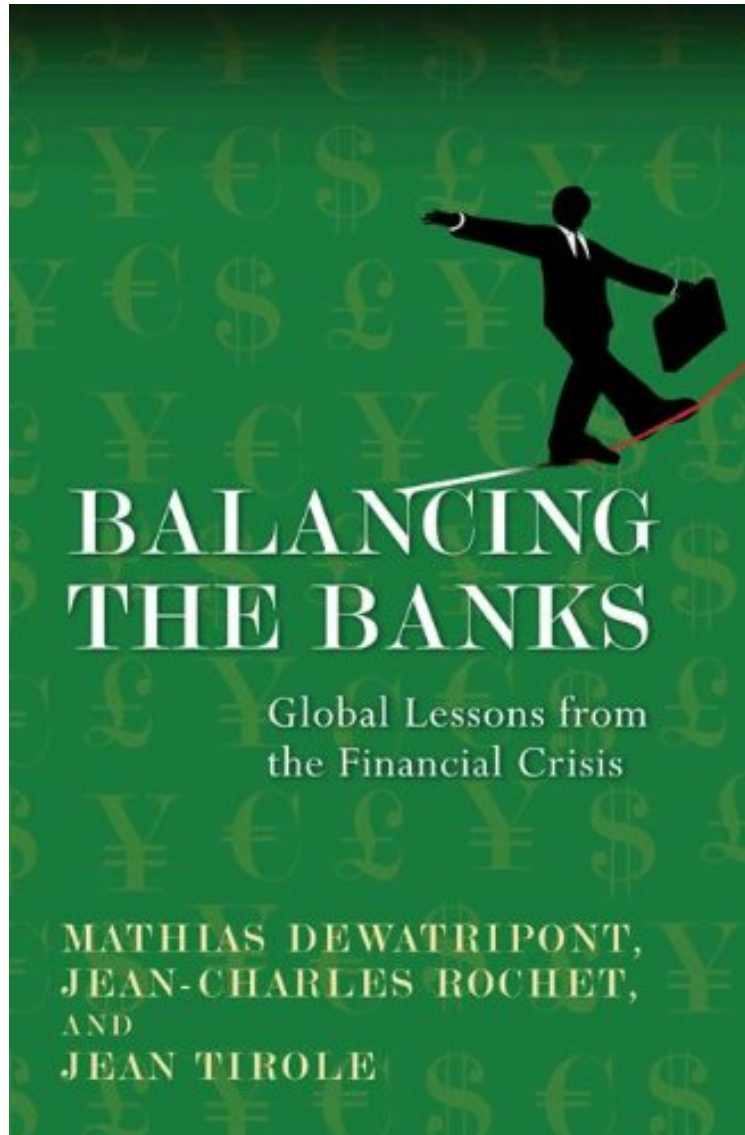


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Balancing the Banks: Global Lessons from the Financial Crisis

Mathias Dewatripont, Jean-Charles Rochet, Jean Tirole

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Mathias Dewatripont, Jean-Charles Rochet, Jean Tirole : Balancing the Banks: Global Lessons from the Financial Crisis before purchasing it in order to gauge whether or not it would be worth my time, and all praised Balancing the Banks: Global Lessons from the Financial Crisis:

3 of 5 people found the following review helpful. The authors understand uncertainty, but still want to go along with VAR models. By Michael Emmett Brady: The authors do an excellent job of presenting their case, which is that "Yes, VAR failed. However, a revised VAR could succeed". Unfortunately, their argument ultimately collapses although they do not realize the contradictions between the different parts of their presentation in their book. Thus, "Take the

example of the credit derivative market...But the uncertainty about the net amounts and their structure...suffices to scare the markets.As Cabolleso and Sinsek(2009)emphasize,the task of knowing not only whether one's counterparties are solvent but also whether one's counterparties counterparties are,their counterparties,and so on,becomes daunting in times of generalized stress".(p.35). This problem,of course,is an application of the beauty contest problem first discussed by J M Keynes in chapter 3 of the A Treatise on Probability(1921,TP) in his discussions of the measurement of probabilities and later in chapter 12 of the General Theory(GT,1936).Keynes later showed in the TP that ,unless the weight of the evidence,w, was equal to 1 and there were no nonlinear probability preferences,it is not possible to assign a point estimate and/or a unique probability distribution to represent the decision problem.Interestingly,Keynes is not mentioned in the book except in one arcane footnote .Neither is Mandelbrot ,Taleb, or Ellsberg.This is because all three of the authors are committed to relying on the basic Value at Risk (VAR)approach.Their hope is that VAR can be revised and improved.Thus, "There is another... reason why the focus on the probability of failure for individual banks may (?-author's query) have been inappropriate: the absence of systemic considerations.A 1 percent probability of failure means either that 1 percent of the banks fail every year or,alternatively,that the whole banking system fails every hundred years...Therefore ,it is crucial for regulators to find ways of discouraging herding behavior by banks...New indicators of risk must be designed based on correlation with aggregate activity rather than the absolute probability of failure."(p.116)The authors seem to have forgotten what they wrote on p.35.It is impossible to assign any kind of a point estimate ,using the standard normal or log normal probability distribution, to beauty contest problems.Keynes had already proven this over a hundred years ago.The view of the authors appears to be that the purpose of society and its economy is to serve the wishes of the bankers.Society has to come up with ways to regulate bankers effectively so that they can continue to play their derivatives game over time and extract profit without production.Warren Buffett had a better idea-ban financial derivatives permanently.Their purpose is purely speculative.They are used to bet on the probability of failure of different corporations and banks.No contribution is made to the production of goods and services.Hopefully,the authors will also come to realize that (a) they are dealing with the tail probabilities of Cauchy distribution and not normal or log normal distributions and (b) that the outcomes cost trillions in losses if you end up on the left tail .1 of 3 people found the following review helpful. Good book for anyone involved in bank supervision and regulation....By Saurav B. PrasadThis is a good book for professionals involved in reviewing banks. I found the chapter on lessons learned to be very useful. Concepts are well explained and easy to understand.

The financial crisis that began in 2007 in the United States swept the world, producing substantial bank failures and forcing unprecedented state aid for the crippled global financial system. Bringing together three leading financial economists to provide an international perspective, *Balancing the Banks* draws critical lessons from the causes of the crisis and proposes important regulatory reforms, including sound guidelines for the ways in which distressed banks might be dealt with in the future. While some recent policy moves go in the right direction, others, the book argues, are not sufficient to prevent another crisis. The authors show the necessity of an adaptive prudential regulatory system that can better address financial innovation. Stressing the numerous and complex challenges faced by politicians, finance professionals, and regulators, and calling for reinforced international coordination (for example, in the treatment of distressed banks), the authors put forth a number of principles to deal with issues regarding the economic incentives of financial institutions, the impact of economic shocks, and the role of political constraints. Offering a global perspective, *Balancing the Banks* should be read by anyone concerned with solving the current crisis and preventing another such calamity in the future.

This compact but powerful book by three internationally recognized European economists is well worth reading. The authors offer a thoughtful review of the current global financial crisis and a number of considered recommendations for ameliorating the next and inevitable one.From the Back Cover"Three giants in the field have teamed up to offer their insightful perspectives on prudential regulation at a crucial time. The book is both academic and pragmatic, a real bridge between these two worlds. Mandatory reading for all policymakers and academics involved in the difficult subjects of banking regulation and crisis prevention."--Ricardo Caballero, Massachusetts Institute of Technology"This is a very good book on the financial crisis by three of the best economists in the world. Unusually among top economists, all three are knowledgeable about banking and the financial system. It will have an important impact on the debate about the reform of regulation."--Franklin Allen, Wharton School, University of Pennsylvania"This timely book provides valuable insights and suggestions from three of the foremost experts in the field of regulation."--Markus K. Brunnermeier, Princeton University"This book offers a clear analysis of the financial crisis: causes, mechanisms, and policy. Written by top experts in economics and prudential regulation, it will be read by many economists and graduate students, as well as journalists, policymakers, the general public, and advanced undergraduate students. The scholarship is top-notch."--Xavier Gabaix, New York UniversityAbout the AuthorMathias Dewatripont is professor of economics at the Universiteacute; Libre de Bruxelles (ECARES and Solvay Brussels School of Economics and Management), annual visiting professor of economics at the Massachusetts Institute of Technology, and research

director of the Center for Economic Policy and Research. Jean-Charles Rochet is professor of mathematics and economics at the University of Toulouse I. Jean Tirole, the winner of the 2014 Nobel Prize in Economics, is chairman of the Foundation Jean-Jacques Laffont at the Toulouse School of Economics, scientific director of Toulouse's Industrial Economics Institute, and annual visiting professor of economics at the Massachusetts Institute of Technology.