"It would be surprising indeed," the economist John Kenneth Galbraith wrote more than 50 years ago, "if a society that is prepared to spend thousands of millions to persuade people of their wants were to fail to take the further step of financing those wants."

According to Philip Coggan, a columnist for The Economist, without some controls of capital, debt expands to gratify consumers and businesses; low interest rates stimulate speculation in equities and property; banks leverage money on hand so they can lend; and, inevitably, a crisis ensues.

In "Paper Promises," Mr. Coggan provides a lucid, learned and illuminating analysis of the role of debt.

He starts with the invention of money (named for the Roman deity Juno Moneta, the goddess of warning and advice) and proceeds to the 1971 collapse of the Bretton Woods agreement, which pegged currencies to the dollar (and, indirectly, to gold). We live in its volatile aftermath: Currency rates of exchange float freely (or are manipulated), countries run budget and trade deficits for decades, and speculative bubbles threaten the global economy.

Along with many other economists, Mr. Coggan considers Oct. 19, 1987, the defining moment of the bubble era. On Black Monday, the Dow fell by almost 23 percent and stock exchanges from London to Hong Kong followed suit. Led by Alan Greenspan, chairman of the U.S. Federal Reserve, central banks promised to prop up financial institutions imperiled by the plunge in prices.

This "Greenspan put" underwrote irrational exuberance. Over the next two decades, output in the United States quadrupled, assets (on paper, thanks in no small measure to housing prices) quintupled, debt rose sevenfold, and the savings rate dropped to 0.4 percent. The vigilantes, Mr. Coggan writes, "seem to have fallen asleep." Just about everyone seemed to be prospering, "rather like a turkey is fattened in the run-up to Thanksgiving dinner."

"Paper Promises" is full of arresting -- and counterintuitive -- insights.

Drawing on Adam Smith, Mr. Coggan indicates that a belief that higher house prices contribute to national prosperity "makes one think of the mythical island where every household earns its living by taking in its neighbor's washing." Rising prices inflate claims, not resources. They do damage when lax lending standards encourage people to acquire assets they cannot afford, borrow more, using those assets as collateral -- and then look to others to bail them out. If at any moment a significant percent of home
owners sell, prices collapse. The decline hurts sellers (who are often elderly folks), but helps buyers (who are often young).

Moreover, Mr. Coggan reminds, there is no significant international market in houses. In general, economies improve with the production of "tradable goods and services": drugs, cars, video games, raw materials. As the developed world aged, he suggests, it should have generated current account surpluses and invested in emerging market companies. Instead, it has been in deficit, acting like a 60-year-old man who goes on a five-year spending spree just before his retirement.

Mr. Coggan is not optimistic about the future. He acknowledges that China is not likely to abandon the dollar, given the trillions it holds in reserve. The Chinese might let their currency rise, reduce their current account surpluses, and put in place a new exchange-rate system, if the United States reduces its deficit and relinquishes autonomy over capital controls. An agreement along these lines, however, would involve political concessions that neither side may be willing to make.

At best, Mr. Coggan concludes, cleaning up the mess will take a long time and involve many false starts. In all likelihood, for many Americans, changes in the global economy "will not be for the better."

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