

BOOK REVIEWS

This Time Is Different: Eight Centuries of Financial Folly

Carmen M. Reinhart and Kenneth S. Rogoff

Princeton, N.J.: Princeton University Press, 2009, 463 pp.

Carmen Reinhart and Kenneth Rogoff's wide-ranging, quantitative study of financial crises is a landmark work. Reinhart and Rogoff have taken advantage of the advances of the last 20 years in economic history, personal computers, and the Internet to assemble a large data set covering most countries of any importance for the world economy. They are the first researchers to base their generalizations about financial crises on data that combine geographic breadth with great historical depth.

The "this time is different syndrome" is the mistaken belief that financial crises happen to other people at other times and places, but not to us here and now, because we are doing things better, we are smarter, and we have learned from past mistakes, so old rules of valuation no longer apply. The book has six parts: a description of the definitions and sources underlying the analysis; sovereign external debt crises; domestic debt crises; banking crises, inflation, and currency crashes; the recent U.S. subprime mortgage crisis and its worldwide consequences; and a summary of what we have learned. There are also nearly 100 pages of data appendixes, including historical summaries of banking crises.

Those of us who live in rich countries think of defaults on sovereign external debt as a malady characteristic of poorer countries, but that is not the case. The United States restructured

Cato Journal, Vol. 31, No. 1 (Winter 2011). Copyright © Cato Institute. All rights reserved.

its debt in 1790 in a partial de facto default, while France defaulted eight times from 1558 to 1788. Yet both then “graduated,” avoiding default thereafter and having their bonds recognized by investors as low in risk. Why some countries graduate and others do not is a puzzle for future researchers to piece together.

As well as defaulting on external debt, many governments have defaulted on their domestic debt. Reinhart and Rogoff’s work here is the most novel part of the book, because before their efforts, long-term international data on domestic debt were severely lacking. Especially valuable is their analysis of debt and inflation. Many inflations have been so high as to drive people away from using local currency, thereby reducing government revenue from the “inflation tax.” The deeper logic underlying this seemingly illogical behavior is that high inflation can greatly reduce the real value of domestic debt.

Although some countries have graduated from debt crises, banking crises are a recurring phenomenon in rich and poor countries alike. The worldwide crisis of 2008–09 is but the latest illustration of this truth. The implication is that economic policymakers need to figure out how to withstand the shocks banking crises cause rather than thinking they can eliminate the shocks.

The chapters on currency crashes and on the U.S. subprime crisis and its worldwide consequences cover ground that has been well trod by others, although part of the apparent lack of novelty is the result of the delay between manuscript submission and publication. Even here, and despite sparse data, Reinhart and Rogoff break new ground by showing how frequently crises have been connected with booms and busts in housing markets.

Summarizing what we have learned from the history of financial crises, the authors conclude that we may be able to have better early warnings of crises with better data, especially data on house prices and on government debt including contingent liabilities. They also observe that banking crises tend to be protracted, and to have huge effects on government debt, which on average rises 86 percent in real terms in the three years following a crisis. They caution against premature celebration for countries that seem to have recently graduated from debt default; many have soon fallen back into default.

Reinhart and Rogoff have written in a style accessible to a broad audience. Each chapter and major group of chapters begins with a

one- or two-sentence summary of their major points. The narrative is clear and moves along well, without getting bogged down in trivialities even where the authors are discussing technical points of definition. But tables, figures, and boxes—almost one every other page in the main text—are so frequent as to be finally annoying rather than enlightening. There are too many statistics in the book and not enough online. Reinhart and Rogoff have made some of the underlying data available online, but the cause of scholarship would be best served by their releasing all data not subject to copyright restrictions.

A work that assembles so much neglected and new data should be judged more by what it does than what it fails to do. Even so, readers should be aware of some gaps in the book's coverage.

The book has much “what” and some “how,” but little “why.” Why are financial crises so frequent? Possible explanations include the effects of war; central banks' mistakes in monetary policy, including their role as lenders of last resort; financial regulations that weaken rather than strengthen financial institutions; political pressures for deficit financing; and the separation between ownership and control in modern financial institutions. The gloomiest explanation, which the authors touch on briefly, is that by the time investors gain enough experience to become chastened, they are old, close to replacement in financial markets and in the rest of life by new suckers being born every minute.

Reinhart and Rogoff have consulted material in English and the Romance languages, which provide ample information about most countries. It would be churlish to complain that they should know a dozen other languages, since there is probably only one economist who does: Leland Yeager. There seems to be important additional information in Arabic, Chinese, Japanese, Russian, etc., so I hope that scholars who read those languages will convey their findings in English for those of us who do not.

For the countries and the period Reinhart and Rogoff cover (1800 to just before the recent global recession), my rough estimate is that they have missed about one-quarter of all banking crises. Even for the United States, they omit the major panic of 1893. The many U.S. bank failures of the 1920s may also qualify as a slow-motion crisis under their definition.

An incautious reader might think from Reinhart and Rogoff's data that financial crises have been rare in socialist monetary

systems. Such is not the case, and it would have been helpful for them to have explained why. Socialist monetary systems suffer chronic but hidden financial imbalances. Central planners direct resources to inefficient uses, using the financial system as a means of enforcing their dictates. When banks and other state enterprises act inefficiently, they do not go bankrupt, transferring control of their assets to better managers. Rather, consumers bear the consequences of their mistakes. The results are pervasive shortages of consumer goods, occasional monetary “reforms” that confiscate part of households’ financial wealth, and exchange controls that make the currency almost useless for buying foreign goods.

To repeat, the book should be judged more by what it does than by what it fails to do. *This Time Is Different* changes the way we can study financial crises. It is the start of a truly comprehensive approach to the subject. It supplements the shrewd insights of previous researchers such as Charles Kindleberger (author of the popular and influential *Manias, Panics, and Crashes*), who had much less data to work with. It adds new ideas that will be useful for gauging the risk of future crises and perhaps even reducing their impact, if investors and policymakers are willing to learn from other people’s mistakes, not just their own mistakes.

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