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If They Tell You They Predicted The Financial Crisis, They're Lying

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Policy

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Nouriel Roubini (Photo credit: Wikipedia)

As early as June 12, 2006, and many times after that, this column at varying locales pointed to the rush into housing as a very negative economic signal. The aforementioned 2006 Op-ed noted that the housing boom of the Bush era made his economic presidency most similar to that of Jimmy Carter's.

In an Op-ed from late October of 2007, I wrote:

> *"Lastly, it should be remembered that housing's greatest decade as an asset class occurred during the inflationary, malaise-ridden 1970s. With the dollar in free fall, housing served as a classic hedge for unsophisticated investors eager to shield their wealth amidst the dollar's fall. That real estate became the asset of choice of the new millennium wasn't so much a signal of a flush economy, but more realistically was the result of renewed dollar weakness that once again made Americans very risk averse."*

But did I predict a "financial crisis"? Not by a long shot. All I predicted was basic economics. Housing is not investment, rather it's consumption. To buy a house isn't to add to the capital base on the way to productivity enhancements, software innovations, cancer and heart disease cures, and transportation innovations, rather housing is just a sink of wealth whose buoyancy relative to actual investment signals economic problems. I didn't predict a crisis, but I did understand as did anyone who'd read Adam Smith and John Stuart Mill (to name two Classical thinkers) that the housing boom signaled a weak, investment starved economy.

Moving to hedge fund manager John Paulson, he raised a $147 million dollar fund to buy insurance on mortgages and mortgage securities that he felt would eventually go bust. Paulson wound up making billions off his trades, but did he predict the financial crisis? Not even close.

Indeed, going back to the undeniable truth that mortgages, home construction and housing purchases represent consumption, Paulson simply predicted a very economically healthy market correction. Mass consumption of housing signals, on average, a capital deficit (notable here is that the IPO market all but dried up during the Bush housing boom) for the businesses eager to attain financing in order to acquire human and physical capital so that they can grow. Since it does, Paulson's riches weren't the cause of a crisis as much as they provided a precious signal to the markets that further consumption of housing and investment in the securities that enable the latter would be a bad idea.

What about those people whom we all know who kept telling us that housing was headed for a collapse in the years leading up 2007 and 2008. Did they predict a crisis? No, they did not. For an individual to suggest that a falling market for consumption goods could cause a crisis would be for that person to rewrite simple economics.

To paraphrase Schumpeter, there are no entrepreneurs without capital, so any correction of manic consumption could hardly have authored a crisis. Furthermore, and this is contrary to most of the media narrative to this very day, by '07 and '08 housing hadn't corrected all that much. As Michael Lewis noted in *The Big Short*, for the mortgage skeptics to eventually profit, *"Home prices didn't even need to fall. They merely needed to stop rising at the unprecedented rates they had the previous few years for vast numbers of Americans to default on their home loans*" (my emphasis).

So once it's properly understood that a correction in the mortgage and housing markets couldn't have caused a financial crisis, it's useful then to point out what did. What needs to be stressed is that there was nothing ‘financial' about the crisis.

Since there wasn't, for one to have predicted the ‘financial' crisis it's surely the case that this amazing ‘seer' into the future first predicted the failure of Bear Stearns, or some other financial institution like it. Having predicted the latter, this same individual with a hotline to the future would have had to predict a bailout of Bear, or some institution similarly situated. After that, to have seen a crisis in his or her crystal ball this visionary would have pointed out that with the markets having priced in bailouts for everyone, a panic would naturally ensue once an even larger financial institution (Lehman Brothers) than Bear was allowed to go under.

Put very plainly, Lehman only caused the markets to convulse insofar as the allowance of its bankruptcy surprised the markets. Investors logically panic when information is opaque, and as such, Lehman was only a crisis for investors lacking a clear understanding of the hapless Bush administration's policies toward financial institution failure. On its own Lehman's decline could never have caused a crisis owing to the basic economic truth that a capitalist system thrives on constant failure that releases poorly managed assets and human capital to better managers. If this is doubted, readers need only visit Silicon Valley. A visit there would alert them to the happy reality that the world's foremost tech locale thrives precisely because failure is the economy and innovation-boosting norm. Banks are no different, and the system is only *weakened* when failures are not allowed.

From there, this billionaire (only a billionaire could possess such foresight) would have had to sense months ahead of it happening that the Bush administration would not only blink on bailouts that were wholly unnecessary (if Japan can revive itself quickly after having two atom bombs dropped on it, our economy could surely have handled the failure of Citigroup without the financial system collapsing on the way to the "Mother of All Great Depressions" - Bernanke), but that it would be so obtuse as to ban short sellers too. To be blunt, if you want to add gasoline to the fire of a financial crisis, ban the very short sellers whose skepticism brings precious price signals to a market bereft of them, and who for being short sellers bring to a market desperately needed buying power that will eventually put a floor under the collapsing market. But when short sellers were needed most, the Bush administration banned the price information and buying power that they offered in abundance on the way to even more market panic.

And then having predicted a series of anti-capitalist errors, the predictor of the crisis would have had to understand the very negative implications for finance that would result from all of this intervention. While free markets crushed central planning in the 20th century, the visionary would have to know that calls for massive re-regulation of the economy would quickly rise to the top of governmental priority lists, thus scaring markets even more, not to mention those same governments doing everything possible to blunt the positive market corrections that would quickly revive the global economy.

To be very clear, the financial ‘crisis' had nothing to do with market corrections that spoke to a healthy capitalist economy fixing itself, rather the ‘crisis' was wholly a creation of governments - the Bush administration most notably - running away with great speed from the very capitalistic fixes that would have authored a powerful rebound from previous errors. And since no one predicted the various mistakes foisted on the global economy by governments, it's a tautological truth that those who claim to have predicted the ‘financial crisis' are lying in a very obnoxious way.

Despite this, self-aggrandizing pundits continue to claim that they saw all of this coming. Recently in the *Los Angeles Times*, Institute for New Economic Thinking senior editor Eric Weiner comically asserted that "some people did foresee the disaster. I was one of them." No Mr. Weiner, you did not.

Weiner's Op-ed from July of 2007 argued that corporate takeovers were the driver of Dow 14,000, and would subsequently lead to ugly times. Ok, if you believe Weiner then you probably believe the symbol that is Wall Street could easily keep markets constantly buoyant by virtue of engaging in lots of M&A activity. If only finance were as easy as non-financiers like Weiner presume. M&A involves a lot of debt, and if investors don't buy into the underlying economics of takeovers, the market is going to be rather quiet.

To be fair to Weiner, he concluded his '07 piece with "if history is any guide, this party could turn ugly." Yes, it surely turned ugly, but not for the reasons that his Op-ed stated. The economy-asphyxiating rush into housing consumption didn't even rate mention in his Op-ed that allegedly ‘predicted' the crisis, and then he certainly didn't foresee the interventions that turned what would have been a healthy correction into something much worse.

Nouriel Roubini has most famously made a career out of having allegedly foreseen the carnage, and while he nowhere predicted the mistaken intervention that convulsed the markets, at least in his case it can be said that was correct in drawing a connection between housing health and the eventual ‘crisis.' Problematic for Roubini is that in his case he turned Smith and Mill upside down. By Roubini's economic illogic, an eventual housing moderation or collapse would on its own be the economy and financial system's downfall.

No, it wouldn't have been. Once again, the economy's problem back in the early 2000s was that the productive and capital intensive aspects of it were suffering a capital deficit at the hands of a housing market that was booming. When consumption is crushing savings that's always an economic negative, and its driver was the Bush administration's cheap dollar policies that fostered a run into sinks of wealth least vulnerable to the dollar's devaluation. The run was global given the simple truth that devaluation in the U.S. is nearly always and everywhere a worldwide event.

Roubini predicted an economic crash based on a moderation of housing consumption, and in doing so he missed the true economic forest fire, which was the rush to housing to begin with. A correction of this could never have caused the ‘crisis' that was and is now being misnamed as something ‘financial' in nature. Furthermore, if Roubini truly understood or predicted anything, he would have said housing is set to crash, it will be good for the economy when this occurs, and to ensure quick recovery the financial institutions and businesses most exposed to the sector should be allowed to fail so that they can be acquired by executives and entrepreneurs possessing a better understanding of how to deploy capital entrusted to them.

Roubini did no such thing. Instead, he remarkably called for a stimulus package triple the size of the one President Obama and Congress foisted on the economy, and then later on told the *Wall Street Journal* that U.S. banks should be nationalized. Not only was Roubini's ill-gotten reputation made by the very government intrusion that he advocated, his post-crisis musings, if implemented, would have made a bad problem much worse.

Roubini's general contention several years back was that if governments were to "take away the monetary and fiscal stimulus too soon - when private demand remains shaky - there is a risk of falling back into recession and deflation." Rarely has a mere portion of a sentence been so pregnant with falsehoods and misunderstandings.

First off, there's no such thing as fiscal stimulus of the spending kind. Though it's well known at this point, governments can only spend money they've first taken from the private sector. In short, governments can at best merely steal demand from certain economic sectors in order to fund generalized waste and a bigger state. There's no economic growth to speak of, rather there's decline.

Secondly, it bears mentioning once again that no act of saving ever detracts from demand. Roubini's suggestion that governments must spend when individuals don't defies what saving entails. Indeed, short of stuffing dollars/pounds/euros/yen/yuan under mattresses, when individuals save, their funds are either shifted to others with immediate consumptive needs, or lent to businesses eager to grow.

Even if one wants to believe despite basic economics and simple evidence that the moderation of housing caused the crisis, for Roubini to have predicted anything would have been for the NYU professor to have understood the simple steps to emerge from the same crisis. Roubini clearly didn't as evidenced by an economy that continues to limp along thanks to economists and politicians not Roubini doing as this vastly overrated economist advised: suffocating the economy even further with nosebleed federal spending, dollar cheapening, and programs meant to prop up the very housing market whose government authored artificial levels remain one of the bigger barriers to an actual economic recovery. In short, Roubini at best predicted what should have been an economy-boosting housing correction, and even the latter he plainly misunderstood as evidenced by his post-crisis droolings.

So while it's possible someone, somewhere predicted government errors that turned a healthy correction into a horror show, there's no ready evidence in print or online that anyone did. In that case, if readers want to know when they're being lied to, rest assured that one of the most certain signals that a grand fib is being told is when someone self-assuredly contends that they predicted all the carnage that morphed into a 'financial crisis.' They did no such thing. *They're lying*.

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I'm a speech and op-ed writer, Director of the Center for Economic Freedom at FreedomWorks, editor of RealClearMarkets, and a senior economic adviser to Toreador Research & Trading. My new book is The End of Work: Why Your Passion Can Become Your Job. Other books by me include Who Needs the Fed?(Encounter, 2016) and Popular Economics (Regnery, 2015). **Read Less**