



Slapped by the Invisible Hand: The Panic of 2007 (Financial Management Association Survey and Synthesis)

By Gary B. Gorton

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Originally written for a conference of the Federal Reserve, Gary Gorton's "The Panic of 2007" garnered enormous attention and is considered by many to be the most convincing take on the recent economic meltdown. Now, in *Slapped by the Invisible Hand*, Gorton builds upon this seminal work, explaining how the securitized-banking system, the nexus of financial markets and instruments unknown to most people, stands at the heart of the financial crisis.

Gorton shows that the Panic of 2007 was not so different from the Panics of 1907 or of 1893, except that, in 2007, most people had never heard of the markets that were involved, didn't know how they worked, or what their purposes were. Terms like subprime mortgage, asset-backed commercial paper conduit, structured investment vehicle, credit derivative, securitization, or repo market were meaningless. In this superb volume, Gorton makes all of this crystal clear. He shows that the securitized banking system is, in fact, a real banking system, allowing institutional investors and firms to make enormous, short-term deposits. But as any banking system, it was vulnerable to a panic. Indeed the events starting in August 2007 can best be understood not as a retail panic involving individuals, but as a wholesale panic involving institutions, where large financial firms "ran" on other financial firms, making the system insolvent.

An authority on banking panics, Gorton is the ideal person to explain the financial calamity of 2007. Indeed, as the crisis unfolded, he was working inside an institution that played a central role in the collapse. Thus, this book presents the unparalleled and invaluable perspective of a top scholar who was also a key insider.

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Editorial Review

Review

"Think you know what caused the collapse of Wall Street? Gary Gorton, the Sherlock Holmes of the financial crisis, has news for you."--Robert Hahn, Founder of the AEI Center for Regulatory and Market Studies

"*Slapped by the Invisible Hand* is essential to understanding the deep weakness in the banking sector that led to the financial crisis. Like consumer banks before the Great Depression, the 'shadow banking market' is vulnerable to runs and panics and hysteria, and we are all, in turn, vulnerable to it. By looking beyond this financial crisis to the systemic flaws that make us vulnerable to all sorts of crises, Gary Gorton has created a necessary guidebook for what's happened, and what needs to be done."--Ezra Klein, *Washington Post*

"Gorton has produced the clearest account yet of what has happened...*Slapped By the Invisible Hand* is not a conventional retrospective. Instead it is a real-time chronicle of what the authorities were told at key points in the drama by a practitioner who was steeped in the history of banking as well...it is a major contribution."--David Warsh, *Economic Principals*

"Provides a lucid framework for understanding the crisis truly substantive *Slapped* deserves an audience of more than just crisis connoisseurs."--*Barron's*

"It's must-reading for anyone who wants to understand the recent economic unpleasantness."--Matthew Yglesias, *Think Progress*

"Fascinating for anyone interested in the crisis, or in banking and finance more generally, this is absolutely essential reading."--Tyler Cowen, *Marginal Revolution*, Professor of Economics at George Mason University

"*Slapped by the Invisible Hand* tells us that there were bank panics--systemic crises--in 1873, 1884, 1890, 1893, 1896, 1907, and 1914. On the other hand, there were no systemic crises from 1934 to 2007. The problem, as Gorton makes clear, is that the Quiet Period reflected a combination of deposit insurance and strong regulation--undermined by the rise of shadow banking. So we have a choice: restore effective regulation or go back to the bad old days."--Paul Krugman, *New York Times* "Conscience of a Liberal"

"Gary Gorton has written an important book, one that clearly identifies the issues surrounding the recent financial crisis and separates them from the ongoing macroeconomic policy turmoil....quite an accomplishment, given that many of us are still trying to figure out happened in earlier panics and crises.... By narrowly focusing on the events and institutions of the Panic of 2007, how the economy got to where it is today becomes much clearer."--EH.net

"Offers the most coherent and convincing account of the recent financial crisis that I have seen, stressing its essential similarity to historical banking panics. Gorton's analysis leads to operational proposals for a regulatory environment that would be consistent with a safe, closely regulated banking system and with continued innovation in other financial services."--Robert Lucas, University of Chicago, Nobel laureate in economics

"To understand the actual moment and mechanism of crisis, the definitive take is Yale economist Gary Gorton's, in the delightfully titled *Slapped by the Invisible Hand*. Gorton's is a challenging book for a non-finance type, but there is no better technical explanation of the panic." --Slate.com

"Essential reading for anyone who wants to know what really happened in the world financial meltdown of 2007-08. Gorton writes with a wide grasp of financial history and a detailed understanding of complex areas such as the repo market. This book deserves to be read widely."--Bill Bradley, Former United States Senator

"Think about it. If porcine greed, by itself, is enough to crash the financial sector, why doesn't Wall Street crash every year? For that matter, why should the crash of the subprime market result in a recession so much worse than the one that followed, say, the dotcom bubble? To answer these questions, you should read [this] book. --*National Post*

"An indispensable and insightful guide to the origins and the mechanics of the financial crisis. If you want to be among those who understand what happened and what should be done you must read *Slapped by the Invisible Hand*." --Peter R. Fisher, BlackRock and former Under Secretary of the U.S. Treasury for Domestic Finance

"Gary Gorton's *Slapped by the Invisible Hand* perceptively explains how the financial crisis of 2008 was actually a crisis of 2007 and provides an essential historical context. It needs to be read by all who seek to shape our future policies."--H. Rodgin Cohen, Chairman, Sullivan & Cromwell LLP

"This is the best book on the crisis what makes this book a winner is that [Gorton] lays bare the root cause of the crisis." --David Merkel, CFA - Finacorp Securities, *Aleph Blog*

"Gorton comes to the table with long experience in the study of financial bubbles: he offers a challenging analysis of the late meltdown as a classic bank panic in modern dress." --John D. Ayer, UC Davis Professor of Law Emeritus

"Scholars like Gorton do not get enough attention as we try to understand what caused the crisis and how to prevent a repeat he is one of the people that will play an important role in shaping reform." --TheStreet.com

"Gorton, an authority on financial panics, argues convincingly that our most recent unpleasantness is not so different from earlier monetary disasters. The big change is that this one didn't involve runs on your neighborhood 'retail' banks, but was a 'wholesale' crisis that came close to destroying the huge, unregulated network of brokerage houses that trade esoteric securities largely with each other. He believes that we must understand what caused the crisis before we can take steps to prevent another, similar crash in the very near future. His book is a guide to learning those lessons." --*Internet Review of Books*

"The definitive history of the 2007 meltdown." -*The Electric Review*

About the Author

Gary B. Gorton is the Frederick Frank Class of 1954 Professor of Management and Finance at the Yale School of Management, and Research Associate at the National Bureau of Economic Research. He formerly taught at the Wharton School for twenty-four years and worked in the Federal Reserve System. He is also a former consultant to AIG Financial Products, where he worked on credit derivatives and commodity futures for over ten years.

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