Book Review
A CALL FOR JUDGMENT: SENSIBLE FINANCE FOR A DYNAMIC ECONOMY
BY AMAR BHIDÉ
Oxford University Press, 2010

Since October 2008, many have written about the financial meltdown that sparked the Great Recession. Most books and articles were about "what" happened; very few attempted to write about "why" it happened.

These "what" and "why" attempts informed me but I learned little to draw lessons for corrective actions and for the future. These authors were like the proverbial blind men trying to describe the elephant by touching/feeling its different parts. Additionally these authors were academicians, journalists and financial engineers who wrote from limited perspectives of their own domain expertise or experience, mostly in finance, economics and financial journalism. These authors provided subjective views of a vested or inadvertent participant in the creation of the financial bubble.

I needed a detailed, objective view to learn about why financial meltdown came about and how it could be avoided in the future. Amar Bhidé's Call for Judgment went a long way in satiating that thirst.

Amar Bhidé is Schmidheiny Professor at Fletcher School, and has served as Glaubinger Professor of Business at Columbia University. His book is expansive in its scope.

It has broad content, drawing from scholarship and research in Economics, Finance, Government Regulation, Quantitative Sciences, and Innovation. Bhidé uses his deep knowledge of theory and practice in these seemingly disconnected disciplines to support and tear apart deeply rooted contentions and practices.

Additionally, it is expansive in its time horizons. Bhidé is a credible business researcher and historian. He goes as far back as is necessary, sometimes several centuries, to provide details that evolved and contributed to our current situation. It reveals human frailties, how our collective memories can also diminish with age.

Moreover, Bhidé is objective. He displays not only intellectual honesty but also intellectual bravery. He is not afraid to take on some of the sacred idols and expose their contributions to current debacle.

Furthermore, he is not scared of the devil that resides in the details. His approach has logical and systematic rigor.

Bhidé contends that there were several contributors to the debacle. At the top of his list is that Finance had become centralized, mechanistic and detached from its local customers and conditions. Flawed quant models catalyzed centralized decision-making, with microscopic contributions from local judgment.

The centerpiece of this centralized financial decision-making had some fundamental faults in the way their "mathematical economics" foundation and pillars treated "risk" and Knightian "uncertainty". Pursuit of mathematical elegance required some shortcuts that took economics into untestable territories, where hypotheses were unfalsifiable but implausible, with unimagined consequences.

Separately, banking deregulation, cheered on by prevailing economic theories and certifications from the SEC, allowed banks and investment firms to morph into publicly traded monoliths. These firms were led by inactive, arms-length stockholders management, who paid little attention to increasing risk at their firms. This led to a perverse "Heads we win, tails public stockholders lose" attitude to prevail in the industry. The risk appetite of financial firms went up and with it the share of trading at these firms.

On the other side, threatened banks, whose market share had declined, were now forced to look for alternative sources of profits. They created highly profitable and risky products such as derivatives and Credit Default Swaps.

Aided by these factors, the imprudence or chicanery of a few individuals unraveled several firms and caused widespread damage to the global economy

Bhidé has "A Modest Proposal" to pull us out of this morass. It can be summarized by former Citibank CEO John Reed's comment, "I would compartmentalize the industry for the same reason we compartmentalize ships. If you have a leak, the leak doesn't spread and sink the whole vessel."

He recommends that we reinstate Glass-Steagall's wall between investment and commercial banking, to reduce collateral damage from future speculative bubbles.

His fervor for local touch points between banks and borrowers is not lost. He recommends that we reinstate old-fashioned banking where bankers know their customers. Consequently, we would have to decentralize oversight of banking and finance so that conditions, relations and decision-making can be monitored locally.

His proposal allows "casino bankers" (investment firms) to innovate and speculate but with an arm's length from "utility banks".

Bhidé does anticipate that the unwinding and fragmentation of megabanks will be difficult—97% of more than $200 Trillion in derivatives are held by five US banks: J.P Morgan, Bank of America, Goldman Sachs, Citibank and Wells Fargo.

Additionally, government-led solutions to the current crisis may take a long time. The 2,300-page Dodd-Frank bill may appear to some as "refurbishing regulators' deck chairs from the Titanic." However, as historical examples from previous financial crises show, "a weak first bill doesn't have to be the last word" and "reform delayed isn't reform denied!"

I could see why eminent people such as Former Fed Chairman Paul Volcker and Nobel Laureate (Economics) Edmund Phelps and many others recommended the book. A Call to Judgment has great content and is a treat to read. The material, in lesser hands, could have been boring and tedious. Bhidé strikes a great balance between dryness of the subject and popular writing, with subtle, tongue-in-cheek strokes that are rare in such scholarly tomes.

Amar Bhidé's A Call for Judgment is a clarion call for us to be aware and beware of the current structure of the financial—banking and investment—industry. Global governments and investors need to listen to Bhidé and heed his call to action because we are not out of the woods yet.

The insightful book has probably been targeted at researchers, scholars and policy wonks but the rest of us can benefit from this brilliant work too. I know I did.

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