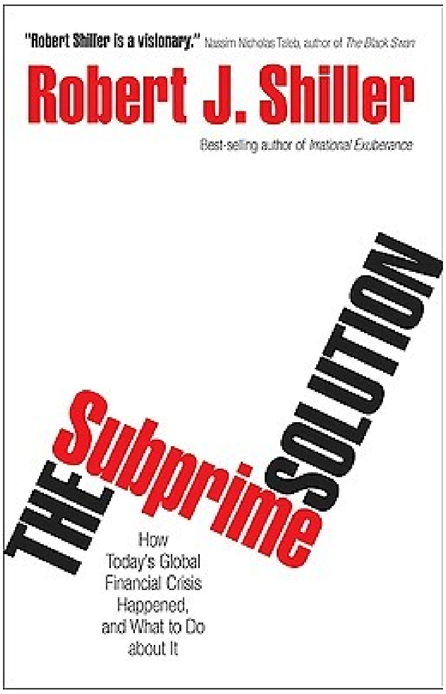

The Subprime Solution: How Today's Global Financial Crisis Happened, and What to Do about It

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The subprime mortgage crisis has already wreaked havoc on the lives of millions of people and now it threatens to derail the U.S. economy and economies around the world. In this trenchant book, best-selling economist Robert Shiller reveals the origins of this crisis and puts forward bold measures to solve it. He calls for an aggressive response--a restructuring of the institutional foundations of the financial system that will not only allow people once again to buy and sell homes with confidence, but will create the conditions for greater prosperity in America and throughout the deeply interconnected world economy.

Shiller blames the subprime crisis on the irrational exuberance that drove the economy's two most recent bubbles--in stocks in the 1990s and in housing between 2000 and 2007. He shows how these bubbles led to the dangerous overextension of credit now resulting in foreclosures, bankruptcies, and write-offs, as well as a global credit crunch. To restore confidence in the markets, Shiller argues, bailouts are needed in the short run. But he insists that these bailouts must be targeted at low-income victims of subprime deals. In the longer term, the subprime solution will require leaders to revamp the financial framework by deploying an ambitious package of initiatives to inhibit the formation of bubbles and limit risks, including better financial information; simplified legal contracts and regulations; expanded markets for managing risks; home equity insurance policies; income-linked home loans; and new measures to protect consumers against hidden inflationary effects.

This powerful book is essential reading for anyone who wants to understand how we got into the subprime mess--and how we can get out.

The Subprime Solution: How Today's Global Financial Crisis Happened, and What to Do about It Details

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From Reader Review The Subprime Solution: How Today's Global Financial Crisis Happened, and What to Do about It for online ebook

Justin Tapp says

Shiller of the S&P/Case-Shiller home price index that's so closely watched. Shiller published this book in mid 2008, before much of the bad stuff happened. The books is very short with very large margins, so it's a quick read. I'll simply link to Ian Ayres review of the book on the Freakonomics blog as he has valid criticisms.

Shiller basically believes that information is the #1 solution for keeping such a crisis from occuring again. The government should basically subsidize financial education, subsidize financial advisers (have them charge a standard hourly fee), etc. Establish national databases of personal and business financial data so that things like FICO scores aren't so important.

He supports the creation of more markets-- home equity insurance, income insurance (in case you lose your job), continuously worked-out mortgages, and an expanded derivatives market (which he helped create) for things like home values in cities.

About the only thing that the Administration seems to have proposed that fits with what Shiller suggested is the sort of "Consumer Lending Safety Commission" that would regulate home loans, credit cards, student loans, etc.

Overall, a good simple economist's view to preventing future crises.

I give it 2.5 stars out of 5. A quick read, you should check it out sometime.

Kate says

I'm a fan of Robert Shiller, but this isn't one of his strongest books. Shiller is famous for predicting the dot.com and housing bubble. While I agree with a lot of his viewpoints in Irrational Exuberance, I thought his viewpoints in The Subprime Solution did not sufficiently address the real culprit of the mortgage crisis. The banks had an incentive to provide mortgages to people who really couldn't afford them because the government bailed out the banks. We need to remove this incentive for financial institutions to make irresponsible loans. As a country, we need to go back to the days when there were no zero down mortgages, and people had to pay at least 10% down. The current lending practices encourage people to stay in debt and live above their means. This is a recipe for disaster.

Lobstergirl says

This little book went to press in 2008, but before the whole financial system almost completely melted down.

After Bear Stearns but before Lehman, AIG, the election of Obama, and the Hank Paulson/Bush administration bailout of Wall Street. Thus the "Global Financial Crisis" mentioned in the title is not completely or adequately explained. The words "credit default swap" do not appear. Shiller (the Arthur Okun Professor of Economics at Yale) concentrates on the housing bubble and the mass psychology behind it.

His solutions include: adopting an inflation-indexed unit of measurement, like the *unidad de fomento* used in Chile, to help consumers understand that dollars are not constant; more widespread use of a liquid market in real estate futures (he believes that derivative markets have the potential to tame speculative real estate bubbles); the issuance of government debt indexed to a nation's GDP; continuous-workout mortgages, that would adjust monthly based on the homeowner's changing ability to pay and changing conditions in the housing market; home equity insurance; and livelihood insurance, which can be seen as a more modern and effective version of unemployment insurance.

Gordon says

This is one of the most creative books on finance I've ever read, not so much because of its diagnosis of the causes of the current economic crisis, but because of its proposed solutions for making sure a similar crisis doesn't happen again.

First, the causes. Shiller says much the same things as most other economists now say, with the advantage of more hindsight. The main cause was the housing bubble in the US, though similar bubbles arose in other places too, such as the UK. The bubble arose out of psychological factors first and foremost: a belief that housing prices would continue rising forever, and at a rate faster than inflation. This "social contagion", as he calls it, affected victims and victimizers alike. Sub-prime borrowers and central bankers both swilled the champagne, based on their recent experience. A longer term view would have led to a different conclusion: "We get the false impression that homes have been a spectacular investment when in fact their increase in value, measured in [real terms:], even over many decades, would generally have been -- at least until the recent housing boom -- nil."

Contributing factors include the financial instruments that allowed bad mortgages to be bundled up and resold to investors worldwide, lax regulation, low interest rates, compensation schemes that encouraged wild risk-taking by banking executives, and unscrupulous mortgage lenders. Needless to say, the Bush Administration was not exactly vigilant in reining in this housing boom, any more than the Clinton Administration reined in the tech boom of the 1990's. Too many people were making enormous amounts of money, and the skeptics were simply written off as party-poopers.

Second, the solutions. Shiller is a big believer that markets combined with better risk management tools are the best avenue to greater prosperity for all, including those on the lowest rungs of the economic ladder who were hit hardest by the collapse of the sub-prime mortgage market. The key problem with housing in particular, as he sees it, is that the typical homeowner is stuck with the worst kind of risky asset: it's financed with debt, it's an undiversified portfolio (a single house, in a single market, which can't be moved anywhere else) and it's not very liquid (you can't sell it quickly). What he suggests is a housing futures market, where homeowners could hedge their risk, so that they could buy an option to sell their house at a fixed price at some point in the future. In effect, it's insurance against the house losing value. This is a pretty clever idea. And he has lots more in a similar creative vein.

At 178 pages, this is a pretty quick yet fascinating read.

Mark Kiner says

Reading this book on the 10th anniversary of the Great Recession is both enlightening and sad. Most of the lessons and suggestions put forward by Shiller have not been listened to by world leaders, and much was done in the exact opposite, especially in the EU. We are still living in the shadow of the Great Recession and will be for many years to come it seems. This book, especially towards the end, shows how it might have been if only our populace and leaders were better educated.

Ed Terrell says

The Fed has been doing it since 1914 and the Bank of England has been doing it for 100s of years. Bailouts: Cui bono and who will suffer. Fair and unfair are far from clear-cut.

Shiller, who is better known for his work in creating the Case-Shiller home price index in 2002, does a fine job with this book which is part historical without being too detailed, part educational without being too pedantic and part forward thinking without it being shoved down your throat. Published in 2008, while the second great depression was just beginning to lurch its way forward, it gives a brief nod to the search for the exogenous cause, the list of which is none too short but suffice to say that it encompasses everything from moral hazard and overly complex financial machinery to the excessive optimism and social contagion typical of speculative booms.

Shiller puts forth a good case for the money illusion, and how people tend to think of prices in nominal not real terms. It is our difficulty understanding inflation which creates the impression that homes have been a spectacular investment. This is not the case: real prices for homes have not really increased much over a 100 years. The error in our thinking is "one of proportion and exaggerated attention." Information cascades lead to more and more stories in talk and in the media until they dominate public thinking and it is these stories that can lead to severe changes in human behavior long before traditional economic indicators stand up and be noticed.

Great book which balances the intellectual arrogance of the zeitgeist and conventional wisdom against "Bubbles" which have complicated, sometimes random and usually unpredictable dynamics.

James says

Despite its somewhat unfortunately low-brow title, this is a serious examination of the causes of the new economic Depression. Shiller is the co-founder of the Case-Shiller Index, so he knows a thing or two about Real Estate. His analysis is persuasive, for example, discussing how the easy credit and low lending standards created the bubble. His solutions are innovative, but I'm not sure all of them are workable. His idea of baskets is, at best, untested. More people need to read this book to at least absorb his lexicon.

Recommended for everyone.

Crease says

Having eavesdropped on Professor Schiller's Yale University lectures for years now thanks to iTunes U, I expected a thorough analysis on the real estate situation we've found ourselves in these last 5 years...and I was not disappointed.

Two things keep me from giving this book 5 stars:
1. Professor Schiller writes The Subprime Solution from the standpoint of one who is at best overly optimistic and at worst downright naive about mortgage investor's willingness to go along with what's best for all of us. In a Star Trek-like utopia, ALL of his recommendations would be in place; alas, this is hardly the world we live in, nor is it likely to be in my lifetime.

2. The book assumes a basic understanding of finance and therefore won't be for every interested reader. If you have no background in finance/economics, pick up Econ for Dummies first.

Jannis says

Do you support the financial system as it is? Do you think it should get even bigger with more people involved? Do you think exorbitant wages of financial executives are not the reason for social inequality and why millions of people lost their jobs and homes? Then you should read Robert Shiller's "attempt" to explain the subprime crisis. Yes, the book was published before the collapse of Lehman Brothers, Merrill Lynch, ... unfolded and before the Eurocrisis commenced. Yes, by that time, people probably did not know, yet, about the dimensions of shadow banking, moral hazard, fraud and so on. But Shiller tries to oversimply the cause of the subprime crisis, arguing that it was not the financial system itself, but merely the emergence of a speculative bubble. According to Shiller, the subprime crisis only grew so big because people did not know that is was a bubble and that they did not know how to handle it. I agree that flawed group intelligence was certainly one of the reasons of the subprime crisis, but it was not the only one.

The reason, why I give this book only one star is the ignorance of Shiller about the financial system itself. He does not think the financial system is too big, he thinks it should be even bigger!! In the epilogue, he even rejects policy interventions against evildoers of the financial system!! In his book, you will not find anything about the prompt emergence of financial crises since the deregulation of the financial markets in the 80's by Reagan and Thatcher. You will not find anything about increased leverage of both financial and non-financial sector, as well as nothing about ever-increasing household debts! Saying that the expansion of the financial system will reduce social inequality is an insult against those people who lost their jobs, savings, homes or company because of financial misconduct.

Besides these inherent flaws, Shiller's short- and long-term solutions are mostly infeasible and ineffective, creating moral hazard and even more inequality. All of these recommendations ought to improve the risk-management of the financial system and induce the democratisation of finance. But how is this supposed to work, if Shiller's recommendations include home equity insurance, livelihood insurance and financial advisers and other services? How are low-income people supposed to afford these services? Shiller implicitly suggests that the financial sector should be democratised, but only for people who can afford it, which is obviously bogus. These arguments are only the tip of the iceberg, making Shiller's recommendations highly questionable.

Concluding, the book is out of date, out of touch with reality, highly provoking and almost disrespectful, especially in the epilogue. Stay away from this book!

Bob says

Shiller, a Yale economist who, with Karl Case, developed the Case-Shiller Index of Home Prices, predicted the bursting of the tech-stock bubble while the rest of the world gushed over the permanence of the "New Economy". Again, he predicted the bursting of the housing bubble along with a dramatic decline in home values, while the conventional wisdom held that house prices, nationally "never decline, and can't". He's not prescient, but he's a damned good economist.

In this, his latest clarion-call, he insists that much more dramatic actions will be required of both government and markets to prevent the current housing and financial meltdown from causing horrific, lasting damage to our economy and our people. He calls for dramatic short term measures, not to prevent the collapse in prices, which must occur, but to prevent the price collapse from devastating households that can't bear the consequences. Moral hazard be damned, he calls for a number of "bailouts" for the public good.

In the longer term, he calls for a modernization of financial markets and a "democratization of finance" through new and imaginitive policy tools and currently available information technology.

Policy makers ignore the warnings of this visionary at our peril.

Joe says

The book describes the housing bubble, and focuses on the author's solutions of how to deal with it and prevent it from happening again. Why should we care? The author is economist Robert J. Shiller, of the Case-Shiller Home Price index, and he's one of the few people that was willing to call housing prices a bubble, before it popped.

This book is pretty short, and so necessarily doesn't really do justice to a lot of the topics it covers. But that's OK, there are plenty of other books that do that: a good place to start is in another book from this same author "Irrational Exuberance".

Good parts: this book provides a nice quick overview of the housing crisis; it does a very good job of showing the silliness that lasted seemingly forever in this country that real estate operates in a way that is completely unlike any other financial area, and completely outside the normal operation of economics; the author presents some interesting ideas in how to deal with the housing crisis in the short term, and how to prevent it in the long term.

Bad parts: the book talks about the housing crisis and larger economic problems, but it doesn't really go into any other aspects of the recent financial collapse. The author talks about the great depression, but he virtually ignores the resulting solutions -- meaningful financial regulation -- that worked for decades (and the further evidence that they really worked: large-scale economic collapse shortly after they were repealed). Some of the author's ideas seem silly: radical changes that would never be implemented, or ideas that might seem attractive to an economist but ignore the greater realities of actual life.

Teddee says

Very timely book with some much needed reality. Great general thrust, though it would be nice if solutions were a little more specific and concrete.

David says

interesting, concise, timely analysis of the origins of the financial meltdown, along with short-term and long-term recommendations re what to do about it. There's a bit of "I told you so" directed at Alan Greenspan et al. for missing the signs that the housing bubble was going to burst.

The author's core explanatory concept for bubbles seemed to be social contagion of thought -- just as there are fads in behavior, fads in thinking/expectation (e.g., housing prices will always keep going up) can lead you to ignore otherwise-obvious information and warning signs until it's too late.

His short-term recs seemed to be drawn from analogies regarding what worked or didn't in dealing with the Great Depression. Long-term ideas (example: home equity insurance) all sounded great to me, but I'm not confident I know enough in this area to know the pitfalls. Would like to see him debate someone who takes a different view but is equally knowledgeable.

Having some familiarity with the book publishing process, I'm blown away that he got this out so fast -- it's very current.

Mark says

More financial instruments are the solution to all of our problems? Adding speculative futures markets for home prices will reduce the fluctuation? There are those who think the oil price fluctuation was caused by speculation in futures.

To me, the proposal to enlarge and rely on the financial industry is not a convincing solution for market stability and avoidance of financial meltdowns.

Shiller proposes pricing things by using baskets of goods instead of money itself? Well ... how about not inflating the money supply in the first place? And who controls the basket of goods? Rates of inflation (core inflation) in my view have been dishonest. There is clear motivation for the government to underestimate the real rate of inflation. And where there is opportunity and motive ... there is usually the act too. Especially when government is involved.

Robert J. Shiller should read some of Derrick Jensen's books.

Andy says

-A house is, in many cases, not the great investment it's allways been cracked up to be
-Homeownership is good for America
-An outline for a some fundamental changes to the financial system.