

## Study Questions

### *The Global Economy: Connecting the Roots of a Holistic System*

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## Chapter 8: The Financial Sector: Crisis and Its Aftermath

### Section 8.1 Introduction

Questions to Consider:

1. Quote: "Ideas, knowledge, art, hospitality, travel – these are the things which should of their own nature be international. But let goods be homespun whenever it is reasonably and conveniently possible; and above all, let finance be primarily national." John Maynard Keynes
  - a. What is Keynes main point in this quote?
  - b. Do you agree with his position?

### Section 8.2 Patterns of Financial Crises

Terms to Consider:

white swan  
black swan  
Nassim Taleb  
Reinhart and Rogoff

Questions to Consider:

1. Patterns of Financial Crises
  - a. What does the story about white and black swans tell us about patterns in financial crises?
  - b. Why are humans caught off guard or slow to recognize rare and novel events?
  - c. Why does economist Nouriel Roubini think the 2008 financial crisis was a white swan event, not a black swan event?
  - d. What did Reinhart and Rogoff conclude in their book *This Time is Different: Eight Centuries of Financial Folly*?
  - e. What are the 11 patterns that are in almost all financial crises?

### Section 8.3 Financial Crises

Terms to Consider:

tulip mania  
stock market  
Roaring Twenties  
Stock Market Crash of 1929  
New York Stock Exchange (NYSE)  
Andrew Mellon  
Smoot-Hawley Tariff  
Great Depression  
Dot-Com Bubble  
Japan  
Finance Minister Hayato Ikeda  
Plaza Accords

Tokyo's Imperial Palace  
 "Lost Decade"  
 East Asian Financial Crisis  
 market liberalization  
 fallacy of composition  
 crony capitalism

Questions to Consider:

1. Tulip Mania

- a. What was the setting for Tulip Mania?
- b. Why did it occur in 17<sup>th</sup> century Netherlands?
- c. What was the result of the crisis?

2. The Roaring 1920s and the Stock Market Crash of 1929

- a. Explain the Richard M. Salsman quote on page 305.
- b. What new financial innovation was created in the 1920s? What impact did it have?
- c. What role did debt play in the stock market frenzy?
- d. Why was the 1920s called a "New Era?" Was it a "New Era?"
- e. What role did deception play in the crash?
- f. What happened when the stock market crashed?
- g. What was the government's response to the crash and following depression? Is this a similar response by many people today?

3. The Dot-Com Bubble (1995-2000)

- a. What event/s helped fuel the bubble?
- b. What was the result of the bubble?
- c. What followed after the bubble popped?

4. Japan's Asset Price Bubble (1980s onward)

- a. What happened in Japan after World War II?
- b. What was the difference between the U.S. and Japanese economic model?
- c. What role did Finance Minister Hayato Ikeda play in developing the Japanese model?
- d. What role did the Japanese government play in the economy?
- e. What was the significance of the Plaza Accords?
- f. How did Japan's bubble in shares of stock and real estate start to inflate?
- g. What is the significance of Tokyo's Imperial Palace in this bubble environment?
- h. What happened when the Bank of Japan finally decided to pop the inflated bubble in 1989?
- i. What did the banks do in this situation?
- j. What happened to the Japanese economy as a result of the crisis?

5. The East Asian Financial Crisis of 1997-98

- a. What role did the International Monetary Fund (IMF) and the U.S. Treasury Department play in the East Asian Financial Crisis?
- b. What happened when market liberalization opened up the Thai economy?
- c. Describe the managed version of capitalism in East Asia.
- d. Why did the East Asian tigers have the best investment opportunities in the world in the late 1980s and early 1990s?
- e. What was Japan's role in the East Asian economy?
- f. What was the significance of the fallacy of composition?

- g. What happened when the financial tsunami hit the East Asian countries?
- h. What was the prevailing conventional economic wisdom promoted by the IMF and U.S. Treasury Department?
- i. What part did crony capitalism play in the economic crisis?
- j. What was the IMF's rescue plan? What were the results of the plan?

#### **Section 8.4 Financial Crises of 2007-2008**

Terms to Consider:

Lehman Brothers  
 Richard S. Fuld  
 Sandy Weill  
 Ameriquest  
 New Century Financial  
 Big Five Investment Banks  
 U.S. Treasury Department  
 George W. Bush  
 conservatorship  
 nationalization  
 Hank Paulson  
 Federal Housing Finance Agency (FHFA)  
 Bank of America  
 AIG  
 haircut  
 money market  
 Reserve Primary Fund  
 "broke the buck"  
 commercial paper market  
 Commercial Paper Funding Facility  
 Lender of Last Resort  
 liquidity crisis  
 0 percent interest rates  
 quantitative easing  
 Central Banks  
 Ben Bernanke  
 Troubled Asset Relief Program (TARP)

Questions to Consider:

1. The Fall of Lehman Brothers
  - a. Describe the rise of Lehman Brothers.
  - b. Why was Richard S. Fuld a darling of Wall Street at one time?
  - c. Why did Lehman Brothers collapse?
  - d. What were the consequences of the collapse of Lehman Brothers?
  - e. What role did the government play in trying to avert the disaster of the Lehman Brothers' collapse?
2. Finance: The Circulatory System
  - a. How is the financial sector like a circulatory system?
3. The Financial Crisis: Setting the Stage
  - a. How did trillions of dollars vanish into thin air?

- b. In what ways did the big brokerage firms construct their empires on a shaky foundation?
- c. In what ways did cheap and plentiful money issued by the Federal Reserve contribute to the Wall Street juggernaut?

#### 4. Ameriquest

- a. What is your reaction to the story about Ameriquest?
- b. Were you surprised to learn about what was going on in one segment of the mortgage industry at the time?

#### 5. Events of the 2008 Financial Crisis

- a. What happened when the bubble started to pop?
- b. What was the problem with the large number of toxic assets on the balance sheets of financial institutions?
- c. Who were the pre-crisis Big Five Investment Banks?
- d. Why did Bear Stearns experience difficulty in the spring of 2008?
- e. Why did Fannie Mae and Freddie Mac experience difficulties in the spring and summer of 2008?
- f. Why did the government respond to Fannie Mae and Freddie Mac problems? What did they do?
- g. What was Secretary of the Treasury Hank Paulson's meeting on September 13, 2008 about?
- h. What was the result of this meeting?

#### 6. Six Developments: AIG

- a. What happened to AIG as a result of the financial crisis in the fall of 2008?
- b. Why didn't the federal government "take a haircut" on the AIG losses?

#### 7. Six Developments: Money Market Funds

- a. What happened to money market funds as a result of the financial crisis in the fall of 2008?
- b. What was the significance when Reserve Primary Fund "broke the buck?"

#### 8. Six Developments: Commercial Paper Market

- a. What happened to the commercial paper market as a result of the financial crisis in the fall of 2008?
- b. What did the Federal Reserve do to alleviate the commercial paper crisis?

#### 9. Six Developments: Lender of Last Resort: The Federal Reserve

- a. What did the Federal Reserve do as lender of last resort as a result of the financial crisis in the fall of 2008?
- b. Why did the Fed lower interest rates to 0 percent?
- c. How did these developments affect Main Street? Wall Street?

#### 10. Six Developments: Quantitative Easing

- a. What is quantitative easing?
- b. Why did the Feds think it was necessary?
- c. What was the result of the Federal Reserve's quantitative easing moves?
- d. Why wasn't much attention focused on the quantitative easing program?
- e. Why was there a fear among many experts that the U.S. would be entering a "Lost Decade" as in Japan?

#### 11. Six Developments: The Troubled Asset Relief Program (TARP)

- a. What was the TARP program?
- b. Why was it considered necessary?
- c. Did it help to ease the crisis?
- d. What was the reaction by Congress to TARP? What were their objections?

#### 12. Insights: The 2008 Financial Crisis

- a. What did Joseph Stiglitz mean when he said, "They all employed the same logic that had gotten the financial sector into trouble to get it out of it?"
- b. What happened to home ownership rates by 2010?
- c. What was the attitude by Wall Street financiers as the crisis unwound?

### **Section 8.5 The Aftermath of the 2008 Financial Crisis**

Terms to Consider:

revolution  
 restore  
 normal  
 reaction  
 austerity  
 Tea Party  
 proprietary trading  
 reform  
 stimulus  
 multiplier effect  
 Dodd – Frank Wall Street Reform and Consumer Protection Act  
 Volcker Rule  
 Consumer Financial Protection Bureau  
 rebuild  
 mixed economy  
 E.F. Schumacher  
 farmers market  
 Bank of North Dakota  
 social enterprises  
 public ownership  
 Tennessee Valley Authority (TVA)  
 healing our planet  
 civilizational paradigm  
 shared values

Questions to Consider:

1. The New Normal: The 5 Rs
  - a. Do you think we are at a critical juncture in our human history? Explain.
  - b. Why haven't our political leaders been able to solve the problems we face?
  - c. What are the five responses to our current economic quandary? Briefly describe each one.
2. Response #1. Revolution
  - a. What is a revolution?
  - b. What problems does Greece face?
3. Response #2. Restore
  - a. What do you think is "normal" today?
  - b. What do people often do when they face an unknown future?
4. Response #3. Reaction
  - a. What does reactionary mean?

- b. What is austerity? Why do reactionaries want to impose austerity?
  - c. What is the Tea Party?
    - 1. Why did the author put them in this reaction category?
    - 2. Do you think they belong in this category?
  - d. What groups support the reactionary philosophy?
  - e. Why do the banks support reaction?
  - f. What is proprietary trading?
  - g. How has the Federal Reserve been reactionary?
  - h. How have reactionaries regarded housing and consumption?
  - i. How do reactionaries regard labor and social inequality?
  - j. Do you think reactionary policies are the right approach to solving the global economic problems?
  - k. What are the benefits and drawbacks of reactionary policies?
5. Response #4. Reform
- a. What is reform?
  - b. What is the big question for reformers in the 21<sup>st</sup> century? Do you think this is a good question?
  - c. Do you agree with the reformers who are putting forth a reform agenda based on economic growth as the path to economic prosperity? Explain.
  - d. Why do reformers want an economic stimulus? Do you agree with this idea?
  - e. What is the multiplier effect? Why is it important?
  - f. Why do reformers want to break up the TBTF banks?
  - g. What is the Dodd – Frank Wall Street Reform and Consumer Protection Act? Why was it passed?
  - h. What do critics of the bill think are its drawbacks?
  - i. What are five ways in which those against the Wall Street Reform bill are trying to sabotage the bill?
  - j. What is the Volcker Rule?
  - k. What is the Consumer Financial Protection Bureau?
  - l. What are the six largest banks in the U.S.? Do you have business with one of these banks?
6. Response #5. Rebuild
- a. What does rebuild mean in this context?
  - b. What is a mixed economy?
  - c. What challenges does rebuild bring to those advocating change?
  - d. What are the five ways the rebuilding process can take place?
7. Response #5. Rebuild -- #1 Emphasizing the Small and Local
- a. What relevance does E.F. Schumacher's book *Small is Beautiful* have today?
  - b. Do you think it is important to emphasize small and local?
  - c. How does a farmers market contribute to a small and local economy?
  - d. How does a bank, such as the Bank of North Dakota, contribute to a small and local economy?
8. Response #5. Rebuild -- #2 Challenging the Consumer Growth Model
- a. Do you think that challenging the consumption model is an important way to rebuild the economy? Explain.
  - b. What is worker ownership?
  - c. Do you think worker ownership is important in rebuilding an economy? Explain.
  - d. Why is Cleveland, Ohio the site of worker ownership initiatives?
  - e. What are social enterprises?
  - f. Do you think democratized ownership forms of business are important in rebuilding the economy? Explain.
9. Response #5. Rebuild -- #3 Renewing Public Ownership
- a. What does public ownership mean?

- b. Do you think it is important to revive public ownership?
- c. What is the importance of the TVA?
- d. Why is government-provided health insurance more cost effective than private health insurance?

10. Response #5. Rebuild -- #4 Healing our Planet

- a. Explain what healing our planet means. Do you think it is important?
- b. What is a new civilizational paradigm that author Naomi Klein talks about? Do you think we need one?

11. Response #5. Rebuild -- #5 Changing to Shared Values

- a. Do you think creating shared values is an important component in rebuilding our economy?
- b. What different values, if any, do you think are important?

12. Concluding Insights: The Aftermath of the 2008 Financial Crisis

- a. Why is our American standard of living slipping?
- b. Why is this declining standard of living a shock to many Americans?
- c. What do you think are the choices we need to make for a viable future?