; the failure of policy and politics; and reforms needed to avoid a repetition of a similar crisis. He indicates that without fundamental changes in economic policy and regulation, the position of the US in the world political and economic arena will continue to weaken significantly.

Stiglitz notes that unlike the multitude of other crises before it, this crisis was “Made in the USA” and quickly spread around the world; the last time that America had exported a major crisis was during the Great Depression of the 1930s. He describes the basic outline of the crisis as follows: Alan Greenspan, the Fed Chairman, had allowed the tech (dot.com) bubble to develop that had sustained a strong growth in the late 1990s. As the tech bubble burst, America went into a recession in March 2001. The President George W. Bush pushed through tax cuts and the Fed lowered interest rates,

thus flooding the market with liquidity. With so much excess capacity, the lower interest rates replaced the tech bubble with a housing bubble. The mortgage equity withdrawals – which in one year hit $975 billion or more than 7 percent of GDP -- allowed borrowers to continue their consumption binge. Two-thirds to three-quarters of the economy was housing-related. When the housing bubble burst, house prices fell and people cut back their spending; many lost their jobs and their homes; many lost their savings, retirement funds, money for their children's college, etc. Americans had been living beyond their means; average savings rate had fallen to zero. The banks had created complex products resting on top of the mortgages; and they had engaged in multi-billion dollar bets with each other and with others around the world. Like the consumers, the banks were highly leveraged and due to the complexity of their financial products they did not know whether their liabilities exceeded their assets. The trust among the banking system disappeared and they refused to lend to each other and demanded high interest to compensate for bearing the risk. The unfolding residential real estate crisis was followed by commercial real estate crisis; consumption fell as property values and stock market declined; companies reduced their inventory quickly as a result and that led to a manufacturing collapse in America.

The Fed and the Treasury acted in tandem to rescue the banking sector by providing hundreds of billions of dollars of tax money. He notes that Henry Paulson, the TreasurySecretary, threw $89 billion life line to AIG, then it was almost doubled to $180 billion. AIG's obligations were settled in very questionable manner with, for example, $13 billion handed over to Goldman Sachs, the previous employer of Paulson. President Obama kept much of the old team in place and their rescue package, linked to Wall Street, was also flawed. "Revolving doors in Washington and New York also stoked the movement to prevent new regulatory initiatives."

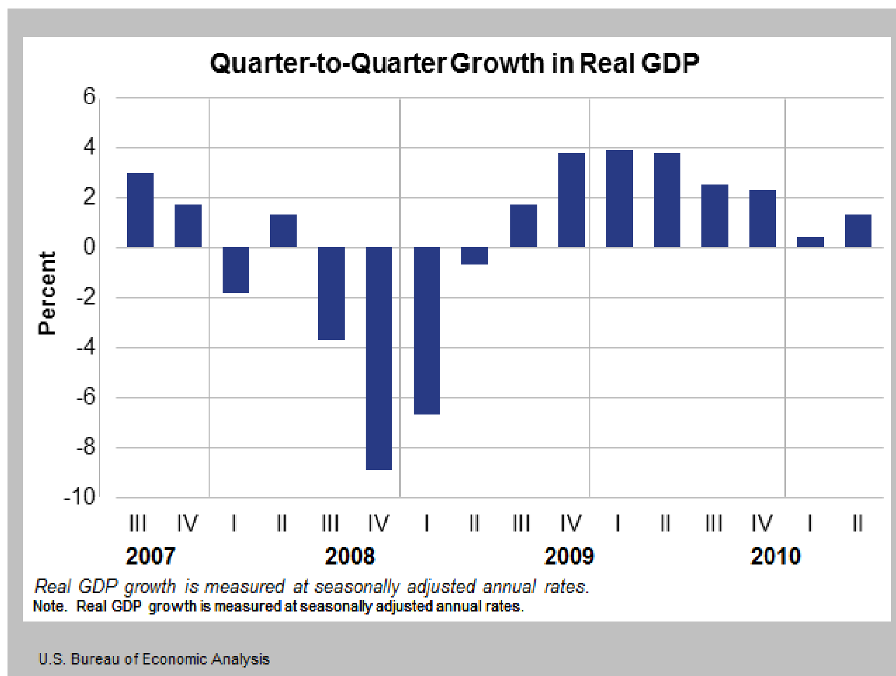
The author notes that the Great Recession of 2008-2009 was the worst recession since the Great Depression of the 1930s. The regulation that was passed after the Great Depression brought stability and prosperity for fifty

years but then free market fundamentalism took hold in America and in Washington. "For a quarter century, certain free market doctrines have prevailed: Free and unfettered markets are efficient: if they make mistakes, they quickly correct them. The best government is a small government, and regulation only impedes innovation. Central banks should be independent and only focus on keeping inflation low." He notes that even the high priest of that ideology, Alan Greenspan, now acknowledges that this was a flawed reasoning. Stiglitz notes that "markets lie at the heart of every successful economy but markets do not work well on their own… Government needs to play a role, and not just in rescuing the economy when markets fail and in regulating the markets to prevent the kinds of failures we have just experienced…" He notes that over the past twenty five years, this supposedly self-regulating apparatus, our financial system, has repeatedly been rescued by the government. Crises in developing countries have occurred with surprising regularity – 124 between 1970 and 2007. He points out several areas of economics that need reforming and where battles of ideas are being fought.

Stiglitz notes, in the Afterword to the Paperback Edition, that since the publication of the hardcover edition, "the events have (sadly) unfolded as expected: growth has remained weak, sufficiently anemic that unemployment has remained stubbornly high; mortgage foreclosures have continued apace; and while bank bonuses and profits have been restored, the supply of credit has not, even though the resumption of credit was supposedly the reason for the bank bailout. And, as predicted, political fallout from these failures means it is unlikely that Congress will pass the kind of second stimulus package that is needed." He further notes "The real news of the last eight months has been the slow acceptance by government officials and economists alike of the dismal picture of the immediate future about which I had warned: a new "normal" with higher unemployment rates, lower growth, and lower levels of public services in the advanced industrial countries."

The Business Cycle Dating Committee of the National Bureau of Economic Research (NBER) has indicated that the last contraction

(recession) started in December 2007 (Q-VI) and ended in June 2009 (Q-II).The GDP expanded at a 1.3 percent annual rate in the second quarter of 2011, after a 0.4 percent growth rate in the first quarter. The GDP stood at $13.27 trillion at the end of the second quarter of 2011, below the $13.33 trillion peak of the fourth quarter of 2007. The unemployment rate climbed to 9.2 percent in June 2011. Consumer spending, which accounts for about 70 percent of GDP, slowed while there was a 4.4 percent decline in purchases of durable goods. The US faced default if the congress did not raise the $14.3 trillion debt ceiling. This economic and political performance is consistent with Stiglitz's analyses and predictions in *Freefall*.



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