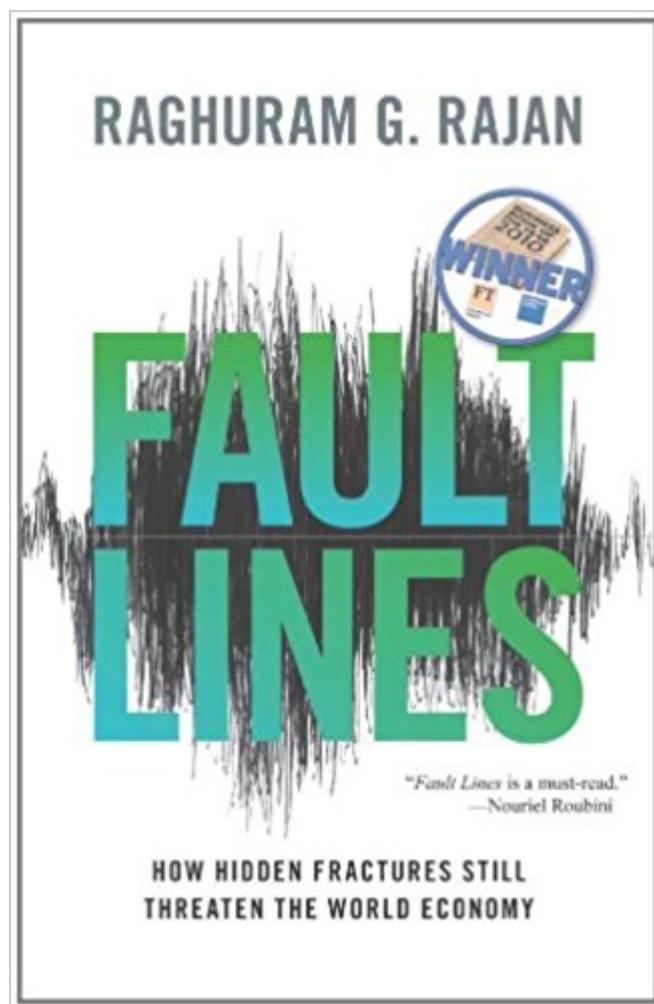


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# Fault Lines: How Hidden Fractures Still Threaten The World Economy



## Synopsis

Raghuram Rajan was one of the few economists who warned of the global financial crisis before it hit. Now, as the world struggles to recover, it's tempting to blame what happened on just a few greedy bankers who took irrational risks and left the rest of us to foot the bill. In *Fault Lines*, Rajan argues that serious flaws in the economy are also to blame, and warns that a potentially more devastating crisis awaits us if they aren't fixed. Rajan shows how the individual choices that collectively brought about the economic meltdown--made by bankers, government officials, and ordinary homeowners--were rational responses to a flawed global financial order in which the incentives to take on risk are incredibly out of step with the dangers those risks pose. He traces the deepening fault lines in a world overly dependent on the indebted American consumer to power global economic growth and stave off global downturns. He exposes a system where America's growing inequality and thin social safety net create tremendous political pressure to encourage easy credit and keep job creation robust, no matter what the consequences to the economy's long-term health; and where the U.S. financial sector, with its skewed incentives, is the critical but unstable link between an overstimulated America and an underconsuming world. In *Fault Lines*, Rajan demonstrates how unequal access to education and health care in the United States puts us all in deeper financial peril, even as the economic choices of countries like Germany, Japan, and China place an undue burden on America to get its policies right. He outlines the hard choices we need to make to ensure a more stable world economy and restore lasting prosperity.

## Book Information

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## Customer Reviews

Raghuram G. Rajan, Winner of the 2013 Deutsche Bank Prize in Financial Economics, The Center for Financial Studies Winner of the 2010 Business Book of the Year Award, Financial Times and Goldman Sachs Winner of the 2011 Gold Medal in Finance/Investment/Economics, Independent Publisher Book Awards Winner of the 2010 PROSE Award in Economics, American Publishers Awards Winner of the 2010 Gold Medal Book of the Year Award in Business & Economics, ForeWord Reviews Finalist for the 2010 Paul A. Samuelson Award, TIAA-CREF Finalist for the 2010 Book of the Year Award in Business and Economics, ForeWord Reviews One of *strategy+business* magazine's Best Business Books of the Year for 2010 Best Crisis Book by an Economist and Named one of Bloomberg News's Thirty Business Books of the Year for 2010 Finalist for the 2011 Estoril Global Issues Distinguished Book Prize One of Financial Times's Books of the Year in Business & Economics, Nonfiction Round-Up for 2010 "Fault Lines is a must-read."--Nouriel Roubini, *Forbes.com* "[E]xcellent. . . . [Fault Lines] deserve[s] to be widely read in a time when the tendency to blame everything on catch-all terms like 'globalisation' is gaining ground."--Economist "Like geological fault lines, the fissures in the world economic system are more hidden and widespread than many realize, he says. And they are potentially more destructive than other, more obvious culprits, like greedy bankers, sleepy regulators and irresponsible borrowers. Mr. Rajan . . . argues that the actions of these players (and others) unfolded on a larger world stage, that was (and is) subject to the imperatives of political economies. . . . [A] serious and thoughtful book."--New York Times "A thought-provoking new book. . . . [Rajan's] voice is worth listening to."--Martin Wolf, *Financial Times* "The book, published by Princeton University Press, saw off stiff competition from five others on the shortlist, to be chosen as 'the most compelling and enjoyable' business title of 2010. The final intense debate among the seven judges came down to a choice between *Fault Lines* and *Too Big to Fail*, Andrew Ross Sorkin's acclaimed minute-by-minute analysis of the collapse of Lehman Brothers. The book identifies the flaws that helped cripple the world financial system, prescribes potential remedies, but also warns that unless policymakers push through painful reforms, the world could be plunged into renewed turmoil."--Financial Times "Rajan is worth reading not just because he was correct when few were but also because his writing is clear as a bell, even to nonspecialists."--Christopher Caldwell, *Weekly Standard* "The left has figured out who to blame for the financial crisis: Greedy Wall Street bankers, especially at Goldman Sachs. The right has figured it out, too: It was government's fault, especially Fannie Mae and Freddie Mac. Raghuram Rajan of the University of Chicago's Booth School of Business says it's more complicated: Fault lines along the tectonic plates of the global economy pushed big government and big finance to a financial earthquake. To him, this was a Greek tragedy in which traders and

bankers, congressmen and subprime borrowers all played their parts until the drama reached the inevitably painful end. (Mr. Rajan plays Cassandra, of course.) But just when you're about to cast him as a University of Chicago free-market stereotype, he surprises by identifying the widening gap between rich and poor as a big cause of the calamity."--David Wessel, *Wall Street Journal*"In a new book . . . entitled *Fault Lines*, Rajan argues that the initial causes of the breakdown were stagnant wages and rising inequality. With the purchasing power of many middle-class households lagging behind the cost of living, there was an urgent demand for credit. The financial industry, with encouragement from the government, responded by supplying home-equity loans, subprime mortgages, and auto loans. . . . The side effects of unrestrained credit growth turned out to be devastating--a possibility most economists had failed to consider."--John Cassidy, *New Yorker*"[C]onvincing."--Christopher Caldwell, *New York Times Magazine*"What if the financial crash of 2008 was really caused by income inequality? Not greedy bankers, not reckless homeowners, but the ever widening-gulf between the rich and the poor? And what if the lack of social services--like health care--made things much, much worse? This is the startling new theory from Raghuram Rajan. . . . [Fault Lines is] especially fascinating because it mixes free-market Chicago School economics with good-government ideas straight out of Obamaland."--John Richardson, *Esquire.com*"A high-powered yet accessible analysis of the financial crisis and its aftermath, *Fault Lines* was awarded the *FT/Goldman Sachs Business Book of the Year*. Rajan . . . was one of the few who warned that the crisis was coming and his book fizzes with striking and thought-provoking ideas."--*Financial Times* (FT Critics Pick 2010)"What caused the crisis? . . . There is an embarrassment of causes--especially embarrassing when you recall how few people saw where they might lead. Raghuram Rajan . . . was one of the few to sound an alarm before 2007. That gives his novel and sometimes surprising thesis added authority. He argues in his excellent new book that the roots of the calamity go wider and deeper still."--Clive Crook, *Financial Times*"Few people were able to foresee the recent economic downturn. Raghuram Rajan . . . was one of them. This makes his new book, *Fault Lines*, worthy of consideration amidst the rampant speculation about the causes of the financial crisis. . . . *Fault Lines* is valuable primarily for its clear explanation of unintended economic consequences from well-meaning government intervention."--*Washington Times*"Rajan's writing is clear and direct."--James Pressley, *Bloomberg News*"Former IMF chief economist Raghuram G. Rajan . . . in his new book, *Fault Lines*, brings together and explains the diverse failings that contributed to the crisis--the fault lines, as he puts it, that were exposed by the events of the past several years. Rajan then puts forward broad policy recommendations to ward off a future problem. . . . Rajan's book takes a comprehensive look at what got us into the crisis and offers an

intriguing approach to avoiding another one."--Phillip Swagel, *Finance & Development*"I devoured Raghuram Rajan's *Fault Lines: How Hidden Fractures Still Threaten the World Economy* in a very short span of time last night. It's brief, well-written, and extremely interesting. I would definitely recommend adding it to your financial crisis reading list."--Matthew Yglesias, *Yglesias blog*"The proposed global reforms that [Rajan] lists in *Fault Lines* run the gamut from the prosaic to grandiose. Along with revamping Wall Street's pay system, he offers innovative ideas on building capital buffers into the global credit system, obviating much of the need for bailouts of companies deemed too big or too enmeshed in the financial system to fail."--Barron's"Economists who can challenge their peers while remaining accessible to the general reader are rare, but Rajan belongs to this elite group. No short summary can do justice to this well-written, insightful, and nuanced study."--Choice"In 2007, then-chief IMF economist Raghuram G. Rajan delivered a stark warning to the world's top bankers: financial markets were headed for doom. They laughed it off. In the wake of the collapse that followed, Rajan has written a new book, *Fault Lines: How Hidden Fractures Still Threaten the World Economy*, that warns the system is doomed to repeat its mistakes. Like many defenders of the market, Rajan urges us not to demonize the bankers. But it's this fiscal conservative's focus on inequality that makes him stand out from the pack. The growing wage gap, he argues, is a hidden driver of financial instability, putting constant pressure on politicians to enact short-term fixes."--Toronto Star"The critics are wrong: Raghuram Rajan's analysis of the global financial crisis remains highly relevant and deserves to be widely read. . . . The breadth of Rajan's explanatory framework--which is presented cogently and concisely within 230 pages of text--marks this book apart from many others that tackle the same themes."--Mark Hannam, *Prospect*"Dozens of experts have explored the reasons behind the ongoing global economic turmoil, and Raghuram Rajan provides his own elegant and thoughtful analysis in *Fault Lines*."--BizEd"With *Fault Lines*, Rajan has made an original diagnosis of the credit crisis, one that goes much further than those of greedy bankers or wasteful mortgage giants such as Fannie Mae and Freddie Mac."--Christophe De Rijcke, *De Tijd* (translated from the Dutch by K.C.L.)"A book that should be the default choice of discerning finance professionals when they enter the store the next time."--D. Murali, *Business Line*"Rajan's *Fault Lines* is . . . expansive and policy-focused and clearly destined to become a must-read on any list of books on the recent global crisis."--Jahangir Aziz, *Business Standard*"Insightful, educative and incredibly gripping, if you want just one book to understand the ongoing global financial crisis and the way forward, *Fault Lines* it is."--Gautam Chikermane, *Hindustan Times*"Best Crisis Book by an Economist (2010)."--James Pressley, *Bloomberg News*"*Fault Lines* has a strong claim to be the economics book that best caught the spirit of 2010.

Raghuram Rajan's receipt of the Financial Times and Goldman Sachs annual business book award only confirmed his book's widespread popularity. It is not hard to see why so many people liked it. Fault Lines eschews hyperbole for a lucid and balanced account of the crisis."--Fund Strategy"Rajan . . . comes up with original and important long-term remedies. . . . Rajan's book is a bold enterprise in three ways: firstly it aims to explain the US financial crisis by looking at deep, decade-long fractures in economies and societies; secondly it suggests well-known but radical solutions that few dare put forward; and finally it supplies innovative answers to practical questions. . . . [T]he book will please any reader looking for an inquiry into the deepest causes of the recession and a consistent account of government's errors of omission and commission."--Natacha Postel-Vinay, British Politics and Policy"In a well-written, well-organized study, he focuses on ten of the most important issues bedeviling a still shaky world economy. Neither too technical for laymen nor too glib for specialists, the book ought to be a significant contribution to policy-makers' discussions of where we go now."--Joel Campbell, International Affairs"Just when you thought you had heard it all and that there is not much more that we can learn from the recent financial crises, here comes a brand-new assessment from another angle. . . . Written with clarity and persuasion."--Good Book Guide"[T]his book is a must read for analysts, academics, politicians, economists, and the like."--Emilia Garcia-Appendini, Financial Markets and Portfolio Management

"Fault Lines provides an excellent analysis of the lessons to be learned from the financial crisis, and the difficult choices that lie ahead. Of the many books written in the wake of our recent economic meltdown, this is the one that gets it right."--George A. Akerlof, coauthor of *Animal Spirits* and *Identity Economics*"Amidst the welter of books about our financial crisis, Rajan's book stands out for several reasons: the author's intellectual distinction, his academic and real-world involvement in the problems of finance and the macroeconomy, his global perspective, his search for the roots of the financial crisis in America's growing economic inequality, and also his prescience. In 2005, Rajan foresaw the coming financial collapse--and was fiercely criticized for his insight."--Richard A. Posner, author of *A Failure of Capitalism: The Crisis of '08 and the Descent into Depression*"Beautifully clear, cogent, and highly readable. This is the best book out there on the global imbalances that gave us the last financial crisis and might well give us the next one."--Kenneth S. Rogoff, coauthor of *This Time Is Different: Eight Centuries of Financial Folly*

I am working my way through every book about the financial crisis of 2007-09 and finally got around to this, although I was familiar from secondary sources with the first of his theses -- that the crisis

was caused in part by pro-home-mortgage-indebtedness policies the federal government sponsored for decades, across multiple administrations, as a way to keep the middle class and working class content as globalization and other forces put downward pressure on their wages and salaries, a thesis supported by the recent book "House of Debt" which came out while I was reading this one. Having read a good deal of these books, I have developed my own views, which happen to coincide with Rajan's , not merely the aforementioned thesis regarding federal governmental distortion of housing finance, but the others developed in this book, specifically the role of other nations' economic policies leading them to keep a constant appetite for US debt instruments, and so I approached this favorably disposed, and I was not disappointed. This is quite an insightful and instructive book, and of course since it was published, the author has been appointed head of India's central bank, and also on record for having warned of excess risk in the financial system years before the crisis, so this is someone more than a mere academic whose views need to be taken seriously. Yet it is written in a very clear and non-technical manner. If it has any weakness, in fact, it is a little too non-technical, and a little too lacking in citations to supporting data (other books such as Guaranteed to Fail and House of Debt, however, contain supporting data. Toward the end he offers a fairly standard list of policy prescriptions (invest more in education, reduce consumption subsidies, reduce banking system risk, and so on), although my favorite was his call to finally fully privatize the GSE's, so that they are just E's, without the GS, which is long overdue.

In his previous book, Raghuram Rajan wanted to save capitalism from the capitalists. As he and his coauthor described, market forces can be annihilated by those bent on rent seeking and monopoly power. A few years after this first book, and in the midst of a world financial crisis, there is still ample proof that capitalists hold predatory views on capitalism, and that they want to hijack the system for their own private interest. But instead of distributing the blame for the crisis that befell upon us, Rajan argues that our post-crisis world economy needs to be saved from a new kind of threat: a combination of populist-driven politics and of geopolitical power shifts that create deep and lasting imbalances. These are the areas where he situates the fault lines that lie at the origin of the current world crisis and that, if unattended, may well provoke the next one.In geology, fault lines are breaks in the Earth's surface where tectonic plates come in contact or collide. In using a geological metaphor, the author suggests that the cracks and imbalances in the world economy cannot be easily mended, and that they are almost beyond our control. But if mankind cannot prevent tectonic moves and earthquakes, we can build resistant buildings and improve the resilience of our economic systems. This is what Rajan proposes, in a set of recommendations that goes well

beyond the usual fix in the financial sector that is now commonly discussed. As Raghu Rajan emphasizes, his proposals are neither from the right nor from the left. They derive from his long experience as an academic originator of cutting-edge economic research, and as a decision-maker who, during three years, occupied the number-two seat at the IMF in Washington. His personal background as a US non-resident Indian also shows throughout the book. He mentions in passing that he is the director of a company, Heymath, that is based in Chennai in India and that helps teachers around the world to create teaching materials for math lessons and homework assignments. More generally, he insists that economists should analyze the US economy with the same tools and frameworks that they use for emerging countries. US policy-makers could also learn a thing or two from developing economies. For instance, health management practices in India could show the way to making US healthcare more affordable. Or conditional cash transfers in Mexico could encourage poor parents in American urban ghettos to pay more attention to their children's nutrition, health, and education by making welfare payments conditional on parents meeting certain milestones. Neither left nor right, many of his prescriptions are from the South. It is unlikely that people from the radical left will read this book, but they should. For a start, the metaphor of "fault lines" is close to the Marxist concept of contradiction. For Marxists, capitalism is branded by an immanent want of balance, of crippling contradictions. This is exactly why it changes and develops incessantly: constant development is the only way for it to resolve and come to terms with its constitutive imbalance. Contradictions and fault lines are not digging capitalism's grave; on the contrary, they highlight its flexibility and adaptability, and also show the amount of work required in sustaining it. Similarly, Rajan's own explanation of the financial crisis comes close to the concept of overdetermination. For psychoanalysts, a phenomenon is overdetermined if it is caused by a combination of multiple factors, which taken in isolation cannot account for the effect alone. The financial crisis originates in the follies and excesses of the financial sector, but also in the "other scene" of growing domestic inequalities and global imbalances. Although he quotes neither Marx nor Freud, Rajan shows up as a skilled dialectician. For him, politicians are part of the problem, and yet they are the ones that we must rely on to provide the solution. Likewise, our current predicament derives from the planet's growing interdependence, but the way out is to be found in more globalization, not less. Or to take another example, fixing finance from the consequence of financial engineering gone wild requires more financial innovation, albeit of a different, more inclusive kind. The art of the dialectical reversal is also displayed in the author's disregard for conventional ideas and political party lines. In *Saving Capitalism*, he argued that capitalist rent-seekers' best friends were the trade unions and antiglobalizers pushing for trade protection and anticompetitive practices.

Likewise, he argues in *Fault Lines* that the IMF and the World Bank should seek their best supporters among the civil society organizations and media outlets that are so often found vociferating against the dictates of the Bretton Woods institutions. I will not try to sum up the argument or reproduce some of the reasoning, because all chapters seem equally worthwhile. In every book I read, there are parts that deserve less attention and that I tend to read in a more cursory way, taking less notes and time to ponder the reasoning. Not so in *Fault Lines*: my scrapbook was full of notes, and there was not one passage where I felt left out or in need of additional explanation. The writing is never dull or technical, and there are real gems in style and composition. The author has a real talent for catching the attention of the reader head on and keeping him alert until the very last page. This is not only the best book on the financial crisis I have read so far, but also one of the most stimulating and readable economic volume that I have had the opportunity to review.

Rajan, now head of the Reserve Bank of India, is one of the smartest financial economists out there. This is probably the second best book you can read about the financial crisis (after Calomiris and Haber, *\_Fragile by Design\_*). Although Rajan makes an appearance in Charles Ferguson's horrid anti-Wall Street film *\_Inside Job\_*, this book quite appropriately lays much (though not all) of the blame where it actually belongs -- on lax monetary policy that pumped up the bubble and federal housing policy that debased lending standards. The book is weakest at the end, where Rajan provides recommendations for the future. But the book's analysis of the factors that led up to the crisis is both nuanced and sure-footed.

Rajan is an important thinker who is willing to challenge the economics establishment on its ridiculous assumptions. Some of his points are argued better than others. However, it's a short read that should make those with all kinds of political beliefs think deeply about their inherent assumptions about the nature of the U.S. and domestic economy. However, I do not recommend this for the absolute layman. A reader without a strong understanding of basic economic theory is not going to get much out of this. I'd recommend at least reading "Economics in One Lesson" by Henry Hazlitt or "Basic Economics" by Thomas Sowell before this book.

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