The Meltdown According to Stiglitz
The Nobel prize-winning economist argues that Obama's response to the financial crisis was far too timid

By James Pressley

Freefall: America, Free Markets, and the Sinking of the World Economy
By Joseph E. Stiglitz
W.W. Norton & Co., 361 pp; $27.95

Barack Obama ran for President on the promise of "change we can believe in." When it comes to the financial crisis, he has instead "only slightly rearranged the deck chairs on the Titanic," writes Joseph E. Stiglitz in Freefall, his unsparing new account of the meltdown and its aftermath.

Stiglitz, a Nobel prize-winning economist, is perhaps the closest thing we have to John Maynard Keynes in both his theoretical outlook and his cogent kibitzing of policymakers. In Freefall, he brings his formidable brain to bear on how flawed theories and misguided policies brought us the worst crash since the Great Depression.

Although Stiglitz spends much of the book exploring what went wrong and why—"peeling back an onion," he calls it—his emphasis is on the future, not the past. The message: We have a once-in-a-generation chance to design "a more efficient and a more stable economy" by readjusting the balance between markets and government. Obama has so far squandered this opportunity, Stiglitz says.

The President did engender a sense of hope, he writes. "And yet, in a more fundamental sense, 'no drama' Obama was conservative," observes Stiglitz. "He didn't offer an alternative vision of capitalism." Obama chose instead to "muddle through"—"to take a big gamble by largely staying the course that President Bush had laid out." He retained two leading members of George W. Bush's economic team, Ben Bernanke and Timothy Geithner. Both have garnered their share of withering criticism—Geithner most recently for the role he played as former head of the Federal Reserve Bank of New York. During the depths of the crisis, it turns out, the New York Fed ordered American International Group to withhold details of payments the insurer made to banks, according to e-mails between the company and its regulator. The New York Fed says Geithner wasn't involved in decisions on AIG's disclosures.

Obama also brought in Lawrence Summers, who boasted of having ensured during his stint as Bill Clinton's Treasury Secretary that derivatives would stay unregulated. These were the deck chairs Obama shuffled as the ship of state listed.

Stiglitz frames Freefall as a book about "a battle of ideas." He means the conflict between those who say the market is a wondrous, self-regulating apparatus and those who note that deregulation often wrecks the machinery, as economists Carmen M. Reinhart and Kenneth S. Rogoff showed in This Time Is Different, a landmark book released by Princeton last September.
Yet *Freefall* is no academic history of efficient-markets theory. It's more a stream of rat-a-tat dispatches from a military strategist who's tracking troop movements and counteroffensives. After years of crafting policy for the World Bank and the Clinton Administration, Stiglitz knows all the arguments against regulation. He counters them, one by one, and anticipates opponents' moves in detailed and often spunky footnotes. Anyone seeking an easy scapegoat for the crisis—be it government homeownership policy or the existence of the Federal Reserve—won't get much joy here.

Moral outrage courses through these pages as Stiglitz surveys the wreckage: millions of people who have lost their homes and their jobs; a financial sector that used its political influence to secure "a trillion-dollar bailout;' a U.S. public-debt-to-gross-domestic-product ratio that surged to almost 60% in 2009 and is expected to reach at least 70% in the next decade.

Stiglitz' proposals for fixing the mess will be familiar to anyone who follows his public comments. Americans should be prepared for a second dose of stimulus spending after the current round winds down. "When an economy is weak," Stiglitz says, "attack with overwhelming force."

Stimulus money should be spent on investments to build a brighter, more sustainable future, Stiglitz argues. Deficit-financed spending can't last forever, so he calls, more controversially, for heavier taxes on "upper-income" Americans. That phrase is disturbingly vague. If Stiglitz lived in Belgium, as I do, he would know how quickly "upper-income" comes to mean middle-class families handing more than half their wages to the government (excluding taxes on sales, dividends, property, and so on). More sensibly, he wants people to pay a high price for greenhouse gas emissions, which would provide incentives to waste less and innovate more.

Over the longer term, Stiglitz seeks a new vision of the financial system that would return banks to the core functions of providing an efficient payments mechanism, making loans, and managing risk. He also calls for the creation of a new global reserve currency to alleviate the need for countries to stockpile dollars as a safeguard against financial upheavals.

Above all, he urges Americans to pause and reflect on what kind of society they want—and what kind of economy is needed to achieve those goals. Whatever one's opinion of Stiglitz, he offers much to think about in this book. I can only hope Obama makes room for it on his nightstand.

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**Financial Circuit Breakers**

Joseph Stiglitz is no fan of globalization. In a paper presented at the American Economic Assn's annual meeting this January, he writes that given a choice between complete integration of global financial markets and total separation, the latter is better. Stiglitz says the recent crisis shows that just as with power grids, financial networks need proper circuit breakers to prevent a blackout in one part of the grid from ruining the entire system.

To read the paper, go to http://bx.businessweek.com/globalization/

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