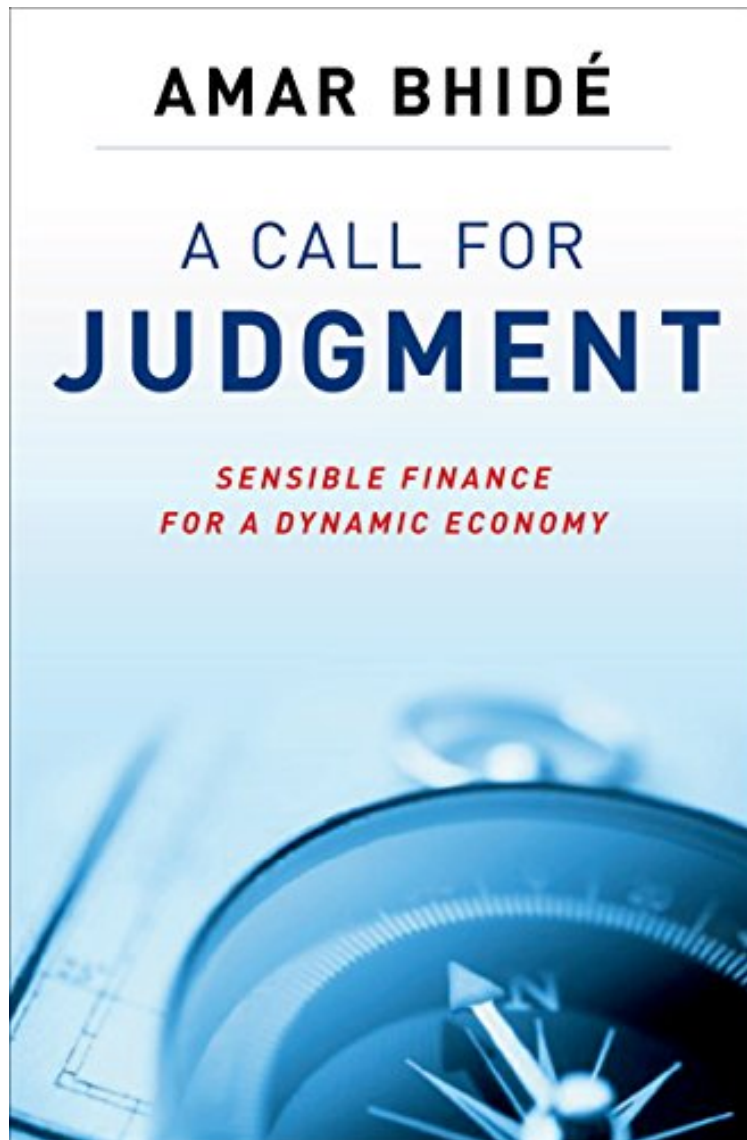


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A Call for Judgment: Sensible Finance for a Dynamic Economy

Amar Bhidé

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won't regret it. 19 of 19 people found the following review helpful. Objective and expansive view financial meltdown

By Pradeep Anand

Since October 2008, many have written about the financial meltdown that sparked the Great Recession. Most books and articles were about "what" happened; very few attempted to write about "why" it happened. These "what" and "why" attempts informed me but I learned little to draw lessons for corrective actions and for the future. These authors were like the proverbial blind men trying to describe the elephant by touching/feeling its different parts. Additionally these authors were academicians, journalists and financial engineers who wrote from limited perspectives of their own domain expertise or experience, mostly in finance, economics and financial journalism. These authors provided subjective views of a vested or inadvertent participant in the creation of the financial bubble. I needed a detailed, objective view to learn about why financial meltdown came about and how it could be avoided in the future. Amar Bhidé's *Call for Judgment* went a long way in satiating that thirst. Amar Bhidé is a Schmidheiny Professor at Fletcher School, and has served as Glaubinger Professor of Business at Columbia University. His book is expansive in its scope. It has broad content, drawing from scholarship and research in Economics, Finance, Government Regulation, Quantitative Sciences, and Innovation. Bhidé uses his deep knowledge of theory and practice in these seemingly disconnected disciplines to support and tear apart deeply rooted contentions and practices. Additionally, it is expansive in its time horizons. Bhidé is a credible business researcher and historian. He goes as far back as is necessary, sometimes several centuries, to provide details that evolved and contributed to our current situation. It reveals human frailties, how our collective memories can also diminish with age. Moreover, Bhidé is objective. He displays not only intellectual honesty but also intellectual bravery. He is not afraid to take on some of the sacred idols and expose their contributions to current debacle. Furthermore, he is not scared of the devil that resides in the details. His approach has logical and systematic rigor. Bhidé contends that there were several contributors to the debacle. At the top of his list is that Finance had become centralized, mechanistic and detached from its local customers and conditions. Flawed quant models catalyzed centralized decision-making, with microscopic contributions from local judgment. The centerpiece of this centralized financial decision-making had some fundamental faults in the way their "mathematical economics" foundation and pillars treated "risk" and Knightian "uncertainty". Pursuit of mathematical elegance required some shortcuts that took economics into untestable territories, where hypotheses were unfalsifiable but implausible, with unimagined consequences. Separately, banking deregulation, cheered on by prevailing economic theories and certifications from the SEC, allowed banks and investment firms to morph into publicly traded monoliths. These firms were led by inactive, arms-length stockholders management, who paid little attention to increasing risk at their firms. This led to a perverse "Heads we win, tails public stockholders lose" attitude to prevail in the industry. The risk appetite of financial firms went up and with it the share of trading at these firms. On the other side, threatened banks, whose market share had declined, were now forced to look for alternative sources of profits. They created highly profitable and risky products such as derivatives and Credit Default Swaps. Aided by these factors, the imprudence or chicanery of a few individuals unraveled several firms and caused widespread damage to the global economy. Bhidé has "A Modest Proposal" to pull us out of this morass. It can be summarized by former Citibank CEO John Reed's comment, "I would compartmentalize the industry for the same reason we compartmentalize ships. If you have a leak, the leak doesn't spread and sink the whole vessel." He recommends that we reinstate Glass-Steagall's wall between investment and commercial banking, to reduce collateral damage from future speculative bubbles. His fervor for local touch points between banks and borrowers is not lost. He recommends that we reinstate old-fashioned banking where bankers know their customers. Consequently, we would have to decentralize oversight of banking and finance so that conditions, relations and decision-making can be monitored locally. His proposal allows "casino bankers" (investment firms) to innovate and speculate but with an arm's length from "utility banks". Bhidé does anticipate that the unwinding and fragmentation of megabanks will be difficult--97% of more than \$200 Trillion in derivatives are held by five US banks: J.P Morgan, Bank of America, Goldman Sachs, Citibank and Wells Fargo. Additionally, government-led solutions to the current crisis may take a long time. The 2,300-page Dodd-Frank bill may appear to some as "refurbishing regulators' deck chairs from the Titanic." However, as historical examples from previous financial crises show, "a weak first bill doesn't have to be the last word" and "reform delayed isn't reform denied!" I could see why eminent people such as Former Fed Chairman Paul Volcker and Nobel Laureate (Economics) Edmund Phelps and many others recommended the book. *Call to Judgment* has great content and is a treat to read. The material, in lesser hands, could have been boring and tedious. Bhidé strikes a great balance between dryness of the subject and popular writing, with subtle, tongue-in-cheek strokes that are rare in such scholarly tomes. Amar Bhidé's *A Call for Judgment* is a clarion call for us to be aware and beware of the current structure of the financial--banking and investment--industry. Global governments and investors need to listen to Bhidé; and heed his call to action because we are not out of the woods yet. The insightful book has probably been targeted at researchers, scholars and policy wonks but the rest of us can benefit from this brilliant work too. I know I did.

Our prosperity requires the enterprise of innumerable individuals and businesses who exercise their imagination and judgment and bear responsibility for outcomes. And widespread enterprise is fostered through dialogue and

relationships, not merely prices in anonymous markets. Yet modern finance blatantly neglects these necessary elements for enterprise. In the last several decades finance has become increasingly centralized, distanced, and mechanistic. Instead of many lending officers making judgments about borrowers they know, credit decisions are the output of the models of a few Wall Street wizards and credit agencies. This robotic centralized finance stifles the dynamism of the real economy and leads to recurring collapses. A Call for Judgment clearly explains how bad theories and mis-regulation have caused a dangerous divergence between the real economy and finance. In simple language Bhid? takes apart the so-called advances in modern finance, showing how backward-looking, top-down models were used to mass-produce toxic products. Thanks to excessively tight securities laws and loose banking laws, anonymous transactions have displaced relationship-based finance. And Bhid? offers, tough simple rules for restoring relationships and case-by-case judgment: limit banks--and all deposit taking institutions--to basic lending and nothing else. A Call for Judgment is both a primer on the role of finance in a dynamic modern economy, and a cautionary tale about the pitfalls of banks functioning as highly centralized, mechanistic entities. It is essential reading for anyone interested in bringing the economy back to a point at which decisions can be made that foster organic economic growth without the potentially disastrous risks currently accepted by modern finance.

"Events have raised large questions about the academic theories supporting the concept that our heavily 'engineered' financial markets are self-disciplined and efficiently allocate capital. Amar Bhideacute;'s skeptical analysis should stimulate basic reconsideration."--Paul Volcker, chairman of the Economic Recovery Advisory Board and former chairman of the Federal Reserve "This great book, Amar Bhideacute;'s third in a decade, is an essential and distinct contribution in our hour of need. It first reformulates how modern capitalism does what it does best--innovation. Then, in high gear, it shows us how our capitalism has been brought down by a thousand cuts: the idea that rational investors always know precisely what they're doing, the perversion of the banking industry, the errors of deregulation and the striking errors in some new regulations. A Call for Judgment is not a cry for some auto da feacute; on Wall Street but rather a brilliant and reasoned plea for a basic revamp of our capitalist institutions so as to regain the dynamism of old."--Edmund S. Phelps, McVickar Professor of Political Economy and Director of the Center on Capitalism and Society, Columbia University, and 2006 Nobel laureate in Economics "A Call for Judgment is an intellectual firecracker--full of wisdom, common sense, and hard-hitting reform proposals. Few other writers, if any, can match Amar Bhideacute;'s deep knowledge of economic theory and historical detail with his first-hand experience in both entrepreneurship and real-world finance. It's hard to imagine a more useful analysis or guide for what must now be done."--Thomas K. McCraw, Straus Professor of Business History, Emeritus, Harvard Business School, author of Prophet of Innovation: Joseph Schumpeter and Creative Destruction "A Call for Judgment presents many interesting insights on necessary innovations in the world of today and tomorrow. Amar Bhideacute; prompts also some conclusions for improving the rules and ways for future banking-supervision in the United States. This book is a very positive contribution to a necessary debate."--Hans Tietmeyer, former president, Deutsche Bundesbank "Amar Bhideacute;'s analysis of the economic crisis that exploded on us a few years ago is extremely informative and thought provoking. He writes from an experience both in business, where he could see what was going on around him, and in academia, where he has had the time to study and reflect on what happened and why. Bhideacute;'s discussion of what we need to do to avoid a recurrence is illuminating and persuasive."--Richard R. Nelson, George Blumenthal Professor of International and Public Affairs, Business, and Law, Emeritus, Columbia University and winner of the 2006 Honda Prize and co-author of An Evolutionary Theory of Economic Change About the Author Amar Bhideacute;,, Schmidheiny Professor at the Fletcher School at Tufts University, has served as Glaubinger Professor of Business at Columbia University, a consultant at McKinsey Company and a proprietary trader at E.F. Hutton. Bhideacute; is a founding member of the Center on Capitalism and Society, editor of Capitalism and Society, and has written about the financial crisis in the Wall Street Journal, Business Week, and Forbes. Author of The Venturesome Economy, The Origin and Evolution of New Businesses, and Of Politics and Economic Reality, Bhideacute; received a doctorate and an MBA with high distinction from the Harvard Business School.