# 2008 financial collapse summary

- Dave Levengood

## “ Too Big to Fail” vs. “ How an Economy Grows and Why it Crashes”

The Great Recession of 2008 was not only the largest economic crash of this decade, it was the largest economic crash since the Great Depression. The Great Recession has been studied extensively since it happened, and there are finite conclusions as to why it occurred that can be drawn from the facts. First, ineffective government regulations of the banking system allowed the Wall Street banks to carelessly loan out money to essentially anyone who asked for it. Second, many of those loans, which originally stimulated the housing bubble, were defaulted on when the nearly 8 trillion dollar housing bubble burst, leaving behind billions of dollars of debt. Third, this debt destroyed consumer confidence in the large banks, causing a drop in the stock market as people withdrew their money. The lack of “ credit” as Ben Bernanke describes it, almost threw the American Economy into an abyss much deeper than that of the Great Depression. Two works that both outline the causes and results of the Great Recession are Peter Schiff’s “ How an Economy Grows and Why it Crashes,” and the HBO film, “ Too Big to Fail.” Schiff’s book uses a comical portrayal of the U. S. economy in the form of islanders of the nation Usonia, with “ fish” as dollars. HBO’s documentary focuses more on the day-to-day actions by the government and banks trying to prevent this recession forming into a depression. In all however, both works draw on and allude to the known problems in the U. S. economy that led to the Great Recession.

“ Too Big to Fail” implies that the start of the entire economic fall was when President Reagan deregulated the banks, giving them much more freedom to give out loans. This freedom was then abused by overconfident banks and thus the recession occurred. Schiff does not share the same view outright in his book, however his comments on the frequency and careless loans by the banks cannot be overlooked. That being said, Schiff focuses extensively on the changing value of currency over the course of the recession. After being taken off the gold standard, Schiff describes how the U. S. economists were free to change their currency as needed to sustain growth. The ONLY reason why this worked was because the U. S. had become such a large economic player that the Reserve Note was backed up by the “ trustworthy” reputation of previous years. Had other nations not accepted our dollars as a reserve note, we would have a much more difficult time borrowing and spending money today. Furthermore, Schiff describes the acts of the Federal Reserve inflating currency as the “ re-officialization” of the dollar bill into ¾, then ½ of its original value. This crack of instability in our currency was heavily leaned upon during the great recession when the value of our currency was questioned. After the large investment banks lost money, consumers seriously questioned the value of the dollar. As true with all expectations, when confidence and expectations are low, they tend to be self-fulfilling prophecies in that they come true because people think they will. Therefore, “ Too Big to Fail” describes the original cause of the recession as the deregulation of the banks by Reagan, while Schiff might argue that the underlying cause was because of the insecurity in the value of the United States dollar.

The second cause of the Great Recession was the housing bubble. While there may have been some disagreement in the underlying causes of the recession between the two works, both Schiff and “ Too Big” are in agreement over the catastrophic consequences of the bursting of the housing bubble. “ Too Big to Fail” details how the banks were truly sunk by the defaulting of housing loans. In forcing mergers and subsidies, the problem was constantly the “ toxic assets” which were the housing stocks. After the burst of the bubble, all of the large Wall Street banks were left with billions of dollars owed to them in the form of housing debts. Nobody knew if those debts would be repaid, however given the look of the housing markets at the time, the banks assumed the worst. Schiff also details the housing bubble as the “ hut rut.” After political and fiscal dancing by the leaders of Usonia to re-stabilize their fish note, things in the Usonian economy began to look up. Schiff describes the hut rut as a gradual idea at first, with large dependable borrowers striving for the “ American Dream” of owning a hut. Then, the government stepped in to help subsidize the buying of homes and restricts interest rates from being too high for risky buyers. This was most likely a large political move to gain re-election by making it appear as though homes were provided to all of the country. The result of these subsidies and restrictions was an upward spiral in the hut-market. The spiral increased speed until it was completely out of control of the government that originally regulated it. All semblance of legitimate value was lost, as consumers just demanded to get a hut to attain social status. As this towering house of cards grew and grew, so did the doubts and fragility within the market. Finally, the peak was reached and instead of all buyers of huts and small sellers, there were only sellers of huts. The prices deflated exponentially, and thus the hut bubble burst in a spectacular fashion. Therefore, Schiff describes how the subsidies and interest rate restrictions promoted excessive buying of houses by people who could not afford them, and “ Too Big” demonstrates the effect of those defaulted loans on the banks that made them.

The final act of the recession was the actual bailing out of the major companies, subsidies given, and eventually cash injections forced onto Wall Street banks. This part of the recession is the part most focused on by “ Too Big to Fail.” The first domino to fall was the bailing out of Bear Stearns by the U. S. government as it was bought JP Morgan. This fall then caused the next smallest bank, Lehman Brothers, to get hit hard by shaky consumers. The combination of Richard Fuld’s ignorance in the Korean negotiations, and poor loan choices by the bank itself led to Lehman Brothers’ declaration of bankruptcy. While this causes an appreciation in the U. S. dollar for a short span, the lack of confidence originally in Lehman Brothers spreads like a disease to all the other banks in the system. One aspect of the recession that the film covers that Schiff does not is AIG. AIG took on an unbelievable amount of housing risks, expecting all of the assets to go up, however when the housing bubble crashed hard, so did AIG. The effect of AIG’s faltering was extrapolated throughout the economy due to the massive size of the company. Providing insurance to essentially all areas of the economy, AIG was “ too big to fail” however, when it did, it threatened to take down the entire system with it. In an attempt to re-stabilize the system, Timothy Geithner, a policy-maker during the recession, attempts to merge the investment banks to boost confidence, however that fails miserably. The eventual plan that is decided upon is a 700 billion dollar bailout that would be used to purchase the “ toxic assets” that were such a problem to the investment banks. However, after discovering the toxic asset plan too slow, Henry Paulson, secretary of the treasury during the recession, decides to give direct cash injections to the bank, with the hope of them lending it out. The only problem with the TARP bailout, is that the banks did not lend out the money. The economy continued to slope downward until 2009 when the market finally stabilized. While the collapse of AIG and the investment banks were truly scary notions, the true threat that faced the economy was the lack of credit. As described by Ben Bernanke, the ability to borrow money and pay it back plus interest is the heart and soul of an economy. Without credit, an economy will grind to a halt. This lack of credit is addressed by Schiff as well, who describes the government’s policies towards the lack of credit as simply throwing fish at it until the economy corrected itself. The only real policies that Schiff addresses by the government during the recession is the bailing out of Freddie Mac and Fannie Mae by George Bush to stop them from hurting the economy any more than they already had. Schiff believes that the savior of the U. S. recession was China, in the form of lending the U. S. the money necessary for the cash injections and stimuli. The problem that Schiff describes with this plan is necessity to repay China all of the debts that we owe it. Therefore, Schiff details how China supplied our government with the “ real” money necessary to stop the bleeding of the housing market, while “ Too Big to Fail” shows the steps taken to stop the bleeding itself.

In conclusion, the Great recession of 2008 was an event long in the making, starting with the deregulation of the banking industry by Reagan and formation of the Fed by FDR. This caused weakness in the economy that was exploited by the crash of the housing bubble, and the resultant scramble for cash by out government has left us trillions of dollars in debt. The largest problem coming out of this recession is the probability of another bubble in the form of treasury bonds. If this bubble develops and the government does not kill it before it has time to grow, we could be facing a much larger and more permanent crash. Luckily, this recession did not turn into a depression. This is outlined in an article by Chris Isidore, a senior economics editor at CNN who attributes the survival of our economy to the trillions of dollars poured into the econmy by Ben Bernanke. While Schiff may not have agreed with the extensive borrowing to finance this, there is no doubt that Bernanke saved our economy from total collapse, even if he did use any mean necessary. Schiff's epilogue sums up the current position of U. S. political leaders, in that they do not have the courage to do what is necessary to fix the economy, instead worrying about their jobs and money. Hopefully we can learn from the mistakes shown in both of these works and ensure a stable and steadily growing economic future.