POLS/ECON 409 · *Economics of the Financial Crisis, Part 1*

Regulation Q	Fannie Mae	leverage ratio
special-purpose vehicle	Freddie Mac	counterparty risk
credit default swap	Gramm-Leach-Bliley	commercial paper
collateralized debt obligation	FOMC	lender of last resort
securitization	"breaking the buck"	"Minsky moment"

1. How and why was Glass-Steagal weakened and repealed? In what other ways did the US deregulate finance in the 1990s? What consequences did these changes have? What role did partisan politics play?

2. Why did investment banks become so highly leveraged over the 1990s and 2000s? What risks did this pose for banks and the larger economy? What incentives changed for investment bankers to encourage the use of leverage? What role did technological change play in this process?

3. Proponents of financial deregulation often argue that such moves are needed to reap the benefits of newly discovered financial instruments and technologies. Is there such a thing as "financial innovation"? Is innovation the driving motivation behind financial deregulation? What consequences does financial innovation have for risk managment and for systemic risk? What does the growing size of the financial sector suggest about its efficiency in allocating capital?

4. What role did securitization play in feeding the housing bubble? What about lending standards? Fannie Mae and Freddie Mac? Rating agencies? Is it fair to refer to the financial crisis as a "subprime mortgage" crisis?

5. In what ways was the 2007-2008 financial crisis similar to a classic "bank run"? How did shadow banking contribute to this? Why did regulation fail to stop these runs?

6. In what ways did financial innovations make relationships among banks and shadow banks more complex and opaque? What consequences did this have during the financial crisis?

7. The "shadow of the future" is often used to explain reputational arguments. Why did reputation and the threat of future sanction fail to constrain behavior in the run-up to the financial crisis? How did CDOs change the incentives of mortgage originators? Of investment banks?

8. Why did investors and central bankers underestimate the scope and consequences of decline in housing prices and collapse of subprime lending in 2006–2007? What role did memory of previous economic and financial crises play in policy makers' responses to the crisis? What does this suggest about the rationality of economic policy?

9. What does it mean for a financial market or bank to face a problem of liquidity? How does this differ from problems of solvency? Provide examples. How do appropriate policy responses differ?

10. In 2007 and 2008, why did central banks – and in particular the Fed – find themselves taking over for other regulators, like the SEC with respect to Bear Stearns, and the Office of Thrift Supervision with respect to AIG?

11. Wolf seems to cast doubt on many articles of faith in modern macroeconomics in favor of older theories. What is your take on his conclusions?

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