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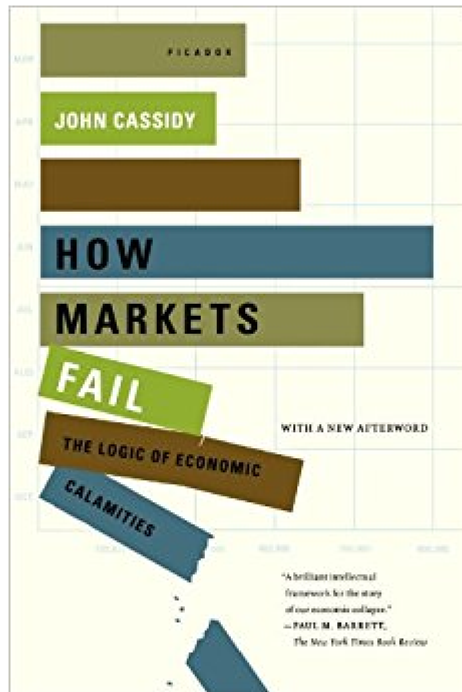
How Markets Fail: The Logic Of Economic Calamities



Synopsis

For fifty years, economists have been developing elegant theories or how markets facilitate innovation, create wealth, and allocate society's resources efficiently. But what about when they fail, when they lead us to stock market bubbles, glaring inequality, polluted rivers, and credit crunches? In How Markets Fail, John Cassidy describes the rising influence of "utopian economies"â •the thinking that is blind to how real people act and that denies the many ways an unregulated free market can bring on disaster. Combining on-the-ground reporting and clear explanations of economic theories Cassidy warns that in today's economic crisis, following old orthodoxies isn't just misguidedâ •it's downright dangerous.

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Customer Reviews

The 2007 and 2008 crisis in world economics and financial markets have spawned many books. This is one book that talks about the same crisis but perhaps in a much more insightful way than any other. Dwelling on the interplay between economic policies and financial markets this book is difficult to put down once you realise the enormous promise it holds when you read the 12 pages of the 'Introduction' chapter. That promise is not belied although John Cassidy, the author, could have been clearer and more elaborate in the solutions he offers.Cassidy refers to the idea that a free market economy is sturdy and well grounded as an "illusion of stability". He calls this "Utopian economics". This forms the first of three parts of his book and includes eight fascinating chapters on the people and ideas that shaped it.This section of the book first lays out in great detail how

economic theories and economists came about to have a large sphere of influence in central banks' monetary policy matters and governments' economic policies. It describes how the "Chicago School" of economics, propagating free market economy with almost zero regulations, ended up enormously broadening their sphere of influence in the top echelons of the US Federal Reserve and the Treasury department of the US government. What follows is an excellent exposition of 10-12 most-influential economists including Adam Smith, John Keynes, Milton Friedman, Robert Lucas and Friedrich Von Hayek, as well as a couple of mathematicians such as Eugene Fama.Taking the reader back and forth in time, Cassidy beautifully connects the conservative economists with the "neo" liberalists, mathematics with economics, and evangelist-led economic theories with existing practices in financial markets and governmental regulations.

Cassidy analyzes how orthodox economic theory (he calls Utopian economics) went astray. While Adam Smith advanced the merits of market competition and free trade in "Wealth of Nations" in 1776; He warned against unregulated credit creation and ensuing speculative excesses. But, economists focused solely on Smith's benefit of free markets. The field of economics became increasingly quantitative based on flawed assumptions including Cassidy's four basic Utopian illusions:1) the illusion of harmony (free markets always generate good outcomes);2) the illusion of stability (free market economy is sturdy);3) the illusion of predictability (distribution of returns can be foreseen); and4) the illusion of Homo Economicus (individuals are rational and act on perfect information).This idealized framework allowed economists to develop overreaching math models increasingly disconnected from reality. This trend started with Friedrich Hayek, leading Austrian economics, who stated in late 1930s that prices communicate near perfect information that determined underlying demand and supply. This was a brilliant insight if not taken too far. In the 1970s, Eugene Fama builds upon Hayek's insight with the Efficient Market Hypothesis (EMH) that stated stock prices captured all available information. Thus, stock prices move randomly and both technical and fundamental analysis do not add value. The theory was popularized by Burton Malkiel in A Random Walk Down Wall Street: Completely Revised and Updated Edition. The EMH was a brilliant insight backed by data (the majority of mutual fund managers do not beat the index to this day).

This book was great in places and painful in others.On the one hand, I think he does do some wonderful things in the way of reviewing history and certain distortions that have lead to crisis. Part 2 of the book of is fairly accurate.On the other hand, in his search to put everything on Alan

Greenspans doorstep, he left out some very important details. Further he also just got parts of finance, particularly the parts that are important to this crisis, just plain wrong. I can't get too mad at him, because if I had a nickel for every journalist, let alone finance professional that has gotten it wrong, half right, somewhat confused, or otherwise, I'd have a lot more than 1$.So let's go through it a bit.1 - While it's nice to blame Greenspan, you really can't just do so, particularly when you're writing a book about market regulation. I mean, while the FRB did create the laws which cover Home Ownership and Equity protection as well as the Equity Credit Opportunity Act, it's actually the FTC that regulates the Mortgage brokers NOT the Fed. Further the FED does not solely regulate the Banking Trusts (Investment banks), the SEC, does that job. Nor does the Fed regulate the ratings agencies or the the insurance companies (AIG). Hence, to put it all on the fed, kind of misses the other parties that were a bit asleep at the wheel and also obsconds one of the major problems in the dependancies of the argument he sets forth in Chapter 1, i.e. "increasing regulation" or seeing the Greenspan as a period of "laissez faire". This is not to say that Cassidy makes the argument that Greenspan's world was without regulation.

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