This Time is Different: Eight Centuries of Financial Folly
by Carmen M. Reinhart and Kenneth S. Rogoff
Princeton University Press, 2009
$56.95, 496 pages
ISBN 9780691142166

Sir John Templeton, the legendary stock investor, once quipped that: 'The four most expensive words in the English language are, "This time it's different."'

Carmen Reinhart and Kenneth Rogoff explain just how expensive those words are in their latest book. The title *This Time Is Different* refers to the firmly held belief that 'financial crises are things that happen to other people in other countries at other times; crises do not happen to us, here and now. We are doing things better, we are smarter, we have learned from past mistakes. The old rules of valuation no longer apply.'

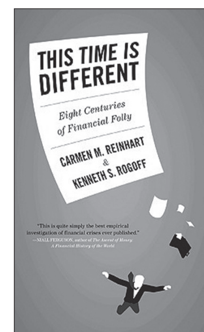
Investors, politicians and government officials alike delude themselves that the latest boom is justified and will last: that 'this time is different.' The central theme of the book is that it almost never is.

The foundation of *This Time Is Different* is the massive database that Reinhart and Rogoff, economics professors at the University of Maryland and Harvard University, respectively, have constructed. They catalogue every financial crisis that they could find going back nearly eight centuries; covering 66 countries; spanning banking, sovereign debt, currency, and inflation crises. They track the levels of debt (both external and internal), real GDP, real house prices, inflation, exchange rates, trade balances, capital flows, and commodity prices, both before and after crises.

Many books have been published on the history of financial crises that were long on stories of personalities and politics but short on data. There are few stories in *This Time Is Different* and the amount of data is almost overwhelming.

What you get is 292 pages of empirical analysis complete with a dizzying 75 graphs, 58 tables, and a data appendix that is 100 pages long (it really is that long).

What the data reveal is a never-ending cycle of boom and bust: 'Countries, institutions, and financial instruments may change across time, but human nature does not.' At its core is the lesson that excessive debt accumulation, particularly short-term debt, whether it be by governments, financial institutions, corporations, or individuals, 'often poses greater systemic risks than it seems during a boom.'



Second, banking crises are an 'equal-opportunity' menace. The incidence of banking crises is remarkably similar across high-, middle- and low-income countries, being particularly high for the world's financial centres: the United States, United Kingdom, and France. Although some countries have been able to graduate from a history of repeated default on sovereign debt or very high inflation, no country has graduated from an ongoing risk of banking crises.

Third, and significantly for the debate around financial regulation, the authors find that for the post-1970s period, high international capital mobility and financial sector liberalisation are associated with a higher incidence of financial crises with varying severity. They note that only in a few countries did financial liberalisation go smoothly but fail to explain why. Further, there is no mention of the empirical analysis done by other researchers using post-1980s data that show greater financial liberalisation leads to higher growth.

Fourth, real housing prices are 'nearly at the top of the list' of reliable indicators of banking crises, the other precursors being slowing economic activity, large current account deficits, and sustained debt buildups. Crises tend to occur either at the peak of a boom in real housing prices or right after the bust. Around banking crises, real housing prices from peak to trough decline on average 35.5%, with the duration of the decline averaging six years. Surprisingly, the magnitude of the decline is not significantly different in rich countries compared to poor countries.

Finally, recessions associated with systemic banking crises are consistently 'deep and prolonged.' Increases in unemployment rates average about 7 percentage points, with the average duration of the increase lasting 4.8 years. Real GDP per capita declines 9.3% on average, with the average duration of the fall lasting 1.9 years. For post World War II crises, it took 4.4 years on average for real GDP per capita to return to its pre-crisis levels, whereas it took 10 years on

average for the Great Depression crises.

Government budgets suffer, mainly because of depressed tax revenues and fiscal stimulus measures rather than direct bailout costs. On average, real central government debt increases by 86% during the first three years following a banking crisis. The authors stress that this is a conservative estimate as it ignores the debts taken on by states and municipalities and also does not take into account government guarantees, both implicit and explicit.

At the time of writing, the cost of insuring Portuguese, Italian, Greek, and Spanish (derisively known as PIGS) sovereign debt was surging and Greece was looking increasingly likely to default or, at least, receive a bailout from the International Monetary Fund (IMF) or other EU nations. The book reveals that this is exactly what we should expect. They find that about two to three years after banking crises, there is usually a wave of sovereign defaults arising from the massive increase in debt. As of 5 February 2010, it was more expensive to insure Greek sovereign debt than Kazakhstan's! Interestingly, the authors' database reveals that since 1829 (the year of Greek independence), Greece has spent 50.6% of its life in a state of default. In fact, countries with a history of repeated sovereign default on external debt are common in every region in the world, including Asia and Europe.

With the IMF standing ready to bail out Greece, the authors reveal that the creation of the IMF since World War II has 'coincided with shorter but more frequent episodes of sovereign default' as both lenders and borrowers believe that if they get into trouble, they can always rely on subsidies from the IMF and the governments of creditor countries. The authors also find that inflation is linked with the level of domestic debt as governments have often tried to inflate away their domestic debt by printing money.

Given the empirical focus of the book, it has few policy recommendations. The authors call for better reporting of macroeconomic data, including the creation of long-dated time series as they have done in their book. They also recommend setting up an international financial regulator—mainly to stop countries competing with each other on regulation. However, it is not clear that regulatory competition between nations is necessarily a bad thing, given the ability of governments to mismanage financial markets and to monopolise banking systems to the detriment of depositors and private borrowers—both things that the authors point out in other sections of the book.

Although the authors touch on financial liberalisation as a broad concept, there is frustratingly little discussion on whether any specific government policies, particularly debt guarantees, affect the frequency and magnitude of financial crises. For example, the authors cite theoretical modeling (as opposed to empirical evidence) that deposit insurance can induce banks to take excessive risk, but no empirical analysis is done to determine its effect, if any, on the stability of the financial system. Nor is there any mention of the empirical work done by John Taylor, a professor of economics at Stanford University, on the role of loose monetary policy in increasing housing price inflation and risk taking during the 2002–06 period.

Despite these drawbacks, *This Time Is Different* is the best, and the only, systematic and empirical analysis on the history of financial crises. To say that the Reinhart and Rogoff's work is a significant contribution to economic history would almost be an understatement, given how often that compliment is made out of politeness. However, this time it really is different.

Reviewed by Brendan Duong

Confusion: The Making of the Australian Two-Party System
by Paul Strangio and Nick Dyrenfurth (eds)
Melbourne University Press, 2009
$49.99, 320 pages
ISBN 139780522856552

The year 2009 was the centenary of the formation of the first national and united Liberal Party in the Commonwealth Parliament, and its creation led to the first two-party (Liberal/Labor) national election in 1910.

The Fusion (as it was called) of the major groupings of Australian Liberalism is one of the pivotal events in our political history, and this book is the most thorough attempt so far to understand its significance. The title I find odd. 'Confusion,' while an obvious play on words, is hardly a dominant idea in the book, and undervalues the editors' achievement in