This Time It's Different: Eight Centuries of Financial Folly-Preface

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Preface

This book provides a quantitative history of financial crises in their various guises. Our basic message is simple: We have been here before. No matter how different the latest financial frenzy or crisis always appears, there are usually remarkable similarities with past experience from other countries and from history. Recognizing these analogies and precedents is an essential step toward improving our global financial system, both to reduce the risk of future crisis and to better handle catastrophes when they happen.

If there is one common theme to the vast range of crises we consider in this book, it is that excessive debt accumulation, whether it be by the government, banks, corporations, or consumers, often poses greater systemic risks than it seems during a boom. Infusions of cash can make a government look like it is providing greater growth to its economy than it really is. Private sector borrowing binges can inflate housing and stock prices far beyond their long-run sustainable levels, and make banks seem more stable and profitable than they really are. Such large-scale debt buildups pose risks because they make an economy vulnerable to crises of confidence, particularly when debt is short term and needs to be constantly refinanced. Debt-fueled booms all too often provide false affirmation of a government's policies, a financial institution's ability to make outsized profits, or a country's standard of living. Most of these booms end badly. Of course, debt instruments are crucial to all economies, ancient and modern, but balancing the risk and opportunities of debt is always a challenge, a challenge policy makers, investors, and ordinary citizens must never forget.

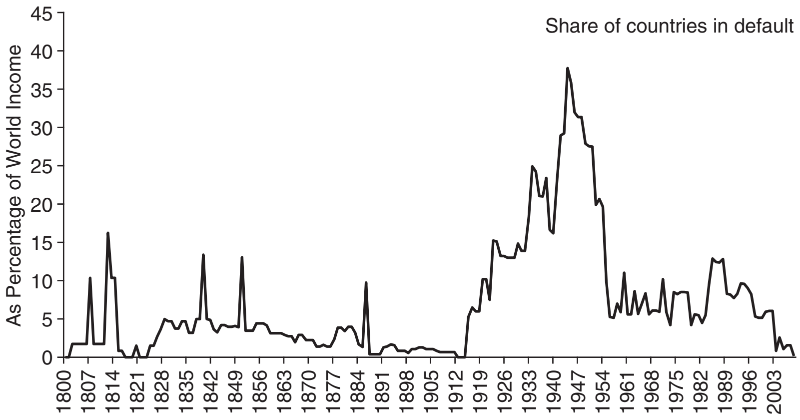

Figure P.1. Sovereign external debt, 1800–2008: Percentage of countries in external default or restructuring weighted by their share of world income.

tutions have done in the contemporary financial crisis. We see a major role for international policy-making organizations, such as the International Monetary Fund, in providing government debt accounts that are more transparent than those available today.

Our immersion in the details of crises that have arisen over the past eight centuries and in data on them has led us to conclude that the most commonly repeated and most expensive investment advice ever given in the boom just before a financial crisis stems from the perception that "this time is different." That advice, that the old rules of valuation no longer apply, is usually followed up with vigor. Financial professionals and, all too often, government leaders explain that we are doing things better than before, we are smarter, and we have learned from past mistakes. Each time, society convinces itself that the current boom, unlike the many booms that preceded catastrophic collapses in the past, is built on sound fundamentals, structural reforms, technological innovation, and good policy.

Given the sweeping data on which this book has been built, it is simply not possible to provide textural context to all the hundreds of episodes the data encompass. Nevertheless, the tables and figures speak very powerfully for themselves of the phenomenal recurrent nature of the problem. Take figure P.1, which shows the per-