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Book review

Menzie D. Chinn, Jeffry A. Frieden, Lost Decades: The Making of America's Debt Crisis and the Long Recovery, W.W. Norton & Company, 2011,

The title of this book raises a question. Is the phrase "Lost Decades" retrospective or prospective? Does it refer to only to Latin America in the 1980s and Japan in the 1990s? Or is it telling us that the past was prologue, and we now face an entire lost decade in the wake of the 2008 financial crisis? Perhaps, even more chillingly, the use of the plural means that more than one lost decade awaits. The subtitle gives a clue; "The Making of America's Debt Crisis and the Long Recovery."

Spoiler alert: In the penultimate chapter, Chinn and Frieden write of two lost decades for the United States; "Americans … lost the first decade of the century to a boom that enriched the wealthiest, and a subsequent bust that impoverished the rest. Now they risk losing another decade to an incomplete recovery and economic stagnation" (p. 221).

Okay, that was not much of a spoiler, at least not for those reading the *Journal of International Economics*. It is not much of a spoiler for the general public, either, the audience that this book targets. The financial crash of 2008 and the subsequent Great Recession will be this generation's watershed economic event. It will cast a shadow over economic policy for years to come, even while debate continues on its causes, the efforts to resolve it, and its likely consequences.

Chinn and Frieden do a good job of making the chronology of the crisis compelling — but that's the easy part. Any of the books on the crisis aimed at the general public are page turners. What distinguishes this book is its explanations of the sources of the crisis, and its provision of a context for understanding this crisis by comparing it to other ones. It is very well written, clearly argued, and sensible. It has a broader focus than many other books on the crisis that focus on particular events, institutions, or people. For these reasons, *Lost Decades* is less likely to be made into a movie than the more sensational books on the crisis. But it is the first book that I would recommend for anyone who wants a comprehensive understanding of the American economy during the lead up to the crisis and its immediate aftermath.

One of the virtues of this book, as compared to many others on the crisis, is that it is analytical and not just descriptive. The book does not begin its chronology with the collapse of Bear Stearns in March 2008, or the "Lehman Weekend" in September of that year, but with a longer perspective of the current account and federal deficits of the United States over the past three decades. Also, while there are some telling stories of individuals' experiences, the focus is on explaining the logic behind the unfolding events which ultimately led to the crisis. For example, the authors describe the search for yield due to the narrowing of the spread between short and long interest rates, which promoted leveraging through securitization and financial innovation (in an environment of lax regulation), which served an integral role in the development of the subprime mortgage market and the shadow banking system, which, with the downturn in housing prices, led to the crash. The broad scope of the book, however, prevents the authors from going into much depth on any one of these topics. It provides a good overview, and for that reason it will appear on my syllabus. But there are many facets to the crisis, more than a single book could cover, and a course on the crisis requires supplementing this book with articles on structured finance, the failure of regulation, the housing bubble, the vulnerability of financial institutions, and the shadow banking system. Still, it seems to me that the authors made the right choice with respect to the level of explanation, given the target audience; enough to provide an understanding of the key issues and the progression of events, but not so much as to cause the narrative to bog down in detail.

The book begins with a quick sketch of the history of the American current account and government budget deficit over the past three decades. There are also references to the experiences of other countries that reinforce the notion of a common pattern of capital inflows leading to a boom–bust cycle. This is followed by chapters on factors specific to the United States in the 2000s, which sets the stage for the subsequent chapter on the fateful period in the autumn of 2008 when the world faced the very real possibility of financial and economic collapse (the chapter is titled "The Death Spiral"). There is a chapter on the immediate response to the crisis ("Bailout"), and another on the anemic recovery ("Economy in Shock") that offers some context by discussing a range of countries' experiences in the wake of other financial crises. The final chapters of the book are somewhat dated by publishing (and reviewing) lags. The chapter on worldwide effects of the crisis does not reflect the deep deterioration in Europe that has occurred since the summer of 2010. The chapter on policy responses offers useful guidelines for policy (such as sustainable fiscal policy, and taxes which are not pro-debt) but, necessarily, cannot opine on current debates. Still, this is preferable to arguing that there was a monocausal explanation for the crisis and, therefore, there is a single solution to preventing future crises ("If only we had done this, none of that would have happened.").

While the authors eschew a monocausal explanation for the crisis, they come close to a unifying theory of crises when they state, in the preface, "The American economic disaster is simply the most recent example of a "capital flow cycle," in which capital floods into a country, stimulates an economic boom, encourages high-flying financial and other activities, and eventually culminates in a crash" (p. xiv). Chinn and Frieden write that, in "broad outlines," this capital flow cycle describes dozens of debt crises in emerging markets, and that this time is not different (but that title's already been taken!). Thus, another interpretation of the title is that the United States' lost decades are very similar to those in Latin America, Japan, and other countries who faced a capital flow cycle.

My main disagreement with the book is that the emphasis on the "capital flow cycle" might lead the reader to view this as an exogenous event, or one mainly driven by the government budget deficit. As discussed above, a careful reading of the book offers chains of reasoning that make sense. But it is also possible to read this book and come to conclusions that involve less tightly linked arguments. For example, the first chapter introduces the capital flow cycle concept

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with the passage "The two deficits, fiscal and current account, pumped up American purchasing power. Increased consumption possibilities spread broadly through the economy. As the government spent more, the recipients of its largesse benefited. As the prices of homes rose, so did the ability to borrow against them, leading middle-income homeowners to more spending money. As credit became more readily available, even to those previously excluded from financial markets, more people could live better on borrowed money" (p. 15). I would have liked to have seen more emphasis on the role of the securitization of subprime mortgages, moral hazard plays leading to excessive short-run focus by managers of financial institutions, and outright fraud. The link between government spending and a housing price boom is not straightforward. Chinn and Frieden discuss these other factors later in the book, but it would be easy for a reader in the target audience to draw a straight line from a government deficit to an unsustainable housing price boom.

This is a relatively minor disagreement that I have with the tone and presentation of *Lost Decades*. Overall, this book is an excellent introduction to the crisis, up through mid-2010. One can only hope that the book is widely read, and its lessons are taken to heart.

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