What Happened?

Making Sense of the Bust

The Wall Street Journal Guide to the End of Wall Street as We Know It
By David Kansas, Collins Business, 224 pages, $15.99

Reviewed by Glenn Altschuler

ON OCT. 1, 2008, THE SENATE PASSED A $700 billion bailout package designed by then-Secretary of the Treasury Henry Paulson to remove toxic debt from the nation's financial institutions. Since the Constitution requires the House of Representatives to initiate legislation, the Senate used an old ploy, "amending" an existing bill. The bill was entitled, quite aptly some might say, the Mental Health Parity and Addiction Equity Act.

With our mental health—and 401(k)s—still at risk, David Kansas, a former editor of The Wall Street Journal's Money & Investing section, has provided a primer on the financial crisis. At odds with its sensational title, The Wall Street Journal Guide to the End of Wall Street as We Know It is a clear, calm, conventional analysis of the implications of the recession for investors, home owners, and debt holders. (The Journal, like Barron's, is part of Dow Jones, a unit of News Corp.)

A combination of factors, Kansas reminds us, encouraged Wall Street to design financial products that hedged risk, fattened fees, and fed a false sense of security. When the market bounced back from the dot-com bubble, financial engineers concluded that credit-default swaps and securitization really did eliminate the black swan of risk. And so, when the Fed reduced short-term interest rates in 2003 to 1%, the Street bundled and sold subprime mortgages to get a higher rate of return. Assuming that real-estate prices would always rise, ratings agencies turned thumbs-up on "a lot of dreckish derivatives." It was, according to Kansas, the classic philosophy of Popeye's pal Wimpy: "I will gladly pay you Tuesday for a hamburger today."

Kansas claims the credit crisis wasn't caused by a lack of government oversight. After all, he writes, Sarbanes-Oxley imposed a wide range of rules on companies and corporate executives. And the repeal of the venerable Glass-Steagall Act in 1999 actually made it possible for the Fed to rescue bank holding companies.

Kansas doesn't, however, adequately examine the implications of the failure to regulate derivatives in the same fashion as stocks and bonds. Or of allowing financial conglomerates to operate commercial banks and investment banks under the same roof. Regulation can't eliminate greed and overconfidence, but as Kansas acknowledges, the system needs "mechanisms that can suss them out before they become endemic and potentially catastrophic."

Although he is skeptical that throwing trillions at the problem will do much, he thinks improved technology and the creative energy of the global economy, especially in Asia, "will help fuel a rebound." Therefore, the market remains the place to be for investors with a longer time horizon, while real estate, "a humdrum asset" for most of recorded history, should be "a place to live and raise your family in," and not a space for speculation.

With unemployment rising and the Dow off sharply, the bears are out in force on Wall Street, Main Street and in the media. Kansas is smart enough to warn readers not to pay attention to TV talking heads, who "often bark loudly and wrong and at the most inopportune moment." But even he can't resist the siren call of punditry. "Rather than the long and enduring downturn anticipated by the glum-faced Wall Streeters," he concludes (writing in December 2008), "look for a more Hobbesian recession: nasty, brutish and short."

He may be right. But then again, a year from now, some of us may be asking, as the journalist William Allen White did more than a century ago, "What's the matter with Kansas?"

GLENN C. ALTSCHULER is the Thomas and Dorothy Litwin Professor of American Studies at Cornell University.