BOOK REVIEW Economics

The Return of Depression Economics and The Financial Crisis of 2008 by Paul Krugman. (1998, 2008) , Penguin Books, Pp. 199, Rs. 399, Isbn: 978-1-1846-14239-0

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Paul Krugman in his book on '*The Return of Depression Economics and the Financial Crisis of 2008*' throws light on how crisis evolved in the United States and the reasons for its occurrence. He also suggested several solutions for preventing such crisis.

The book is a short and easy read divided into ten chapters. The author begins by giving a brief background about the world state of affairs after the fall of communism and the rise of capitalism, during that time the United States was experiencing remarkable prosperity while the other countries were troubled like Japan had not recovered from the bursting of its bubble economy of the 90's, how Europe was suffering from the persistence of high unemployment rates and even in the United States there was increasing income inequalities. Despite the advancement in information & technology and globalization the problems of the third world countries and even the advanced countries continued to prevail. In order to understand the reasons for the crisis, the author in the subsequent chapters two, three and four made us revisit the crises of mid-90's Mexico (i.e. The Tequila Crisis), the 90's Japanese Trap, the 1997-98 Asian Markets Crash, 2000 US Market, 2002 Argentina Crash, and the recent 2007-08 US and the world market collapse. It was found that most of these crises were attributed to the same bank failures, price rise, fluctuating exchange rates, unregulated activity and financial loopholes, etc. In a nutshell, Krugman tried to explain how different economies faced financial crisis and the reasons for the occurrence of all the crisis have been more or less similar in nature starting from the Great Depression in 1930's to what we recently experienced in 2008.

One of the causes for the crisis was the failure of the banking system but how did they fail would be explained a little later. It was observed that in the 1990's there was sharp increase in 'shadow banking' (banks that operated with practically no regulation) and underlined principles of very risky financial plots built on debt. These plots were the main cause for the housing bubbles and similar crisis that affected our global economy. Along with the banking failure we must also understand the concept of Hedge funds. According to *Webster's, "hedge is to try to avoid or lessen the loss by making counterbalancing bets, investments, etc."* In other words, one hedge's in order to make sure that market fluctuations do not affect one's financial health. One tries to make the most of market fluctuations with the help of Hedge funds. These funds can bring very high returns to the investors and at the same time lose money very efficiently.

In chapter six, the author examined that despite occasional warnings from the concerned economists hedge funds have been left untouched by regulation and in 1998 nobody realized that the competition in hedge funds had created financial doomsday machines which lead to tumbling prices and collapsing balance sheet. Even in the recent crisis in 2008, hedge funds were the main culprits. In the next chapter, the reasons for how the financial crisis of 2008 in US originated have been explored. The fore and foremost reason being that the banks had started giving mortgage loans (which were known as subprime loans) to people knowingly that they have virtually no hope of ever paying it back. All these people buying houses could not really afford them and because of the rising house prices more and more people jumped into this and decided to buy a house. At the same time banks were eager to lend them the money to do so. Banks in order to safeguard their position started writing mortgages on which they had virtually no hope of recovery, they packaged these mortgages into investment portfolios paid rating agencies to give them AAA credit ratings so that they could sell them to the investors. This opened up large scale financing of sub- prime lending and as long as the housing prices kept rising, everything looked fine and mortgage backed securities yielded high returns and funds continued to pour in the housing market. This was referred to as the 'Housing Bubble'. The failure of the banking system was largely due to the sub-prime lending. It all began with sub-prime related looses which undermined confidence in the working of the shadow banking system and this led to the burst of the housing bubble. As soon as the housing prices fell and people started defaulting the financial crisis set in. As explained in chapter nine, falling home prices had a direct negative effect on employment which was seen in 2007, US employment rate tended to decline. And the worst was seen after the fall of Lehman Brothers in September' 2008, crisis in emerging markets, collapse in consumer confidence all pointed to the worst recession in the United States.

The author gave various suggestions to solve the crisis. He gave five suggestions which fit properly into what he refers to as the 'Keynesian Compact', a consensus achieved in the 1950s among most economists, also referred to as the 'neoclassical consensuses'. Keynesian Compact is an agreement that an economy can achieve and sustain 'more or less free markets' when the national government is allowed to follow monetary and fiscal policies that can achieve and sustain 'more or less full employment'. In other words, relatively stable free markets require the presence of active governmental policies that are aimed at achieving low levels of unemployment. He gave the following five suggestions:

- Inject more capital into the financial markets in order to unfreeze the capital markets. (Financial markets include capital markets and money markets).
- Regulate the financial system especially the non- banking institutions.
- Government to introduce a lending program to lend the non- financial sector.
- Participate in a global rescue program for the developing countries.
- Support weakened aggregate demand through robust government spending.

In the policy ambit, Krugman argues that policymakers mainly want three things for their economies: discretion in monetary policy so that they can fight recessions and curb inflation; stable exchange rates so that businesses are not faced with too much uncertainty; and free international trade. He concludes that country can only achieve two of these. It is impossible to achieve all three at the same time. In many ways these are the same policy recommendations that were used during 1930s.

It is notable however that Krugman's flow of the writing in this book is not sequential to cite just one example; is that he introduces the concept of shadow banking before (in chapter five) and then explains the causes and solutions for its failure at a later part (in chapter eight and nine respectively). Secondly, the author has tried to cover a lot, starting from the depression in 1990 to 2008 financial crises however there are no footnotes or any references for all the facts and figures given in the book. Footnotes are supposed to signal readers where the stories have been (necessarily) simplified in order to fit on the page, and direct curious readers to places where they can find the stories told at greater length, with more attention to details.

But I would like to conclude, by saying that the book explains the financial and economic crises around the world over the past twenty years. I recommend it for all those who want to understand and get an insight of the fluctuations of the financial markets and global capitalism - it is a short and interesting read.