

administration understands the need to include the unregulated institutions, and to set up at least an early warning system to detect major risks before they arrive. But there is no way yet to know what form the new system will take. One would like to establish some principles before we forget how bad it can get.

The financial system does have a useful social function to perform, and that is to make the real economy operate more efficiently. Some human institution has to collect a nation's savings and put them at the disposal of those

who have productive ways to use them. Risks arise in the everyday business of economic life, and some human institution has to transfer them to those who are most willing to bear them. When it goes much beyond that, the financial system is likely to cause more trouble than it averts. I find it hard to believe, and I suspect that Judge Posner shares my disbelief, that our overgrown, largely unregulated financial sector was actually fully engaged in improving the allocation of real economic resources. It was using modern financial technology

to create fresh risks, to borrow more money, and to gamble it away.

Posner writes:

As far as I know, no one has a clear sense of the social value of our deregulated financial industry, with its free-wheeling banks and hedge funds and private equity funds and all the rest.

That is already a hint that he thinks its social value is limited. As Posner sees it, talk about greed and foolhardiness

is comforting but not useful. Greed and foolhardiness were not invented just recently. The problem is rather that Panglossian ideas about "free markets" encouraged, on one hand, lax regulation, or no regulation, of a potentially unstable financial apparatus and, on the other, the elaboration of compensation mechanisms that positively encouraged risk-taking and short-term opportunism. When the environment was right, as it eventually would be, the disaster hit. □

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