Financial Crises: Institutions and Markets In a Fragile Environment.

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The cost of equity capital mentioned in the previous paragraph is one example of a treatment which does not parallel that found in the most widely used texts. Another example is their treatment of the lease versus buy decision in which they appear to double count by adding the cost of an asset to the present value of financing costs in determining the cost of ownership. The book would be more useful if the authors had reconciled their approaches with those of the major texts or at least provided a key directing readers to texts with similar treatments.

The elementary level of treatment would seem to limit the use of the book for graduate and advanced undergraduate courses, although graduate students would undoubtedly find the glossary and rather complete set of time value of money tables useful. Further limiting the usefulness of the book for graduate courses is a perplexing lack of material on capital structure, cost of capital, and mergers in the section on recommended further reading.

As a desk reference for a business person, the sketchiness, elementary level of treatment, and absence of several important topics would seem to limit the book's usefulness. The use of a continuous case and the use of abbreviations defined in previous chapters may also make the book a bit cumbersome to use as a quick reference.

The book's most likely use would be in a case course following the first finance course. The book would probably be most useful early in the course to remind the students of considerations and techniques which may have slipped their minds. However, the student would certainly need to have a standard first course text handy in case the brief treatment given was not sufficient to jog his or her memory. The book is most likely to be found useful in this setting if the instructor wishes to place little emphasis on working capital management and wishes to use other supplementary material for financial forecasting.

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This volume contains 20 of the papers which were presented at a conference on "financial crises" held at New York University's Graduate School of Business Administration in May of 1976. The editors have done an excellent job of organizing these papers, presenting them in five distinct sections, entitled "Early Warning Systems for Problem Financial Institutions", "Failure Models for Non-financial Institutions", "The American Financial Environment—Fragile or Resilient", "Endangered Financial Markets—Short-Term Markets for Debt", and "Endangered Financial Markets—The Market for Municipals". A summary prefaces each section, and discussants' comments appear at the end of four of the five sections.
My overall impression of the book is favorable. The papers deal with a number of important and interesting subjects related to financial crises, and the treatment of subjects is generally reasonable. The book is likely to be useful to individuals interested in some of the practical aspects of financial crises. However as I will discuss below, the volume is not without its shortcomings: Some fundamental issues related to "crises" are neither acknowledged nor treated.

The section on "Early Warning Systems for Problem Financial Institutions" deals with the efficacy of models for predicting bank failure. The papers in this section concern themselves with the techniques currently used by regulatory agencies (the Fed, the FDIC, and the Office of the Comptroller of Currency) to identify "problem" banks. The discussions which follow the papers are useful in pointing out some problems with the methods employed. For example, George Benston points out that a majority of bank failures are the result of fraud and other irregularities. Since the financial statements on which the early warning systems are based may be misstated, such systems are not likely to be very useful in such cases.

The papers in the section on "Failure Models for Nonfinancial Institutions" are quite well done. The papers by Edward Deakin and Edward Altman reflect a keen awareness of some of the problems in choosing among alternative models for predicting failure. An important point there is that since most firms are not failing, a simple naive model could simply classify all firms as nonfailing. Not only do these authors look at the Type I and Type II errors which alternative failure models imply, but they go so far as to try to specify the costs of classification errors. Their concern with the decision-maker's loss function seems important. I should note that the discussion which follows this section contains a fascinating piece by a lawyer, Marc Blum, dealing with the growing role in the law for models of business failure to 1) aid a regulatory authority in making a decision, and 2) help a court determine whether a past decision was reasonable.

The section on "The American Financial Environment—Fragile or Resilient" contains papers by Hyman Minsky ("A Theory of Systematic Fragility"), Henry Kaufman ("Financial Crises: Market Impact, Consequences and Adaptability"), Henry Wallich ("Framework for Financial Resiliency"), and Kenneth Wright ("A Projected Resilient Financial Environment"). These papers are concerned with the causes and implications of financial crises. As Henry Kaufman points out, a "crisis", or the appearance of one, is likely to lead to regulation.

While this section of the book presents some interesting ideas, the essays of Minsky and Wallich seem vague, and a few of their arguments are hard for an economist to swallow. For example, one aspect of Minsky's view of "crises" is that "Units engaged in Ponzi finance may have a negative net worth in any honest computation of present values"; Wallich claims that "some assets are not always valued correctly" and that "managers of investments tend to underestimate covariance". While the validity of these statements is an empirical question, there is considerable evidence on capital market efficiency which contradicts the view of these authors. Furthermore, to build theories of economic behavior on assumptions of market inefficiency and irrationality may not be the best way to allocate an economic theorist's resources: virtually anything can be "explained" when non-maximizing behavior is admissible.
The last two sections of the book deal with both the market for short-term debt and the market for municipal securities. The papers in these sections examine the impact of financial crises on specific credit markets such as the commercial paper and Eurodollar markets. The impact of events such as the Penn Central bankruptcy and Franklin National Bank difficulties are examined. In addition, Jesse Burkhead and Alan Campbell do a careful job of exploring the factors resulting in what they perceive to be the current “poor health” of the state-local sector.

While the papers presented in the book are quite useful, there are some general difficulties which I should mention. Throughout the papers, there is a pervasive assumption that a “crisis” is “bad”. Few of the authors (Kenneth Wright is an exception) seem concerned about the definition of a crisis. Is it a crisis merely because prices (and the prices of loans) are “high”? Moreover, even if a crisis is “bad”, this does not imply that the optimal number of crises is zero. The “optimal number of crises”, like the optimal amount of crime, depends, in part, on the costs which are involved in crisis-avoidance.

Finally, there seems to be an assumption in many of the papers that “business failure is costly to society”. It is not clear why this is so. It is true that bankruptcies consume the real resources of the judicial system. However, this does not mean that society should necessarily try to avoid bankruptcy. An alternative view is simply that the courts should begin to charge firms (and hence their claimholders) the true cost of adjudicating their cases.

In summary, this book, while not without its problems, is on the whole very worthwhile. My general objections should be taken not to imply anything else. Indeed, those objections only serve to reinforce the view that many important bankruptcy-related issues are as yet unresolved in our profession.

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Principles of Modern Investments is a beginning-level investments textbook. It, like most of the recently published texts in this area, is intended to be “a reasonably comprehensive blend of the modern and traditional approaches to investing.” The topics covered in the text are quite similar to those covered in the recently published books of Fisher and Jordan and Williams and Findlay.

The book is, however, distinguished from most of the available texts by: (1) the inclusion of a chapter dealing with the problem of personal financial planning; (2) a more detailed treatment of the problem of performance measurement; and (3) a lessened emphasis on fundamental security analysis. The inclusion of some material on personal financial planning is commendable as it is useful for the students to be able to relate investment decision-making to an overall financial plan. However, the material on planning is somewhat sketchy and not as well