



An Award for Calling the Crash

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An Award for Calling the Crash

Mason Gaffney¹

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The crash of 2008 surprised most of us. It showed that economic confidence was illusory and economic underpinnings unstable. The episode has led many to ask how economists could have been so in the dark. It was natural that some would ask: Who best predicted the crash of 2008?

There were several economists who long warned of deeply rooted problems and who predicted trouble on the horizon. Many of them have received attention for their forecasts, and I do not wish to take anything away from them. I want to highlight the prediction of one economist who predicted the crash remarkably early and with remarkable precision. I know—even a stopped clock is right twice a day. But if we are going to survey the record of remarkable predictions, we should get the record right and leave as secondary the matter of judging the wisdom behind observed accuracy.

As it happens, I think there is much wisdom behind the remarkable prediction I wish to highlight. It was made by my long-time friend Fred Foldvary—who is a co-editor of this journal (*Econ Journal Watch*). In 1997, Foldvary published an article “The Business Cycle: A Georgist-Austrian Synthesis” in the *American Journal of Economics and Sociology*. Foldvary says that expansions in money and credit fuel malinvestments in higher-order capital goods and speculative cycles in real-estate and land. He takes land values and real-estate trends to be particularly telling indicators of unsustainable booms and impending busts. He applies the ideas to the historical studies of U.S. cycles, building on the idea of real-estate cycles by Homer Hoyt (1933).

Here from Foldvary (1997) is the final paragraph in its entirety:

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The 18-year cycle in the US and similar cycles in other countries gives the geo-Austrian cycle theory predictive power: the next major bust, 18 years after the 1990 downturn, will be around 2008, if there is no major interruption such as a global war. The geo-Austrian synthesis provides a research agenda that can test historical cases in more detail. Much work needs to be done on empirical studies linking the money supply, real estate markets, and business cycle. However, given the evidence as presented here, the Georgist component of the geo-Austrian synthesis is testimony to the insight of Henry George, who originated one of the earliest theories of the business cycle, a theory which has been confirmed by subsequent history as a relevant and important explanation of booms and busts. (Foldvary 1997, 538)

Foldvary's prediction in 1997 of "the next major bust" coming in 2008 was not an off-hand comment, nor was it just one prediction now cherry-picked from a profusion of predictions. Dr. Foldvary is not a newsletter writer or investment guru, but a professional academic economist. After publishing his prediction in 1997, Foldvary followed the economic data and saw continued confirmation of his ideas, and consistently repeated his one great prediction in public lectures and articles. Most importantly, in Spring 2007, well before the crisis hit, Fred published a booklet entitled *The Depression of 2008* ([link](#)). Foldvary stands out as the person who called the 2008 crash.

Furthermore, there is usually a lag of at least two years from the time that a scholarly article is written to the time it appears in print, so Foldvary's prediction, committed to paper, must date from around 1995. Foldvary's prediction distinguishes itself from most others by its having appeared in a refereed professional journal. *The American Journal of Economics and Sociology* was established in 1941 and has long been indexed in the Social Science Citation Index.

When the crash hit in 2008, economic science took a lot of flack. But one scientific journal did call the 2008 crash, way back in 1997.

I am moved to write the present missive mainly to acknowledge a remarkable prediction that has been too little acknowledged. I hope that awareness of Foldvary's prediction will bring more attention to the economic uniqueness of land and how that uniqueness can be better integrated into economic analysis. Land is the only resource that is, by definition, strictly immobile, and is neither created, destroyed, nor hidden, and that is hardly subject to discovery once the territory has been charted.

But there is a second impetus to this missive. In 2010 two contests were held by the Real-World Economics Review Blog—henceforth RWERB. One contest was the Dynamite Prize to select the economists most responsible for the crash of

2008. The other was the Revere Award for three economists who best explained and predicted the recession and crash. It was named for Paul Revere, who famously warned “The British are coming!”

RWERB invited nominations. The blog-post inviting and containing the nominations is no longer listed in the archive, but, as of this writing, still live at [this URL](#). I duly nominated Foldvary’s 1997 article, as did (in chronological order) Rick Heggem, Daniel Klein, Rainer Friedrich, Roy Langstan, Jeffrey Smith, Peter Radford, Edward J. Dodson, Bill Batt, Peter Perisø, and Richard Biddle, as well as two commentators using obvious pseudonyms. Thus, some 13 individuals nominated Foldvary. The nominations of Foldvary were properly uploaded and displayed at the RWERB blog-post inviting nominations. At that post there were nominations for many individuals.

On 31 March 2010 the RWERB posted “Shortlist for the Revere Award” ([link](#)). In that blog-post, the “Editor” writes:

To its great shame, the economics establishment has attempted to evade responsibility for the Global Financial Collapse by calling it an unpredictable, “Black Swan” event. That assertion is manifestly untrue. Numerous non-neoclassical economists foresaw the crisis and warned the public (usually at the cost of ridicule) of its approach. The Revere Award aims to give these economists the professional and public recognition that they deserve, to encourage others to utilize their methods, and—most important—to increase the likelihood that, for the benefit of humankind, empirically responsible economists will be listened to in the future.

97 people have been nominated for the award. Some of these did not fit the requirement stated in the original announcement of the award, that the nominees should be *economists (broadly interpreted)* and to have publicly warned of this particular collapse, not collapses in general. From those nominees who filled these requirements and through consultation with this blog’s community of authors, a shortlist of 12 has been selected. All of them are worthy of our special regard. If any of them had been listened to by the powers that be, a colossal amount of human misery would have been avoided.

Criteria used in the selection included the following:

1. that the prediction was not whimsical or lucky, but was driven by theories, methods, and tools that are clearly within the domain of ‘economic thought’;

2. that the forecast could be replicated given similar data;
3. that the forecast was made public, and
4. that the methods and tools used will spur the development of economics such that the subject gains rather than loses traction as a result of the crisis. (RWERB March 31, 2010, [link](#))

Thus, the “blog’s community of authors”—who remain unnamed—prepared the shortlist upon which RWERB readers would vote. The award’s stated criteria are tailor made to vault Foldvary and his 1997 article into the shortlist. “The Revere Award aims to give these economists the professional and public recognition that they deserve.”

But somehow the blog’s community of authors saw fit to exclude Foldvary from the shortlist. Another blog-post of March 31, 2010 opened the voting:

Through consultation with contributors to the Real-World Economics Review Blog, the following shortlist of twelve economists has been selected for the ballot: *Dean Baker, Wynne Godley, Michael Hudson, Steve Keen, Paul Krugman, Jakob Brochner Madsen, Ann Pettifor, Kurt Richebächer, Nouriel Roubini, Robert Shiller, George Soros and Joseph Stiglitz*. (RWERB, March 31, 2010, [link](#))

At the blog-post you can read many comments objecting to the shortlist. Foldvary was not the only nomination suppressed. For example, the blog’s community of authors also suppressed Nassim Nicholas Taleb. Taleb was active in warning of the coming crash. For example, in *The Black Swan* (2007, 225) he wrote: “The government-sponsored institution Fannie Mae, when I look at its risks, seems to be sitting on a barrel of dynamite, vulnerable to the slightest hiccup. But not to worry: their large staff of scientists deem these events ‘unlikely’.” At RWERB’s blog-post omitting Taleb and Foldvary, several spirited comments pertain to the omission of Taleb. The following remarks come from separate commentators: “The glaring omission of Nassim Nicholas Taleb from this list reflects poorly on your entire organization”; “I agree with Eric that omission of Taleb is very shocking”; “How can Taleb not be a nominee?”; “No one talked as clearly about the crisis beforehand as Nassim Taleb”; “I will second the great disappointment in the omission of Nassim Taleb”; “Too bad Taleb is not on the list”; “I really hope the editors pay some heed to this outpouring of outrage and modify this poll and include NN Taleb” (commentators at RWERB March 31, 2010; [link](#)).

Commentators at the “Voting is now open” blog-post complained also about the omission of, for example, Fred Harrison, Peter Schiff and Marc Faber, all of whom were repeatedly nominated ([link](#)).

In the comments of the “Voting is now open” post ([link](#)), Fred Foldvary on 1 April 2010 pointed out that his 1997 paper was not included, despite being nominated. He registered the same objection, also on 1 April 2010, at the post listing a time-line of papers ([link](#)). On April 13, he wrote, “I have not seen any explanation of why I have not been included in the short list, since my October 1997 article in *AJES* predicted the 2008 crash and presented a theory of the cycle that is consistent with economic history. And why has that paper not been included in the time line?” The only explanation offered was a comment by Lil’D: “You are probably not on the list because your papers read like those of a crank.”

In a subsequent comment (25 April), Foldvary wrote of an article by Steve Hanke published in *Globe Asia*, “The Great 18-year Real Estate Cycle.” Foldvary pointed out that Hanke wrote in his article: “This knowledge [of a real-estate cycle] has allowed for some prescient forecasts. The prize in that department goes to Prof. Fred Foldvary who wrote in 1997: ‘the next major bust, 18 years after the 1990 downturn, will be around 2008’” (Hanke 2010, 24).

A commentator then wrote, “OK everyone, don’t argue with Fred Foldvary.”

As stated at the RWERB website, “More than 2,500 people voted—most of whom were economists themselves from the 11,000 subscribers to the *real-world economics review*. With a maximum of three votes per voter, a total of 5,062 votes were cast” ([link](#)).

The winner was Steve Keen of the University of Western Sydney. The 2nd and 3rd place finishers were Nouriel Roubini (New York University) and Dean Baker (Center for Economic and Policy Research). Keen and Baker are central players at the Real-World Economics Review Blog. Links to their websites are included among the RWERB’s “Family Links.”

An analysis of the publications by the finalists would be beyond the scope of this paper, but an examination of the two RWERB “family” members who placed is warranted.

Keen’s 1995 paper—entitled “Finance and Economic Breakdown: Modeling Minsky’s ‘Financial Instability Hypothesis’” and published in the respected *Journal of Post-Keynesian Economics*—models Hyman Minsky’s “Financial Instability Hypothesis.” The basic idea is that investment and asset prices are based on fragile expectations, subject to change. Euphoric expectations result in a less risk aversion and rising asset prices. There is an expansion of credit and debt. Interest rates rise, but speculative yields exceed interest rates. Ponzi financiers use debt, expecting capital gains greater than debt service. Rising interest rates and asset prices reduce profits, and enterprises sell assets. The boom becomes a slump. The proposed remedies are to tax profits as they rise, and increase government spending as unemployment rises.

Keen certainly deserved to be a finalist, and his 1995 paper merits inclusion in the time-line, but did he forecast the 2008 crash? Keen's paper is quoted by RWERB, presumably to highlight its prescience:

There are, however, severe doubts as to whether the kind of government that has been constructed over the last thirty years is a sufficiently powerful or balanced stabilizer to capitalist investment behaviour.

From the perspective of economic theory and policy, this vision of a capitalist economy with finance requires us to go beyond that habit of mind that Keynes described so well, the excessive reliance on the (stable) recent past as a guide to the future. The chaotic dynamics explored in this paper *should warn us against accepting a period of relative tranquility in a capitalist economy as anything other than a lull before the storm.* [emphasis added] (Keen 1995, as quoted by RWERB May 13, 2010; [link](#))

This, apparently, is the closest that Keen came to predicting the 2008 crash. It is a long way from Foldvary's calling it on the nose more than a decade in advance of the event.

The work by Baker cited by RWERB is Baker's 2002 report "The Run-Up in Home Prices: Is It Real or Is It Another Bubble?," published by the Center for Economic Policy Research ([link](#)). Baker's report is quoted by RWERB, again presumably to highlight its prescience:

While the short-term effects of a housing bubble appear very beneficial—just as was the case with the stock bubble and the dollar bubble—the long-term effects from its eventual deflation can be extremely harmful, both to the economy as a whole, and to tens of millions of families that will see much of their equity disappear unexpectedly. The economy will lose an important source of demand as housing construction plummets and the wealth effect goes into reverse. This will slow an economy already reeling from the effects of the collapse of the stock bubble of 1999, ... Unfortunately, most of the nation's political and economic leadership remained oblivious to the dangers of the stock market and dollar bubbles until they began to deflate. This failure created the basis for the economic uncertainty the country currently faces ... [which] will be aggravated further by the deflation of the housing bubble. This process will prove even more painful if the housing bubble is allowed to expand still further before collapsing. (Baker 2002, as quoted by RWERB May 13, 2010; [link](#))

Again, we have a prize-winning work that is a long way from Foldvary's calling it on the nose more than a decade in advance of the event.

I would like to add that Foldvary's ideas are not the work of a lone seer. As noted, Hanke sees value in incorporating land and real-estate into cycle theory. Economists sensitive to the uniqueness of land have long followed these ideas and anticipated a crash. Consider a work by Fred Harrison also published in 1997. Harrison wrote: "The consequence is predictable. By 2007 Britain and most of the other industrially advanced economies will be in the throes of frenzied activity in the land market to equal what happened in 1988/9. Land prices will be near their 18-year peak, driven by an exponential growth rate, on the verge of the collapse that will presage the global depression of 2010" (Harrison 1997, 27).

My aims in writing the present paper can be summed up by the words that RWERB offered in explaining its aims in conducting the Revere Prize: "to give these economists the professional and public recognition that they deserve, to encourage others to utilize their methods, and—most important—to increase the likelihood that, for the benefit of humankind, empirically responsible economists will be listened to in the future" (RWERB March 31, 2010, [link](#)).

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About the Author



Mason Gaffney is a Professor of Economics at University of California, Riverside, and himself the author of some cycle forecasts dating from 1958, based on Homer Hoyt's classic work that Foldvary used. His latest work is *After the Crash*, Wiley-Blackwell, 2010. His email is m.gaffney@dslexreme.com.

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