The Great Recession: Evidence of Institutional Evolution?

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Abstract

Similar to previous financial crises, the 2007-2008 financial crisis, for many, appeared sudden and without warning. In fact, there was extensive evidence that presaged a crisis. In the aftermath of the crisis, commentators have provided numerous narratives to explain the occurrence. Explanations either imply or directly support the assertion that evidence was ignored by all the major players in the financial system, notably government regulators, banks, insurance companies, ratings agencies, and speculators. Indications of increased risk did not, as commentators assume *ex post facto*, inspire risk mitigating defensive responses by private sector institutions or intervention by government regulators. Rather, the elevated risk encouraged increased risk taking motivated by expectations of greater profit. Commentators lament the failure of the system, but, of course, the system operated per design and accepted practice. Ongoing economic challenges reflect the shortcomings of economic theory and public policy to serve the broader society as celebrated by Adam Smith more than two centuries ago. More than a century ago, Thorstein Veblen examined the functioning of business enterprises. He observed that the orientation of business had transformed from production to finance. This essay applies the writings of Thorstein Veblen to the financial crisis of 2007-2008. Further, the analysis examines common explanations of the crises by commentators responding the crisis.