Business Finance II – 515 - Summer 2016
Book Review Template

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Book Title	After the Music Stopped – The Financial Crisis, the Response, and the work ahead.
Author(s)	Alan. S Blinder
Publisher &Publishing Year	New York Penguin Press (2013)

Author (s):

Born in Brooklyn, New York, with a Bachelors of Art Degree at Princeton University in 1967, a Master of Science degree at London School of Economics in 1968 and a Doctor of Philosophy degree at Massachusetts Institute of Technology in 1971 Alan S. Blinder has an astonishing academic portfolio. His career as a teacher starts from 1971 (Princeton) and he also chaired the Department of Economics from 1988 to 1990. In summary an Economics Professor at Princeton University, who served at the Congressional Budget office on President Bill Clinton's Council of Economic Advisers and as Vice-Chairman of the Federal Reserve Board.

Synopsis of the book:

The title of the book is drawn from Chuck Prince's famous interview in July 2007 in which the Citigroup Chief Executive said "as long as the music is playing, you've got to get up and dance". And furthermore a lucid analysis of Treasury Secretary Timothy Geithner's claim that "we saved the economy, but we kind of lost the public doing it."

With bracing clarity, the author shows us the mere fact that the U.S. financial system had turned out to be a complex hurdle and unregulated mess which was dangerous for public-good and hence resulted in the perfect storm beginning in 2007.

In summary this book gives us a clear picture and pedagogic account of the financial crisis. It has three central points that the financial crisis was a result of too much leverage and complexity which had a price i.e. compensation ironically with little or no regulation.

Blinder starts by describing the culprits of the financial crisis and then back it with economic principle of people have the habit of forgetting. He underlines the main villain: the inflated assets prices, excessive leverage, lax financial regulation, disgraceful banking practices, the crazy quilt of unregulated securities and derivatives, abysmal rating agencies and perverse compensation schemes.

The second point is regarding the Fed and the Treasury, the fact that how they should implement regulations and limit the crisis from becoming a Great Depression (Consumer Protection Bill, Dodd-Frank and Troubled Asset Relief Program(TARP)). He does recognize that many Americans do not understand why the crisis happened, and have little understanding of the government bailouts strategy, hence having ill-regard for TARP and for the Feds.

Lastly he tells us about the steps which are necessary to deal with the crisis and how measures in the long-run should protect consumers.

Key Learning:

1. *The first thing we learn about is the Troubled Asset Relief Program (TARP) which was $700 billion bailout, a clear indication as to how the Federal Reserve used / put taxpayer money on board to rescue Bear Sterns and AIG (but ironically and unfortunately not Lehman Brothers). Fannie Mae and Freddie Mac lobbied and administered the TARP and furthermore the GM and Chrysler bailouts. The mere fact that politics and bureaucracy has a hand to play in every administrative government, this insight from the executive of the Federal Reserve is interesting as how one of the strongest economies collapsed based on greed and after the collapse or such a hazard they were still having differences in opinion and internal lobbies to deal with the aftermath. The question remains why weren't Lehman Brothers saved?*

2. *Policy paradox: the economy needs a boost and is stuck or rather trapped in what is termed a paradox of macroeconomic policy, the policies that work are not tested / implemented whereas the ones tried usually do not work. This is the part of monetary and fiscal policy with a simple concept that is governments leaning push the economy forward when unemployment is high and slow it down when inflation threatens. To do this there are two strategies which are moving taxes or elements of public spending up / down to restrain / propel total spending. This is useful as Blinder tells us how fiscal policy could help speed up economic growth through (i) to cut sales tax to encourage consumer spending (ii) to increase government hiring (iii) sustain a large scale new jobs tax credit which would offer incentives for firms to increase employment. This is interesting insight as to how fiscal policy has largely been sidelined while monetary policy which was undertaken by the Federal Reserve has done the huge heavy lifting to spur the economy.*

3. *The Anti-Government Backlash, the Keynesian Economics held that monetary stimulus (lower interest rates, more money creation) and fiscal stimulus (tax cuts, government spending) are methods to mitigate recessions created a fiscal deficit which rocketed to 10% of the GDP causing a political backlash against 'deficit spending' and creating a fiscal drag and debate in the Congress (2010). However, the hidden economist Hyman Minsky's paradigm is explained that people forget the past and go to extremes, financial excesses grow more and severe as the bubble progresses. That said, this as a result creates greater vulnerability to shocks and more damage when the shock comes. This is a simple yet technical point stating the famous quote of the Citibank executive (mentioned earlier) as to how people 'dance to the music playing' without consequences, and then the major cause was the ordinary man who was the*

sheep and they were sacrificed in the aftermath as their 'taxpayer money' was used for bailouts.

4. *The fact the system can be triggered by greed and that self-regulation is harmful, as many leaders of the financial firms were so indifferent and unconcerned about their risk management system and did not think of the long-run. All the time investment banks and hedge funds compensated their traders in ways that offered fabulous riches for success, therefore the system created huge incentive to take huge risks. The fact that majority of the traders were young ambitious and smart individuals (talent pool) they opted for high risks but when the bust came they bore little of the losses. This is interesting as traders had little to lose in the crash and since then the compensation system has changed, and "go-for-broke incentives will include traders to go for broke" which means that they will also be a major owner in baring the losses.*

5. *Keeping it simple! Extreme leverage – a danger which created complexity backfired on everyone, for example the Synthetic CDOs which were incredibly complexed financial arrangements (securities), were a crucial ingredient in the profitability giving high profitability and high advantage to the insiders as to the outsiders. That said, complexity is a great source of profit and extremely hard to comparison shop, it is hard to get a comparable price whereas it is easier to confuse the other party (people). For example, call option on the Ford Motor stock on the New York Stock Exchange is simple, you get a quote and its standardized but the consequence is that the profit margin to the broker dealers is absolutely tiny. This is interesting as it underlines the fact that we do not need complex systems in the economy and it is a system of 'near fraud' and manipulation as it creates hurdles in judgement and provides benefits to the insiders only.*

Application:

In terms of Pakistan's Financial Landscape, the country's financial system essentially remained insulated from the Global financial crisis. This was possible due to the stringent risk management framework of the Banking Sector regulator i.e. State Bank of Pakistan. Through the prudential regulations, SBP has been at the forefront in devising policy framework for banks to remain within their lending limits both per party, per group and per sector. The regulations have prevented Banks to avoid extreme leverage situations and complex financial arrangements.

In terms of bailouts, the Government of Pakistan has time and again injected tax payers' money into state owned entities such as Pakistan Steel Mills, Pakistan Railways, WAPDA and many other entities which were into the red and were in liquidity crunch to discharge their obligations to financial institutions. These bail out packages provided temporary stimulus to these entities but were not sustainable and time and again in each annual budget an element of subsidy is kept to account for the fiscal and administrative inefficiencies of the state owned entities.

As rightly pointed out by Blinder, if sales tax is cut this would improve consumer spending. But at this stage the Government and its tax machinery are all in to extract the maximum possible from tax. At provincial level, the concept has been applied and Sindh Sales Tax percentage which initially started *at 15% is being gradually reduced 1% annually and currently stands at 13% for the fiscal year 2016-17. This will provide incentive to the services sector and expected to contribute to the growth.*

Government should consider providing tax incentive to entities encouraging employment however, this is only possible if incentive for establishing industrial zones by giving the investor tax exemption. So far this area has been lagging and not much industrial growth has taken place in the country.

The SBP has reduced the discount rate substantially and has brought it to single digit. This financial engineering has led to reduction in budget deficit and appears more politically motivated as it highlights government's achievement to keep the budget deficit in check. But sustaining the budget deficit in the long run is posing a challenge as the oil prices which rocked at $ 29 from the high of $ 145 are now currently trading at over $ 40 and analyst forecast is $ 60. The rising oil prices have a direct impact on the current account balance as Pakistan is an importer of oil and there has been little investment in terms of expanding the refining capacity of local refineries. In addition, the foreign oil exploration companies have scaled down their operations and until day before Baker Hughes wound up their operations in Pakistan. The key affected parties were 70 plus work force of which over 60 have been laid off, OGDC, POL, MOL, PPL and UEP and the company is not offering any explanation or compensation to the sacked employees on terminations without prior notice.

In summary, the regulations of Pakistani market have greatly protected the country from aftermath of global financial crisis.

Grading Plan:

Areas	Marks
Author	1
Synopsis	2
Key learning	5
Application	2