

OLLI Lecture

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Financial Markets Dislocations, Freezing Up of Credit Markets, Crisis and Economic Meltdown: A New View of the Financial Crisis and Its Aftermath

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Financial Markets Dislocations, Freezing Up of Credit Markets, Crisis and Economic Meltdown: A New View of the Financial Crisis and Its Aftermath

Outline

What is meant by “financial markets dislocations”?

What is meant by financial markets “freezing up”?

What are views and theories of some of the great thinkers of the causes and consequences of booms, busts and financial turmoil?

Some recent examples of financial markets dislocations and how they were managed.

How did the US and global economy get into the subprime mortgage crisis, the excessive leverage and layering that took place and the extreme liquidity and credit crunch that resulted?

Some evidence of the breadth and depth of the current mortgage and housing crisis.

What is unique about the 2006-2009 Crisis: Too-Big-To-Fail Policies!

Summary and consequences of these crises and the possible outcome of the current policies adopted by the Fed and Congress. Can it happen again?

Financial Markets Dislocations, Freezing Up of Credit Markets, Crisis and Economic Meltdown: A New View of the Financial Crisis and Its

Aftermath

- **Financial Crises and Economic Stabilization**

Financial market instability has afflicted the American economy for 200 years. (It has been in evidence throughout the developed world for a good deal longer). From business failures, to foreign bonds, Florida land sales, stock market bubbles, savings and loan crises, dot-com boom and bust, housing price bubbles, and subprime mortgage crisis, getting on, getting rich and losing everything has been a repetitive pattern. Each period of distress, has produced “solutions” that promise it will never happen again. Yet it always has.

The repetitive experience of booms, bubbles and busts is indicative of persistent structural and behavioral conditions. With each episode, remedies are adopted that, in retrospect, prove to be either superficial or perverse. In historical perspective, repetition raises a number of questions. Even with long periods of prosperity and only moderate recessions, there have been, over the last 45 years a succession of financial bubbles, involving real estate, the stock market and new technology. In each case, rapid build-ups of wealth resulting from run-ups in the asset prices, have ended in collapses and devastating losses.

Hyman Minsky provided a plausible explanation for such booms and busts. His models depicted a market economy in which “sustainable growth” is an oxymoron because of the psychological fact that booms will be accompanied by euphoria and euphoric expectations of continued prosperity. These are followed by busts of the unsustainable prosperity. In Minsky’s view long-term economic success (including moderate recessions) sows the seeds of its own financial destruction that ultimately destroy prosperity. In other words, business booms and busts are endogenous and not the result of some exogenous “shock.”

Setting the Stage or “Teeing It Up”

- This is the essence of the “New View:” that economic system booms and busts are endogenous to free market and private capital market economies. Ignoring this principle leads to perverse and, at best, ineffective regulation.
 - The Significance of Financial Markets in the Global Economy
 - The Historical Presence of Governments in Financial Markets
 - The Form of the Modern Presence of Government Regulation and Oversight of Financial Markets and Institutions
 - Main Ingredients of Pre-Crisis Regulation
 - Safety and Soundness Reporting and Examination Oversight
 - Capital Adequacy Standards and Prompt Corrective Action
 - Basel I Standards – One-Size-Fits-All
 - Basel II Standards – Big Banks are More Efficient Risk Managers
- Greenspan and Bernanke (2005, 2006):“... the development of risk management techniques has been particularly extensive in the field of bank capital regulation, especially for the banking organizations that are the largest, most complex, and most internationally active.*”

*Bernanke, “Modern Risk Management and Bank Supervision” (speech at the Stonier Graduate School of Banking, June 12, 2006)
<http://www.federalreserve.gov/newsevents/speech/Bernanke20060612a.htm/>.

Setting the Stage or “Teeing It Up”

- **Too-Big-To-Fail and Too-Big-To-Resolve Policy**

- Consequence of the policy that mega-banks are more efficient and necessary to compete globally: “Greenspan never saw a bank merger he did not like.”

Bernard Shull and Gerald A. Hanweck (2001). *Bank Mergers in a Deregulated Environment: Promise and Peril*, Quorum Books, Westport, Connecticut.

- The “Promise” was the Great Efficiency gains from large size and competition.
- The “Peril” is that the mega-financial institutions were ultimately “Too-Big-To-Fail and Too-Big-To-Resolve” and formed a collusive oligopoly.
- The economic costs in terms of resource misallocation to save the “zombie” banks and residential real estate and the under-employment of vast numbers of people and productive assets are only matched in the history of the last two centuries by the Great Depression in the 1930s.
- “Too-Big-to-Fail” has been institutionalized by Dodd-Frank (2010) in the creation of the Financial Risk Board and the notion that there are institutions, financial or others, that can cause financial market instability (SIFIs).

Financial Market Dislocations: What are they?

To Dislocate: v. tr.

1. to put out of the usual or proper relationship with contiguous parts; displace; shift.
2. pathology: to displace a limb or organ from the normal position, especially to displace a bone or joint.
3. to throw into confusion or disorder; upset; disturb.
4. Disruption of an established order.

In other words, a **dislocation** of financial markets is to so perturb them that the usual relationships among market participants and institutions and the market structure are displaced and thrown into disorder and confusion.

The displacement may be so extensive, creating so much disorder, that the former relationships are beyond reconstruction and there may be no viable economic or social reason for doing so. Examples may be the S&L Crisis with mortgage backed securities taking the place of thrifts and the decline in the industry to 1/3 the number of companies in the 1980s and early 1990s.

In History, Prominent Economists' Views of Dislocations

Joseph Schumpeter

The Entrepreneur as a source of dislocation, and booms and busts and economic development through the process of *creative destruction* – “*that kind of change arising from within the system which so displaces its equilibrium that the new one cannot be reached from the old one by infinitesimal steps. Add successively as many mail coaches as you please, you will never get a railway thereby.*” *Economic Development*, p. 64

Irving Fisher

Debt deflation theory of dislocations and depressions through liberal use of credit with unsustainable leverage and the consequent decline in nominal value, but rise in real value and burden as commodity prices declined more rapidly.

Hyman Minsky

The economics of euphoria, debt accumulation, excessive leverage and financial layering that exacerbated the decline in debt and asset values. (Layering means adding debt structures on top of one another such as mortgage-backed securities built upon individual mortgages and its consequences will be analyzed).

Milton Friedman

Ill-advised and ill-executed monetary policy created and exacerbated dislocations and booms and busts (Great Depression)

In History, Prominent Economists' Views of Dislocations

- **Alan Greenspan**

Financial innovation accelerated increased financial market productivity and risk reduction through risk spreading and risk hedging using derivative instruments.

Let the market be the judge of risk and reward, not governments.

In testimony regarding the growing Asian financial crisis before the Joint Economic Committee on October 29, 1997 he said: “...Nevertheless, rapidly developing, free-market economies periodically can be expected to run into difficulties because investment mistakes are inevitable in any dynamic economy. Private capital flows may temporarily turn adverse. In these circumstances, companies should be allowed to default, private investors should take their losses, and government policies should be directed toward laying the macroeconomic and structural foundations for renewed expansion; new growth opportunities must be allowed to emerge. Similarly, in providing any international financial assistance, we need to be mindful of the desirability of minimizing the impression that international authorities stand ready to guarantee the liabilities of failed domestic businesses. To do otherwise could lead to distorted investments and could ultimately unbalance the world financial system.”

And regarding capital standards: “Thus, capital standards should be structured to reflect the lines of business and degree of risk-taking in which the individual bank chooses to engage.”

Examples of Financial Market Dislocations in Recent History and How They Were Managed

1. The Penn Central Railroad bankruptcy in June 1970 and the dislocations in the commercial paper market.

Consequences: the Fed refused a government bailout of Penn Central, but flung open the discount window to banks in order for them to meet the credit demands from CP issuers unable to rollover their paper. An early case of markets “freezing up.” Within a year the CP market had been restructured to include not only backup lines or standby letters of credit from reputable banks, but ratings by Moody’s, S&P or Fitch.

2. The 1973Q4-1975Q1 recession and the REIT near collapse.

Minsky and others claim that this was the most severe recession in the postwar period, up to that time, and that the Fed averted a worse downturn by prompt action via the discount window and open market operations. It also eased the bank-sponsored REIT situation by allowing banks, without regulatory penalty, to assume the assets of their sponsored REITs. (Reminiscent of what was allowed in the 2007-2009 financial crisis – rolling assets into the banking company book from SIVs.)

Examples of Financial Market Dislocations (Continued)

3. The S&L Crisis and the recession of 1990Q2-1991Q1

The S&L crisis started as a commercial real estate debacle after the 1986 tax act rescinded the accelerated depreciation provision and turned into a full residential real estate downturn by 1989.

Thrifts failed and declined from nearly 3,700 at their peak in 1986 to 1,500 in 2001 and 1,300 in 2007.

Many commercial banks failed, reaching a peak failure rate in 1993 and with 787 banks on the “problem bank” list with assets of \$408 billion in September 1992. Their numbers declined from 11,000 in 1984 to just under 8,000 in 2007.

One result was the short recession of 1990Q2 -1991Q1.

The regulatory response was the elimination of the Federal Home Loan Bank System, but not the Federal Home Loan Banks, and creation of the RTC (completed work in 1996) and Office of Thrift Supervision (OTS) by FIRREA in 1989.

The other regulatory response was FDICIA in 1991 that replaced discretionary powers of the regulators for safety and soundness matters with Prompt Corrective Action inclusive of mandated capital standards.

Did these work? *[Apparently not since the 2001-2006 housing bubble followed.]*

Examples of Financial Market Dislocations (Continued)

4. LDC Crisis 1979-1987

Created by huge volume of petro-dollars generated by the run up in oil prices during the embargo period and flowing into banks worldwide hurting LDC countries through widespread inflation. Resolved by the adoption of the Brady Plan securing LDC debt and banks writing off billions of LDC loans in 1987. A credit crisis.

5. October 1987 Stock Market Crash

Not much of a Dislocation. Everything was back to normal by year-end 1987 after the Fed added considerable liquidity through the Discount Window and open market operations.

6. 1997 Asian Currency Crisis

Caused by excessive direct investment in Southeast Asian economies in other than domestic currencies and the following rapid withdrawal of these investments in dollars or yen. The countries could not meet these withdrawals without the substantial depreciation in their currencies. Resolved by severe recessions in Southeast Asian countries, Thailand, Indonesia, and Korea and, contributed to the ongoing recession in Japan.

Examples of Financial Market Dislocations (Continued)

7. August 1998 Collapse of Long Term Capital Management

Not much of a dislocation and created little regulatory response from either the Fed or the SEC. The Fed flooded the markets with liquidity and facilitated the dissolution of LTCM.

8. The 1996-2000 Dot-Com, Telecom and Internet Boom and Bust

This boom-bust cycle is the type that Schumpeter's theory fits best. Great innovations in personal computing, the Internet and telecommunications came together to create an optimism in technology (coincided with Y2k) and its ability to solve any problem. In large part this cycle was an equity cycle leaving out banks, still recovering from the early 1990s, and bringing the venture capitalists and the IPO in full integration with the investment banking firms. The result was a rapid and substantial decline in the value of stocks including many companies unrelated with the boom. For example NASDAQ reached 6,000 at its peak and went to 2,127 (9/16/2009) (S&P500 1,498,1,065). As of 3/24/2014 NASDAQ is 4,446 and S&P 500 is 1,857.

9. 2001-2002 Corporate Governance failures of Enron, WorldCom, Global Crossings, Tyco, etc.

These caused great concern to financial markets and dislocations that resulted in major regulatory and accounting and disclosure reforms embodied in Sarbanes-Oxley. These also caused investment banking firms to review their reliance on company reports and the SEC to intensify their reviews of filings (except Madoff).

Examples of Financial Market Dislocations (Continued)

10. 2003-Present Residential Real Estate Boom and Bust and Subprime Loan Crisis

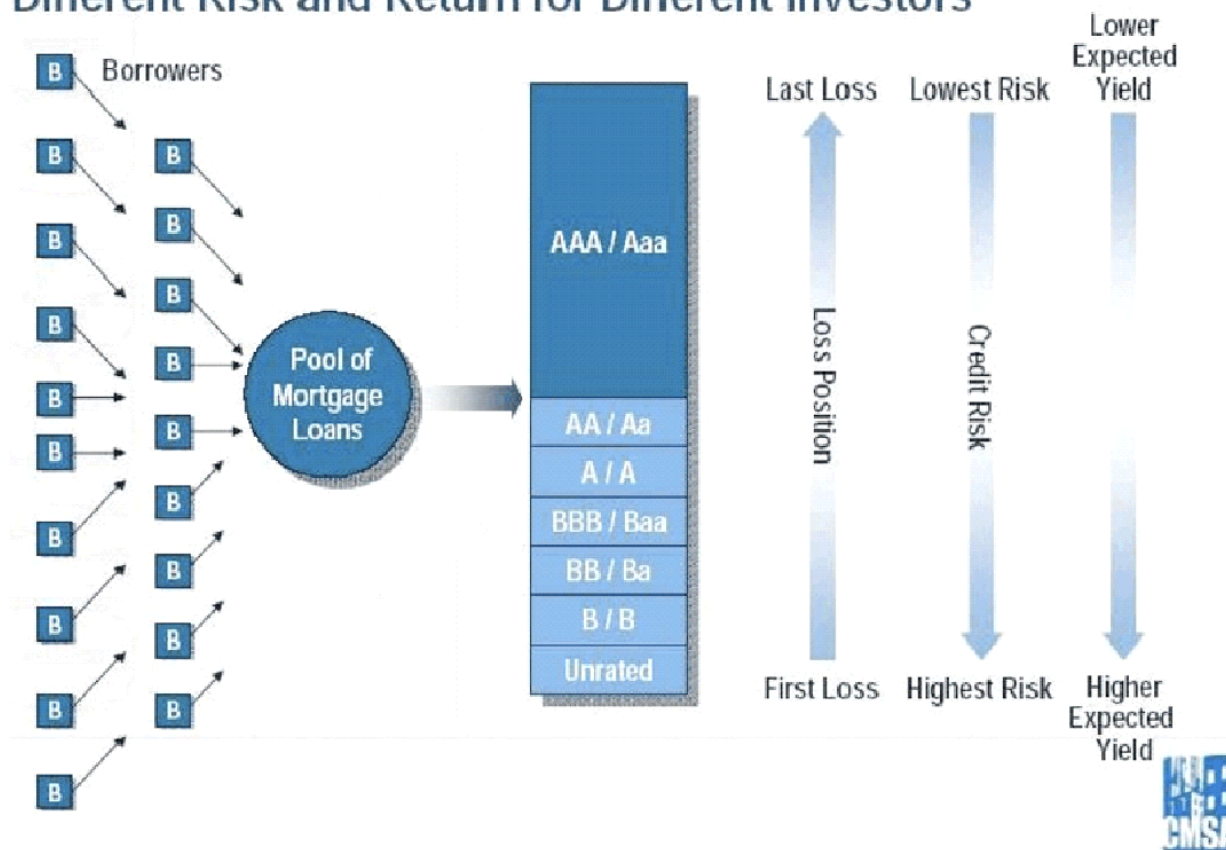
This is a full-fledged credit crisis with many dislocations among financial markets. Many speculate that the low interest rates in 2004 with the Fed Funds rate of 1 percent and 6-month LIBOR at 1.09 percent, created the seeds of a massive refinance boom and low mortgage rates stimulated new housing construction and a speculative housing boom.

However, low rates alone can't do this; the compliance of lenders must be present as well. Lenders filled this role well by essentially lowering standards to the point that many of the subprime loans were made with little or no documentation of income and employment of the borrowers, high loan-to-value ratios, when adding in funds borrowed to meet the down payments, negative amortization loans, and “teaser” interest rates that were low for 2 years or so with the provision that they rose to a markup of more than prime loans at the time of origination.

The secondary mortgage market complied as well by packaging these loans and creating tranches that met AAA standards while the lower tranches were left with a residual of questionable credit quality. As property values declined after 2005, even the “highly” rated tranches were of questionable credit quality as defaults grew. The higher rated subprime MBS tranches were also bundled with others to produce collateralized debt obligations (CDOs) that were sold in the market and used as collateral for borrowing, particularly for asset-backed commercial paper(ABCP).

How Mortgages Are Securitized

Different Risk and Return for Different Investors



Since 2000 Households Undertook Historically Large Mortgage and Consumer Credit Debt Resulting in the Highest Leverage Since the Great Depression

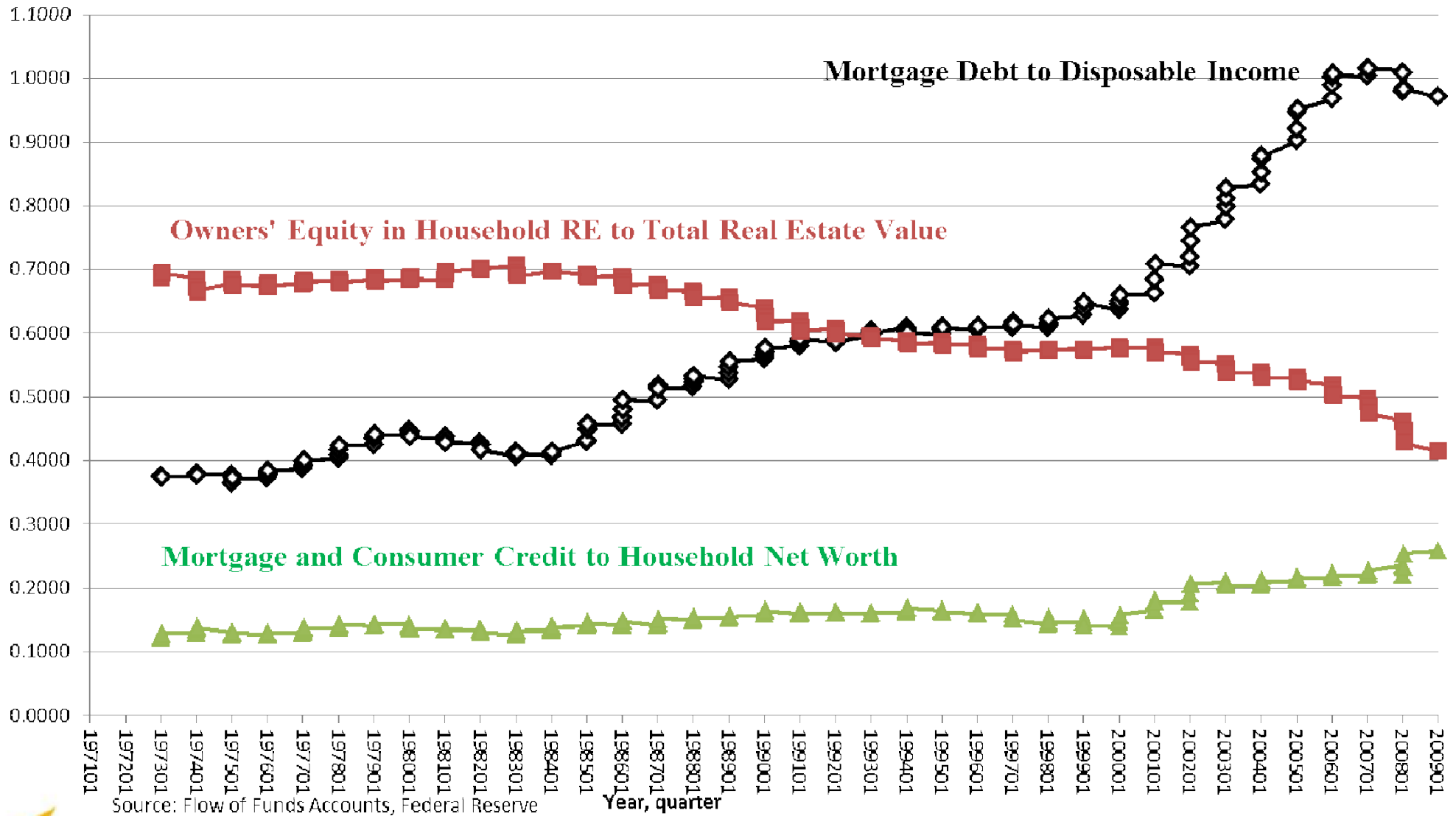
- **Household Leverage Is Excessive**

Mortgage Debt to Disposable Income

Household Equity in Real Estate to Total Real Estate Value

Mortgage and Consumer Credit to Household Net Worth

Since 2000 Households Undertook Historically Large Mortgage and Consumer Credit Debt Resulting in the Highest Leverage Since the Great Depression
(1973Q1 to 2009 Q1)



Source: Flow of Funds Accounts, Federal Reserve

Year, quarter

Residential Real Estate Boom Dislocations (Continued)

10. 2003-Present Residential Real Estate Boom and Bust and Subprime Loan Crisis: Minsky's *Financial Layering* in Practice and Cubed:

Commercial Paper Crisis: Asset-Backed Commercial Paper

Asset-backed commercial paper (ABCP) is:

- CP issued by *special-purpose* vehicles (*SPVs*) – such as *conduits* or *structured-investment vehicles (SIVs)* – to fund a pool of specific assets, such as mortgages, credit-card receivables, or leases.
- SPVs and SIVs used by bank and investment banks to take risky MBS or CDOs assets off their books to reduce capital requirements – there were none for SPVs or SIVs. These mortgage instruments were then financed by short-term ABCP – a maturity mismatch.
- While conduits have further bank line-of-credit backing, SIVs typically have none.

According to Fitch Ratings [“Asset-Backed Commercial Paper Explained,” Nov. 8, 2001 (emphasis added)]:

The main risks faced by ABCP investors are asset deterioration in the conduit's underlying portfolio, potential timing mismatches between the cash flows of the underlying asset interests and the repayment obligations of maturing CP, a conduit's inability to issue new CP, and risks associated with asset servicers.

Financial Markets Dislocations

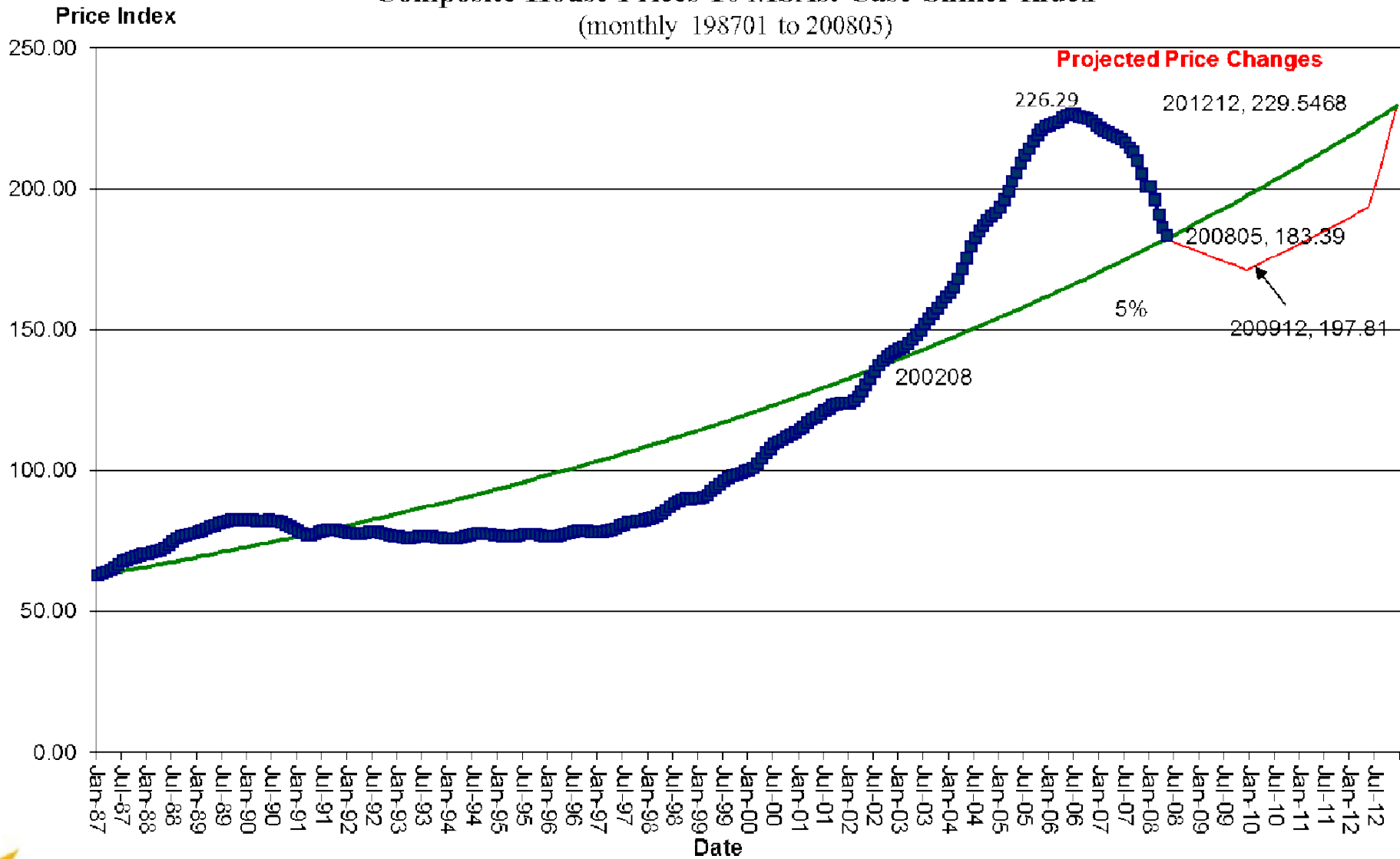
Examples of Financial Market Dislocations in Recent History and How They Were Managed

- **Borrow Short, Lend Long: SIVs and Countrywide**
The SIVs – which are hedge funds or off-balance-sheet conduits created by big banks:
 - held roughly \$350 billion of illiquid, hard-to-value MBS and CDOs, many backed by subprime mortgages...
 - ...funded them with ABCP, often without a “Plan B”...
 - ...and rode the wave.

Then Came the Housing Price Bust

Financial Markets Dislocations

Figure 1
Composite House Prices 10 MSAs: Case-Shiller Index
 (monthly 198701 to 200805)

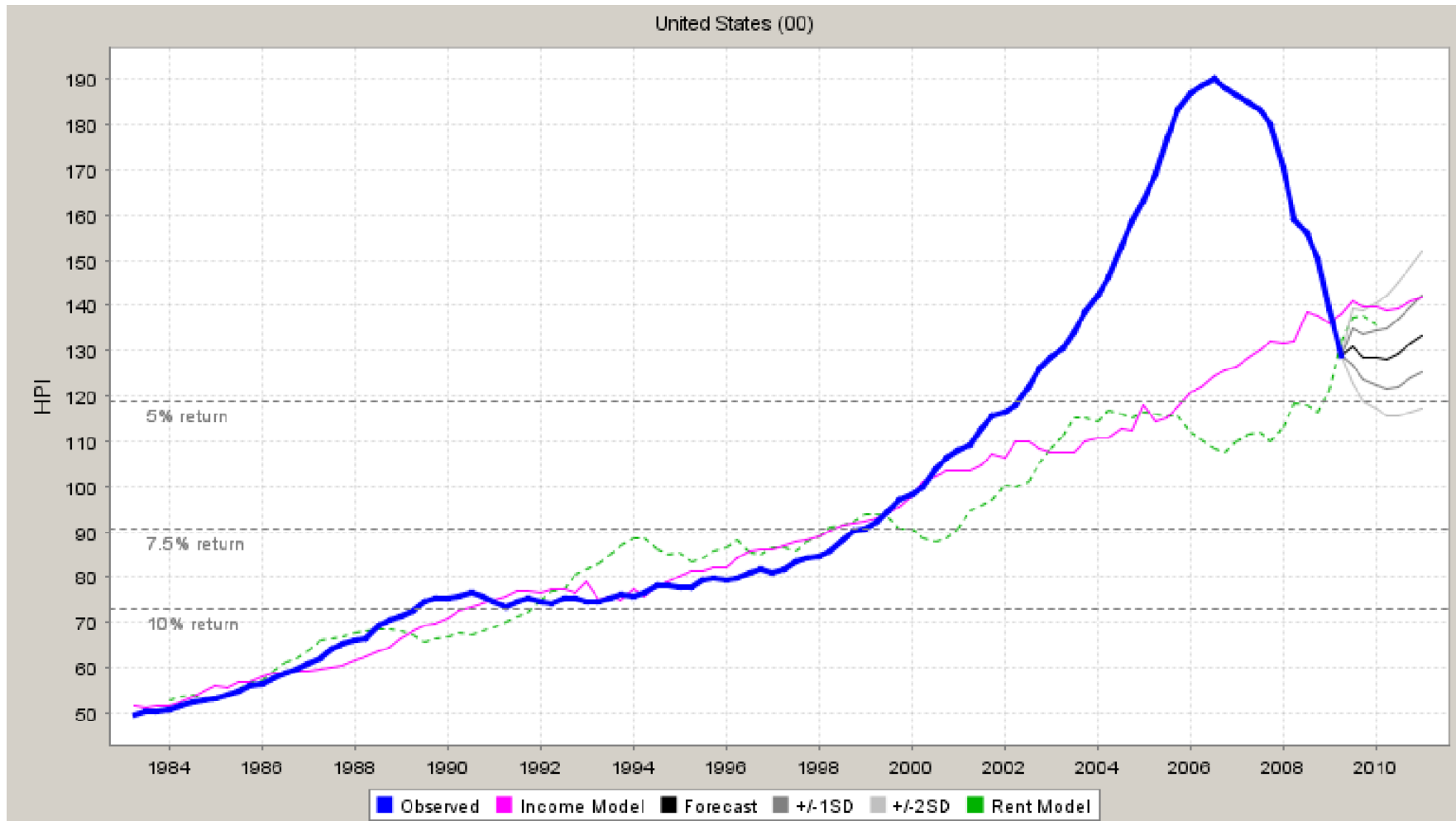


Financial Markets Dislocations

Forecasting Model (Version 1.0)

Latest HPI (Case-Shiller) Observation: 2009-03-31

ARMA Mean Reversion

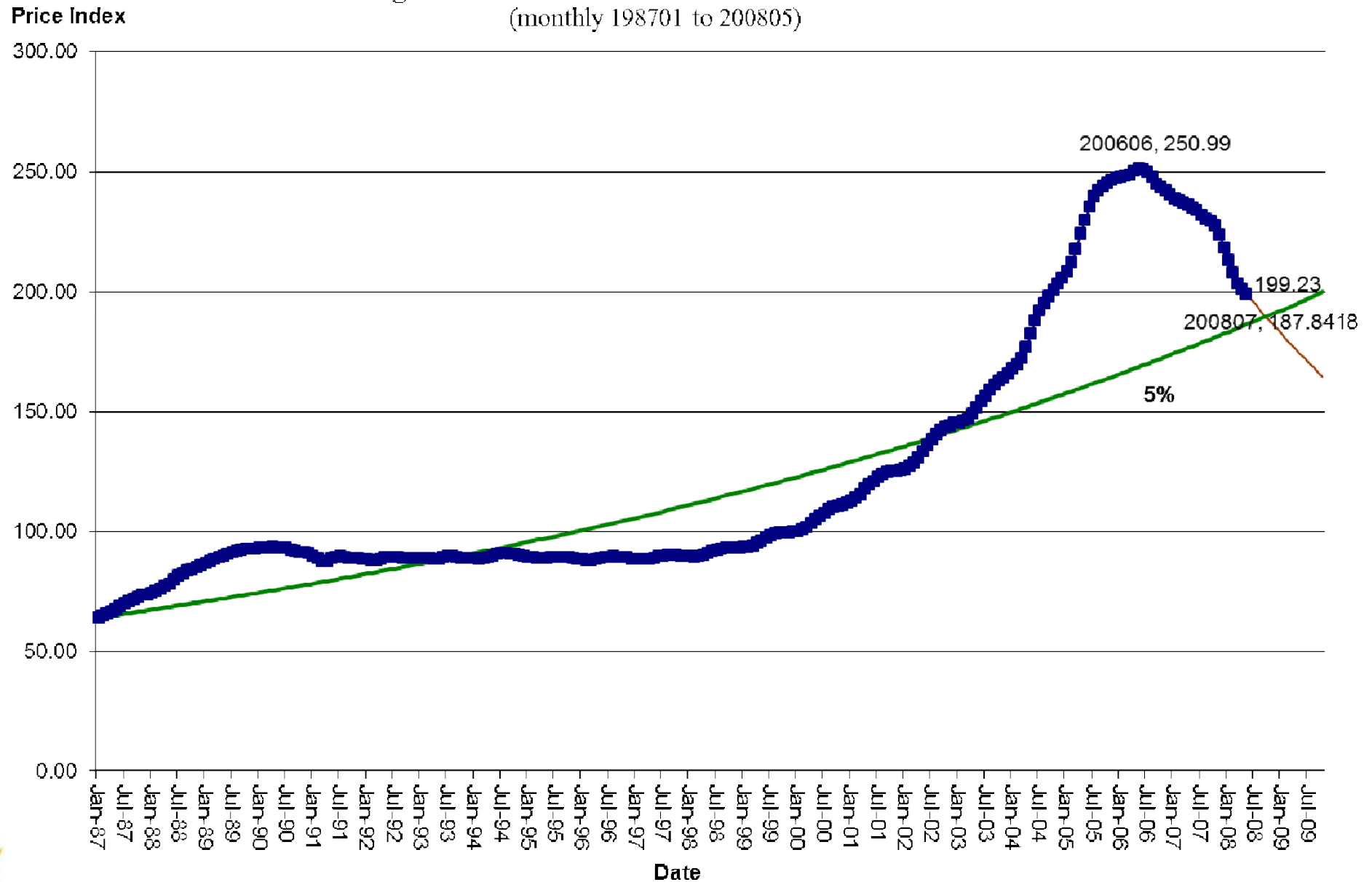


**Forecasting Model
(Version 1.0)**

ARMA Mean Reversion

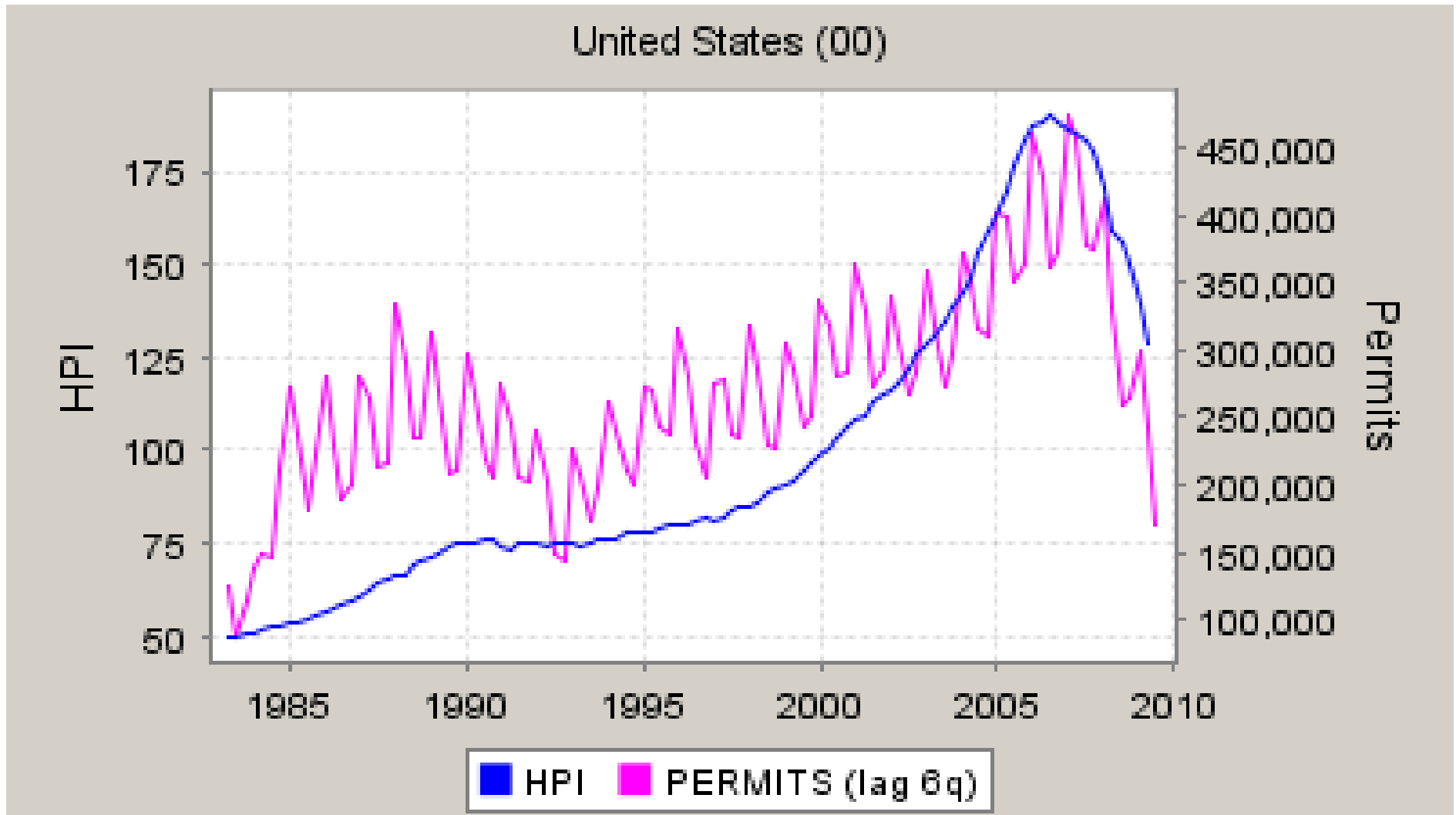
	2009Q1*	2009Q2	2009Q3	2009Q4	2010Q1	2010Q2	2010Q3	2010Q4
HPI (Case-Shiller)	128.81	130.80	128.58	128.35	128.25	129.39	131.66	133.43
__Forecast (%chg from 2009Q1)		1.55	-0.18	-0.35	-0.44	0.45	2.21	3.59
HPI (One SD down)	128.81	126.78	123.70	122.60	121.77	122.25	123.90	125.15
__Forecast (%chg from 2009Q1)		-1.57	-3.97	-4.82	-5.47	-5.09	-3.81	-2.84
Equilibrium HPI (income model)	138.11	141.05	139.91	139.61	138.85	139.33	140.91	141.94
__Distance to equilibrium (%)	7.22	7.84	8.81	8.77	8.27	7.68	7.03	6.37
__Distance to equilibrium (%) (One SD down)	7.22	11.26	13.11	13.87	14.03	13.97	13.73	13.41
Equilibrium HPI (rent model)	132.06	137.39	137.89	135.69				

Figure 3
Washington D.C. MSA House Price - Case-Shiller Index
 (monthly 198701 to 200805)



Financial Markets Dislocations

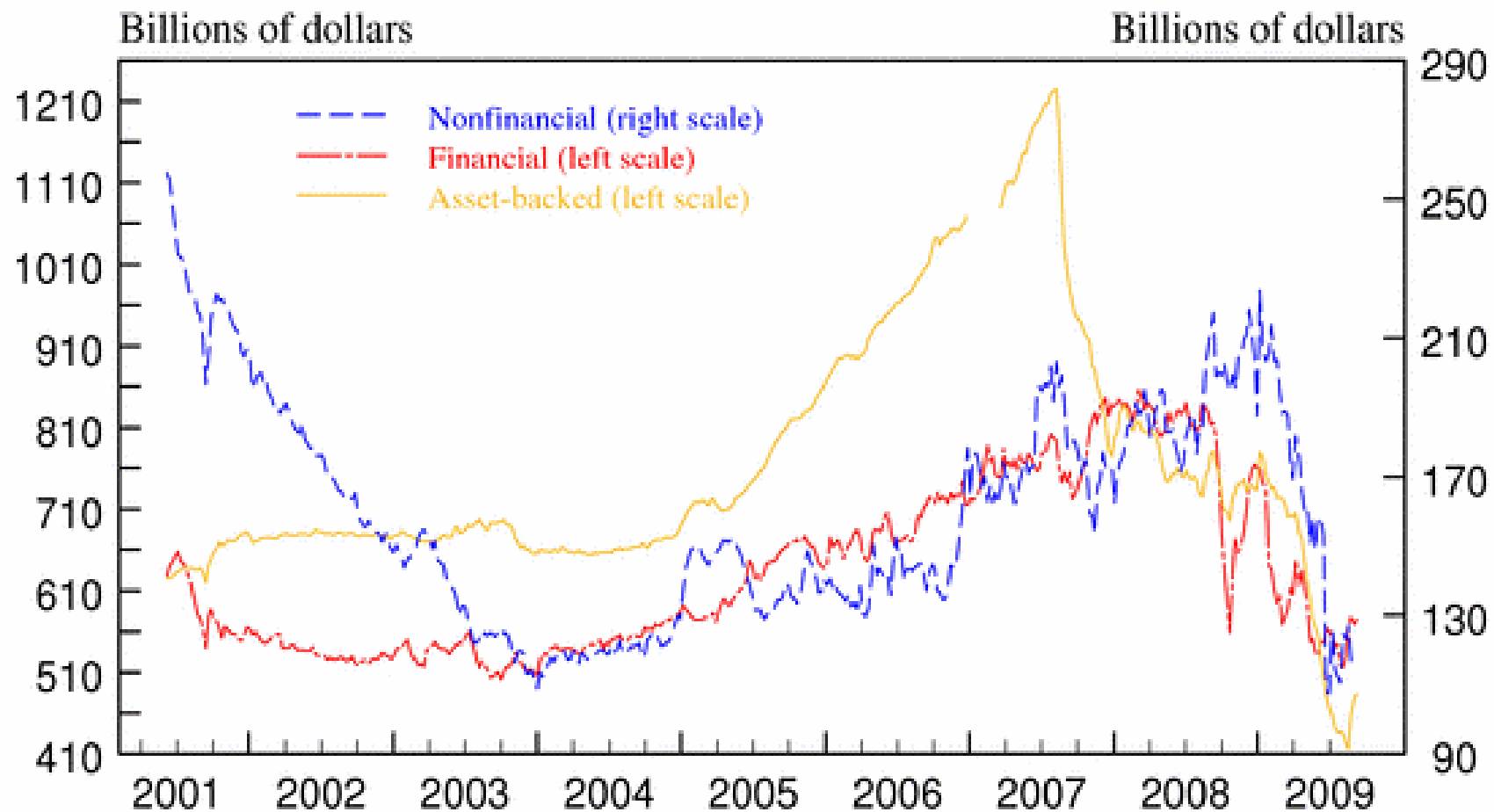
Permits (Lag 6 quarters) and HPI Latest HPI (Case-Shiller) Observation: 2009-03-31



A Clear Market Dislocation

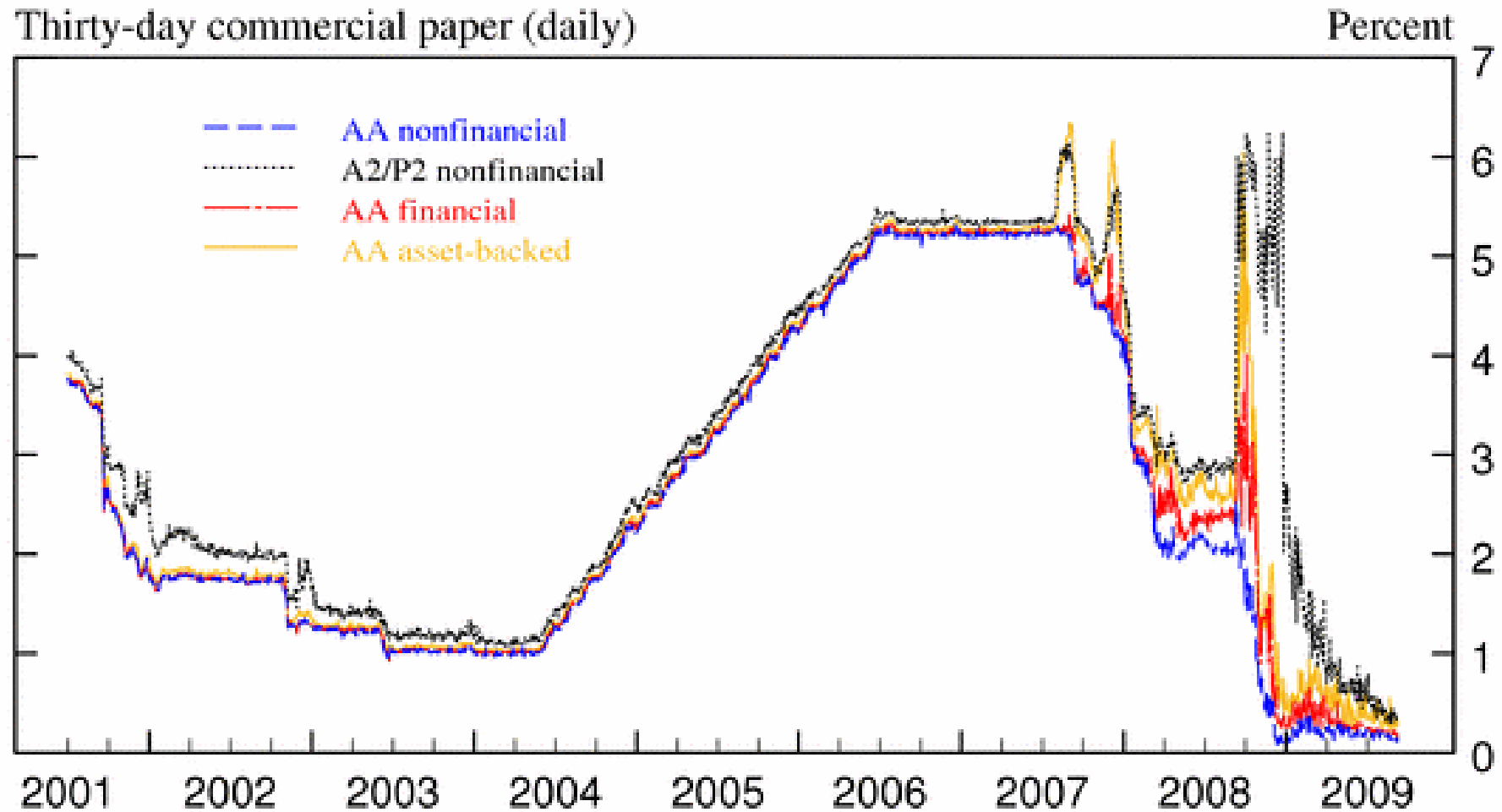
Outstandings: Major Dislocation in Asset-Backed Commercial Paper Market

Weekly (Wednesday), seasonally adjusted



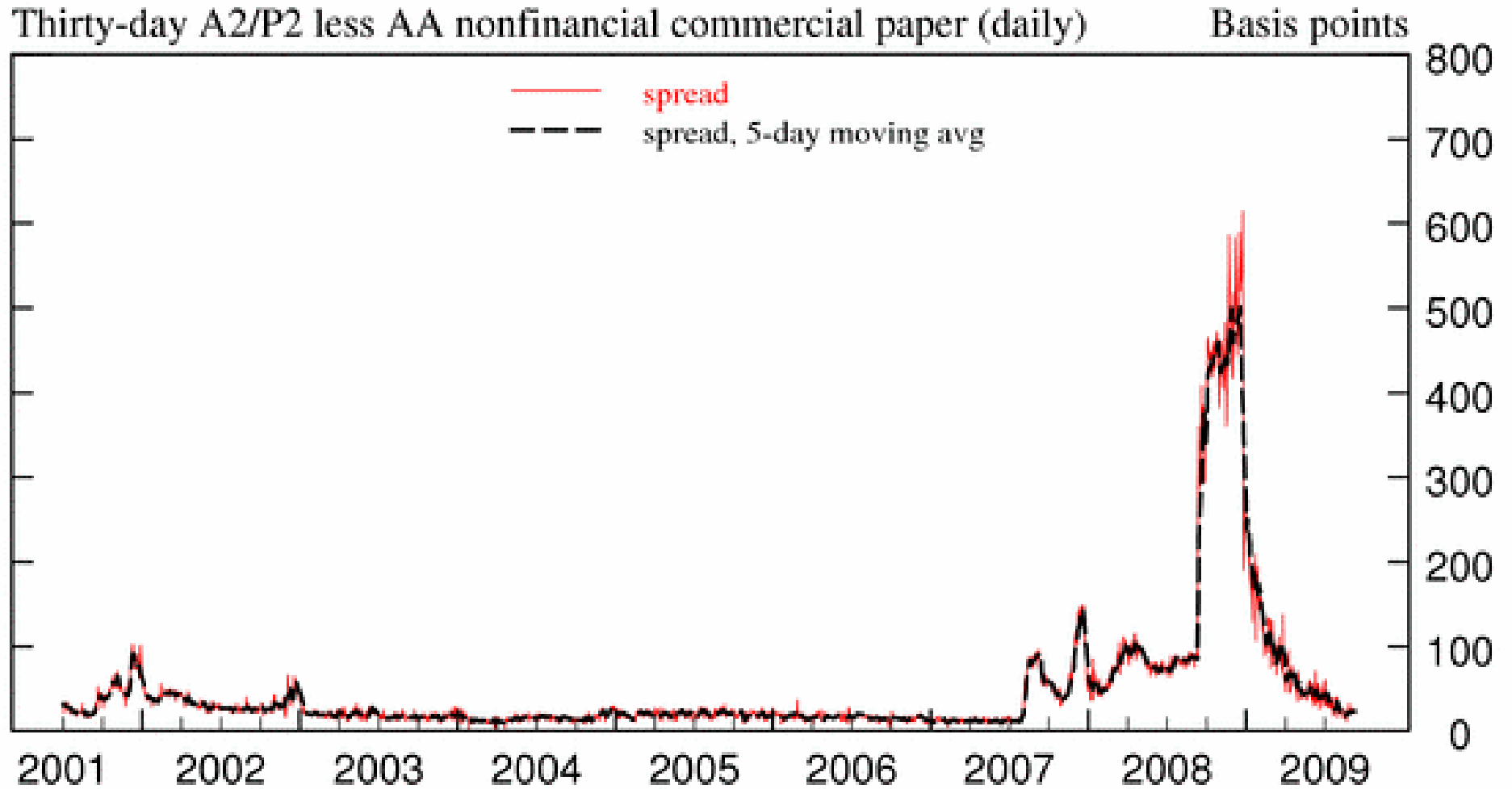
Source: Board of Governors of the Federal Reserve System

Discount rate history: Rates soured on Asset- Backed and Nonfinancial CP



Source: Board of Governors of the Federal Reserve System

Discount rate spread: Even as rates fell, spreads were higher than pre-August 2007, then fell



Source: Board of Governors of the Federal Reserve System

Response to CP/Liquidity Crisis

- August 7, 2007: Interbank lending rates rise sharply; ECB begins injecting huge amounts of cash into the banking system.
- August 7, 2007: “Financial markets have been volatile in recent weeks, credit conditions have become tighter for some households and businesses, and the housing correction is ongoing. Nevertheless, the economy seems likely to continue to expand at a moderate pace over coming quarters, supported by solid growth in employment and incomes and a robust global economy.” – Federal Reserve Board statement.
- August 13, 2007: Goldman Sachs arranges \$3 billion bailout of two of its hedge funds.
- August 15, 2007: KKR asks investors to accept a 6-month delay in repayment on \$5 billion of CP. Merrill Lynch analyst warns that Countrywide Financial, the largest mortgage lender and servicer in the nation, could go bankrupt. Countrywide draws on \$11 billion of bank credit lines.
- August 17, 2007: FRB: “Financial market conditions have deteriorated, and tighter credit conditions and increased uncertainty have the potential to restrain economic growth going forward. In these circumstances, the FOMC judges that the downside risks to growth have increased appreciably.” (Fed cuts discount rate 50 basis points.)
- The Fed has continued with auctions and offered one last week (8/13/08). Has it helped? ECB is no longer involved.

Causes

- **Lax lending standards:**
 - In 2006, NINA (“no income / no asset verification”), SISA (“some income / some asset verification”) and other “no-doc / low-doc” loans make up over 20% of all mortgages, and 50% of subprime mortgages.
 - These loans defaulted at 13% in February, compared to 1.5% of full-doc loans.
 - Subprime mortgages provided funding for people to buy a home who otherwise could not afford to own a home... but at what cost?
 - **Lax credit policies can not be reversed!**
- **Lax valuation standards:**
 - Mark to market, matrix, or model?
 - Most investors in subprime-backed MBS and CDOs chose mark to model.
 - What happens when the model no longer reflects the market?

Causes

Lax ratings standards:

Investors relied – for better or worse – on the ratings agencies to analyze and value the risk in complex debt instruments.

Ratings agencies are paid by the *issuer*, not the investor. Does this create a conflict of interest?

Rating corporate bonds is difficult, but there is a long history of data. Rating structured financial products such as subprime MBS and CDOs is an art; ratings are generally based on a model, with little historical data.

Lax risk management standards:

The housing market had been weakening, and loan defaults had been rising. Should investors have analyzed their portfolios more thoroughly?

Should investors in ABCP – mostly money-market funds – exercised a bit more due diligence with regards to their investments?

Why did financial institutions such as IKB and Merrill Lynch not know their exposure to these markets?

Lax Regulatory standards:

Little or no regulatory oversight because banks were profitable and well capitalized. How could this be when 6-months later many are losing money and undercapitalized?

Unique Causes of the 2007-2009 Crisis: Implementation of Too-Big-To-Fail Policies

- **TOO-BIG-TO-FAIL Policy**

- Unlike other crises, Treasury Secretary Paulson and Fed Chairman Bernanke with Tim Geithner, President of the Federal Reserve Bank of New York, undertook to bailout the largest commercial banks, investment banks and insurance companies through the Troubled Asset Relief Program (TARP, October 3, 2008) and direct funding by the Fed by infusing capital into the banks.
- In no other crisis or in the failures of large banks such as Chicago-based Continental Illinois in 1984 or the Bank of New England Corp. in 1990-1991 was permanent capital infused into financial companies.
- Why this was done in this case is another story, but essentially it preserved every company of the top 6 including the biggest troubled mega-bank CitiCorp and mega-insurance company AIG turning them into “zombie” institutions – dead, but still moving, consuming resources. Note also that, with the exception of AIG, the senior management of each was still in place in 2010 (BAC Lewis and Citi Pandit earning \$1M+).

TOO-BIG-TO-RESOLVE

- Big “zombie” banks only get bigger – reminiscent of the Japanese experience from 1991 to the present.

PERCENTAGE GROWTH OF COMBINED ASSETS, from June 2007 to March 2009

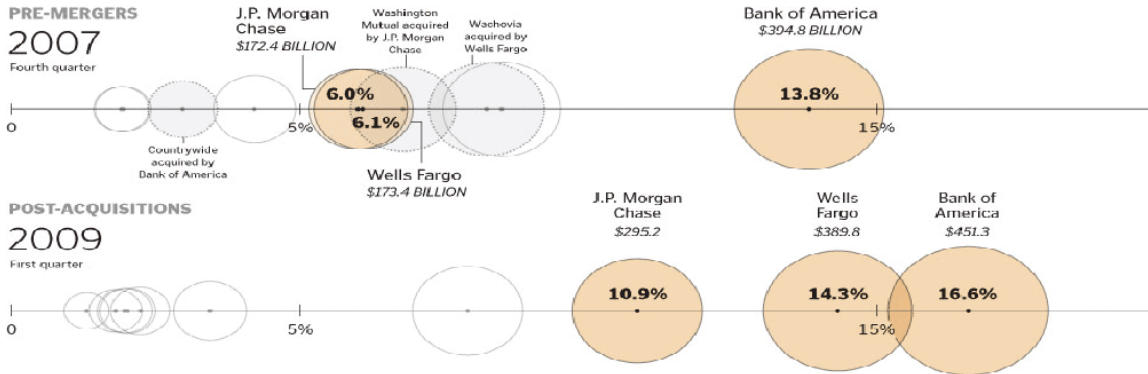


SOURCE: Federal Reserve Bank of Dallas

Residential Mortgages

The three biggest banks in the U.S. seized more of the home loan market by acquiring other top-10 rivals during the financial crisis.

TOP 10 BANKS' PERCENTAGE OF MARKET SHARE (amount of loans issued, in billions of dollars, in *italics*)

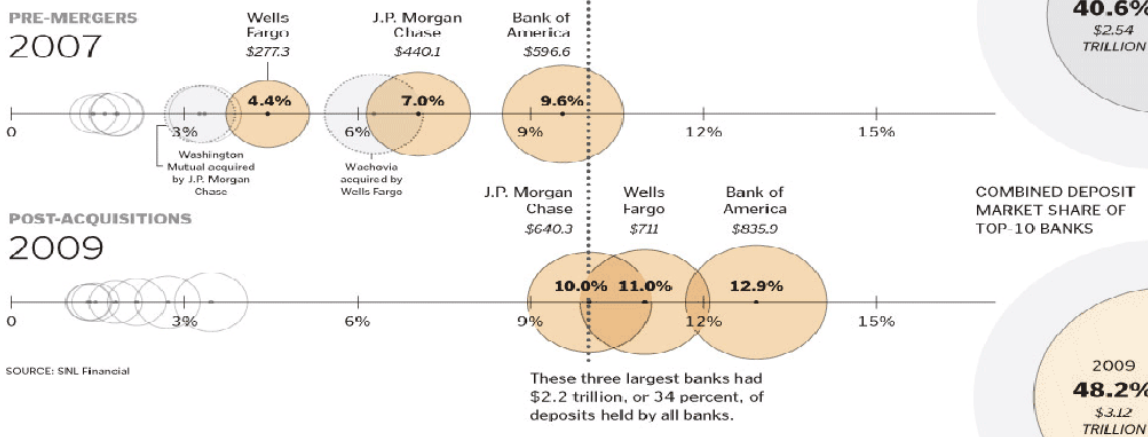


Bank Deposits

Despite federal law that bars banking institutions from holding more than 10 percent of the nation's deposits, three banks were permitted to surpass that level.

TOP 10 BANKS' PERCENTAGE OF DEPOSIT MARKET SHARE

Total deposits, in billions of dollars, in *italics*



SOURCE: SNL Financial

Banks 'Too Big to Fail' Have Grown Even Bigger
 Behemoths Born of the Bailout Reduce Consumer Choice, Tempt Corporate Moral Hazard
 By David Cho
 Washington Post Staff Writer
 Friday, August 28, 2009

The New View

- The foundation of the “New View” is view of Hyman Minsky: Hyman Minsky provided a plausible explanation for such booms and busts. His models depicted a market economy in which **“sustainable growth” is an oxymoron** because of the psychological fact that booms will be accompanied by euphoria and euphoric expectations of prosperity followed by busts of the unsustainable prosperity. In Minsky’s view long-term economic success (including moderate recessions) sows the seeds of financial destruction that ultimately destroy prosperity. Accordingly, the global economic and financial system will witness periods of boom and bust, bubbles and their bursting and is not stable – economy by economy.
- If the “New View” is believed, the massive bank consolidations, extremely low interest rates and quantitative-easings would not have been promulgated by the Greenspan or Bernanke Fed and other bank regulators as the preferred policy choices during the initial years of the Great Recession, all done in the guise of promoting economic stability and expansion. **The dot-com boom and the following subprime mortgage crisis have revealed the soft underbelly of the low interest rate era of Greenspan’s and Bernanke’s Fed and the consequences of a world awash in funds has yet to be realized.**

The New View

- In an analysis of current structural arrangements and recent reforms, including the financial regulatory/supervisory organization in Dodd-Frank (2010) and the Basle capital adequacy reforms, these are likely to be ineffective and may be perverse to economic and financial stability. The perversion arises from regulators' beliefs that these capital policies reduce bank risk transmitted to bankers being told they are well-capitalized – **now euphoria has set in to the regulators and the regulated.** For example the recent (2013) stress tests revealed only one large bank failed the test. What does this say to all the others? Note they are all trying to increase dividends rather than retaining earnings and building capital further. (It is important to recall the “lessons” from lax regulation of the subprime mortgage bubble.)
- These structural arrangements and reforms, along with the Systemic Risk Committee, essentially freeze the current financial structure which is the most concentrated ever and bloated with banking companies “too-big-to-fail” and “too-big-to-resolve.” What is to stop them from spawning another bubble based on something yet to be imagined? **NOTHING.**

The New View

- **Proposition:** In order for the U.S. and world economies to begin sustainable growth, free market forces must be allowed to prevail, harnessing them to promote innovations and create new products and services. The “creative destruction” of Joseph Schumpeter must not be feared by policy makers and central bankers, but embraced. Effectively this means to stop protecting companies such as GM, Chrysler, Citigroup, Morgan Stanley, JP Morgan Chase, AIG, Fannie Mae and Freddie Mac, Deutsche Bank, Credit Lyonnais, Royal Bank of Scotland (RBS), UBS (Switzerland) and labor unions such as the United Autoworkers in the U.S. and labor unions around the world.
- **Corollary:** “Too-big-to-fail” and “too-big-to-resolve” policy options must be abandoned globally with direction of financial regulation and monetary policies being the altered substantially from equating financial stability with the preservation of existing institutions.

EVIDENCE: "The evidence presented in this paper on the additional discount that bond investors offer the largest banks ... is novel and consistent with the idea that investors perceive the largest U.S. banks to be too big to fail," Joao Santos, a vice president at the New York Fed, wrote in a paper on fund-raising by banks, insurance companies and corporations. (March 25, 2014, Reuters)

Conclusions and Consequences: What Next?

Where does the financial system go from here? A more collusive oligopoly under the proposed Systemic Risk Regulator?

How might the Federal Government bailouts of Freddie and Fannie impact the structure of the global financial system? Are we creating even a tighter oligopoly in the mortgage market unless they are resolved by breaking them up?

Will these approaches to stabilization policy by the Fed and Congress sow the seeds of increased moral hazard such that greed will be rewarded without fear?

Are we headed for another bout of euphoria and the consequences of the excessive leverage and layering that will certainly be followed by a bust?

Is financial stabilization even possible? Many agree with Hyman Minsky that it is not. Those that believe it is need to work out how it can be achieved, those who believe it isn't need to work out how to mitigate the serious adverse consequences on the economy, private wealth and incomes. The current policies only create instability by preserving the institutions that caused and exacerbated the crisis.

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