POL2012: Theories and Models in Political Economy

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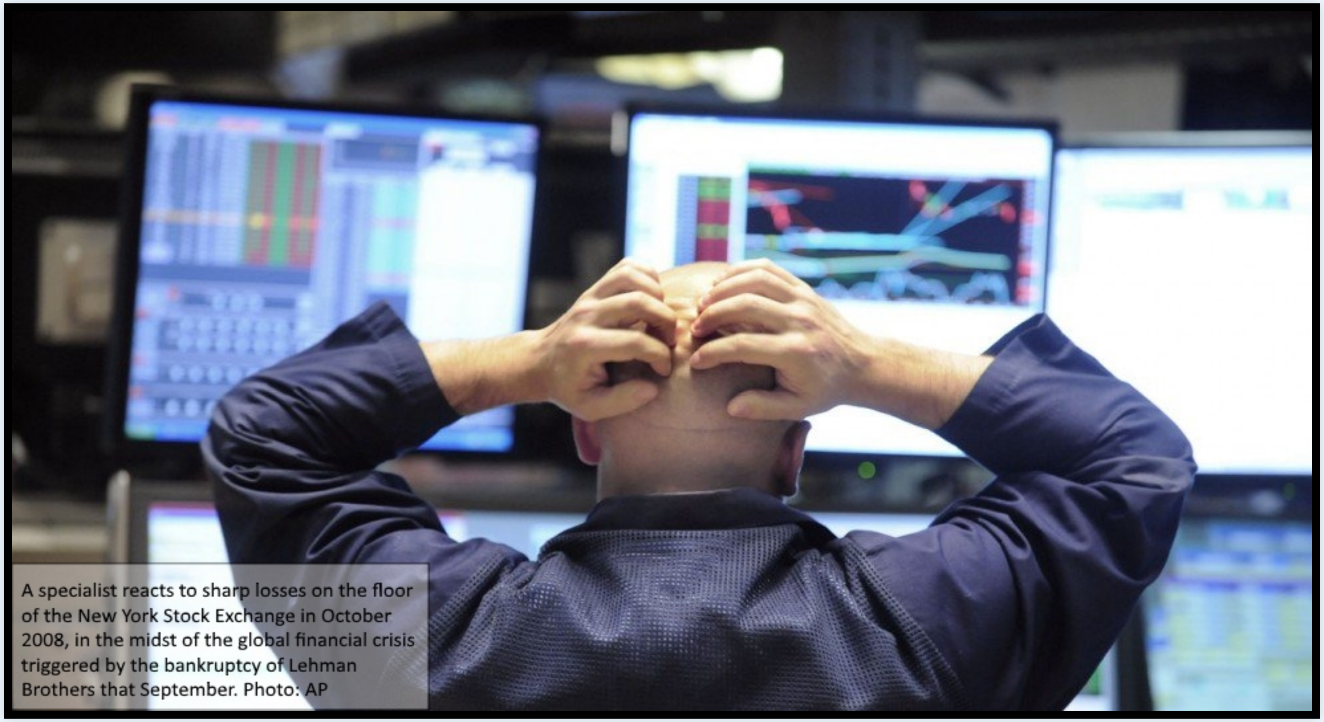
The Global Financial Crisis



A specialist reacts to sharp losses on the floor of the New York Stock Exchange in October 2008, in the midst of the global financial crisis triggered by the bankruptcy of Lehman Brothers that September. Photo: AP

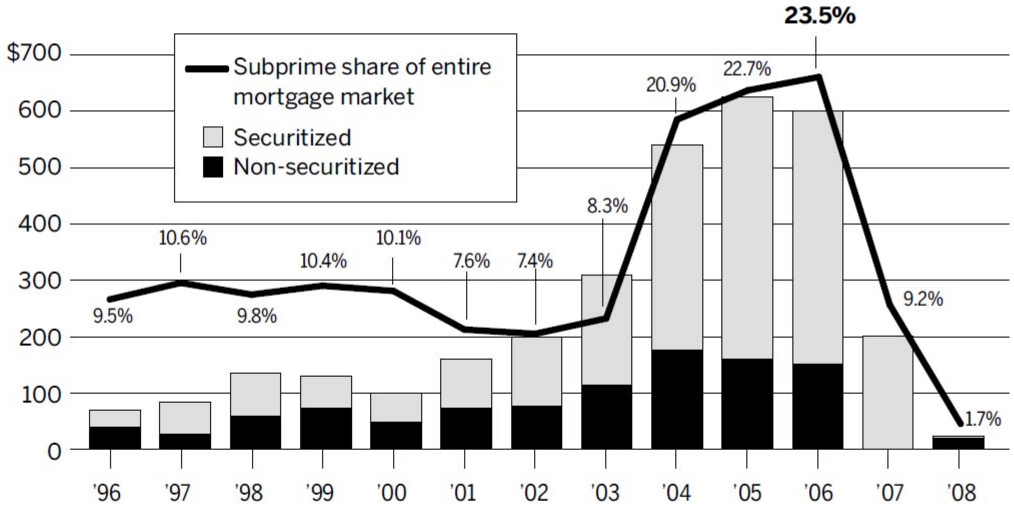
Real Estate bubble

- Home prices up 60%, 2000-2006
- Subprime loans
- Securitization

Subprime Mortgage Originations

In 2006, $600 billion of subprime loans were originated, most of which were securitized. That year, subprime lending accounted for 23.5% of all mortgage originations.

IN BILLIONS OF DOLLARS



NOTE: Percent securitized is defined as subprime securities issued divided by originations in a given year. In 2007, securities issued exceeded originations.

SOURCE: Inside Mortgage Finance

Figure 5.2

Not a New Phenomenon

1720s: South Sea Bubble - 1790s: Canal mania - 1840s: Railway mania - 1890: Baring crisis - 1929: Great Depression - 1997-98: Asian financial crisis - 2001: Dot.com bubble

Why?

- Schumpeterians:

  Financial crises are linked to long economic waves. (Empirically 50-60 years.)

- Marxists:

  Capitalism creates financial crises

- Keynesians:

  Financial crises occur when we don't regulate capitalism

- Neoclassics:

  Government involement creates artificial markets and inefficiencies

Asian Financial Crisis

Asian Financial Crisis; systemic problems

- Banking systems still underdeveloped
- Foreign loans
  - What if there is a devaluation?
- Quasi-contractual relationships between political and economic elites
  - Moral hazard
- Dollar peg
  - Dollar appreciates -> local currencies appreciate

Asian Financial Crisis; Shit Hits the Fan

- Moral hazard -> Bad Loans
  - Real estate bubble
  - Insolvent banks and financial institutions
- Dollar peg
  - Appreciating dollar -> Overvalued local currencies -> Speculative attacks
- Massive outflows of capital
  - Foreign exchange reserves drained
  - From fixed to float, depreciations

Response

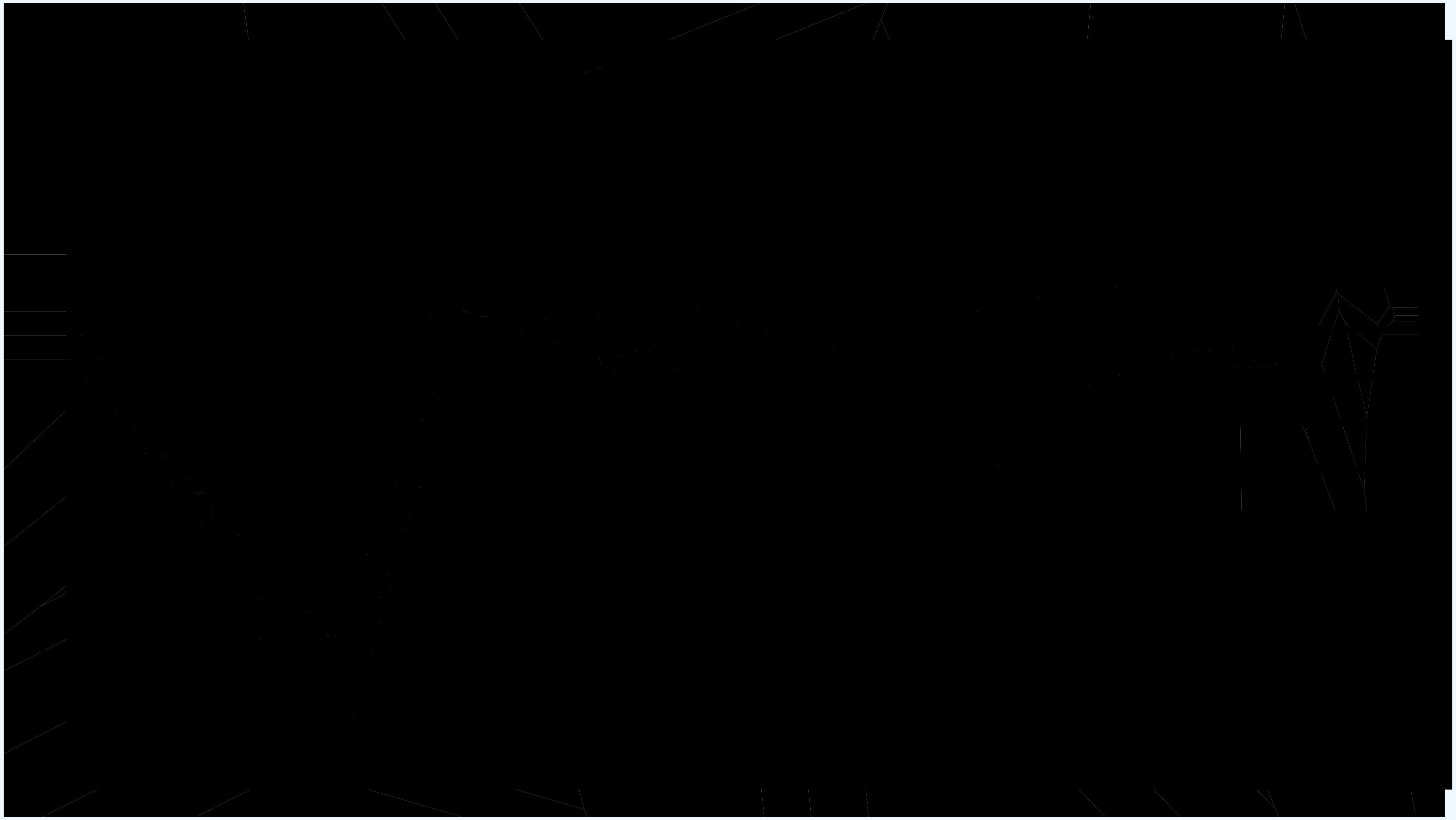
- $200 billion injected into the market by the Fed, the ECB and the Bank of England
- Expansionary monetary policy -> low interest-rates.
- United States continued stimulus in the range of $800 billion
- ECB turned to fiscal discipline
- Sovereign debt

The problem of diversity

- What is appropriate for Germany may not be appropriate for certain other EU countries
- And vice-versa
- The United States has this problem too!
- BUT, its easier to get Americans to bail out fellow Americans

And who did better?

GDP per capita growth (annual %)




OFFICIAL SELECTION
TILDA SWINTON JOHN C. REILLY EZRA MILLER
A film by LYNNE RAMSAY
We need to talk about
Greece

Lazy Greeks or Austerity?

Some perspectives

- Piketty: “Germany has never repaid its debts. It has no right to lecture Greece.”
- Two ways to repay debt:
  - Strict budgetary discipline over 100 years
  - Inflation, tax on private wealth, debt relief
- Krugman: Eliminating deficits during a crisis is a recipe for depression. Leave the Euro.
- Ferguson: Clean slate makes no sense if the problem is structural (see Fukuyama ch6 for account of some of Greece’s structural problems).

Ferguson has Opinions

Do we even need monetary systems?

- Facilitates international transactions
- Makes trade easier and more predictable
- To avoid financial crises.
- Crypto-currency?

Europe going the way of Japan?

- No growth, no inflation, negative interest rates
- A crisis of production and inovation?

Solutions?