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It's the Economy, Stupid: Lessons in Economics, Banking, and Personal Finance from the Financial Crisis of 2008

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Introduction

"It's the economy, stupid." – James Carville

Speaking to his campaign team, James Carville directed this message when he was a political consultant for then-Governor Bill Clinton during the 1992 presidential campaign. The statement ultimately became an informal slogan for the Governor of Arkansas' campaign against incumbent President George H.W. Bush and a famous quote in American politics. Since then, the phrase has been reused and modified several times to stress the importance of the economy in elections.

Carville's remark recognizes the importance large economic forces play in our lives as they relate to personal finance. In other words, while Carville used this message to illustrate the correlated relationship between a healthy economy and political support, his statement also provides insight into how the economy affects the human condition. The ability to be financially secure corresponds with issues of employment, education, health, housing, criminal justice, and much more. Becoming more informed about how our own financial lives relate to the economic state of the country and world also pushes us to analyze our government's role in the economy. The Financial Crisis of 2008 is perhaps the best vehicle to approach this question.

What are the origins of the Financial Crisis of 2008? What kind of disordered and incoherent environment resulted? Who is to blame for the Great Recession? How do our own, individual lives relate to the larger forces of the US economy and the American banking industry? How intertwined is the American economy with the global economy? What should the government's role be in the economy? This curriculum unit addresses these questions by examining the development of the Financial Crisis of 2008 from its origins to its impact on the present-day—by analyzing the involvement of the US banking industry, the American federal government, and the role individuals played in it.

Rationale

This four-week unit plan is designed for high school twelfth-grade Social Science classes at William W. Bodine High School for International Affairs. Bodine is a magnet high school in the School District of Philadelphia (SDP). Bodine is located in Philadelphia's Northern Liberties neighborhood and serves roughly 550 students. Middle school grades, attendance, disciplinary records, state test scores, and other criteria determine student admission. The SDP operates as a Title I school district; under this policy, all students qualify for free or reduced-price lunch. Over ninety-five percent of students at Bodine live below the poverty line. Students attend daily class periods of fifty-three minutes each. Bodine offers Advanced Placement (AP) and International Baccalaureate (IB) courses to its upperclassmen. This unit can be used in AP and IB courses as well as for ninth, tenth, and eleventh-grade students.

At Bodine High School, twelfth-grade students must enroll in Social Science, a civics course that focuses on government, politics, and economics. Keeping the classroom's curriculum as relevant as possible is of the utmost importance. The course's curriculum is modified to teach topics such as lead and health, gerrymandering, school funding, redlining, the presidential campaigning process, mass incarceration, affirmative action, and globalization in the order listed. Respectively, these topics relate to the role of the media, legislative representation, how budgets become law, the federal bureaucracy, political parties, trial courts, appellate courts, and outsourcing. Students are genuinely interested in these topics; therefore, the relevance of these lessons better equips them to understand how the three branches and levels of government work in action. Students are quick to register to vote and become civically engaged, which is one of the goals of this course and unit plan.

To prepare students to become engaged in their local, regional, and global communities, they must be aware of the history of their community and nation. These topics can be used within the classroom to promote active, civic participation, therefore encouraging students to study the past to understand the present. This practice will result in students' ability to apply concepts and practices throughout history to understand the origin and workings of modern-day societies, cultures, and institutions. Understanding the past is crucial when understanding how the history of philosophy, geography, and culture impacts how our government and politics work in today's economic world, both nationally and globally.

I believe there are two glaring gaps in my Social Science curriculum: the government's role in the economy and the importance of personal finance. This unit aims to remedy this issue by having students study the Financial Crisis of 2008 and the Great Recession that followed it. This unit plan will be taught at the end of the year and will take the entirety of the fourth marking period. Ideally, this curriculum unit will help students transition into their first year of adulthood, as many students will take on debt from student loans and will begin to work more hours as young professionals. I hope this unit will both encourage them to remain informed about the country's economic state while also assisting them in learning to become responsible with their money.

Content Objectives

The Financial Crisis of 2008 led to the largest economic recession in the United States since the Great Depression. Known as the Great Recession, the crash's resulting economic contraction fostered harsh criticism of economic inequality, a deregulated banking industry, issues of greed on Wall Street, and even the capitalist economic system itself. Mostly associated with New York City, the globalized economy fell to a series of recessions in the United States and throughout the world. As middle-class and working-class families in the United States saw their levels of debt increase, politicians and government officials weighed out how the federal government would respond to the Financial Crisis of 2008.

Throughout this curriculum unit, students will learn about the capitalist economic system, the development of the Financial Crisis of 2008, and the reaction to the Great Recession—both by the government and by working- and middle-class families. This unit plan contains six sections:

First, students will study the inner workings of today's financial system. By examining the role commercial and investment banks play in the American economy, students will become familiar with the importance of credit in free market economies. Through learning how financial institutions provide liquidity to markets, students will also identify the role companies had in expanding the shadow banking system—a product of when the American economy underwent a period of "financialization." These factors significantly contributed to the Subprime Mortgage Crisis.

Second, students will examine the development of the Financial Crisis of 2008 by taking a close look at the Subprime Mortgage Crisis in the United States' bond market. Students will delve into the role players such as commercial banks, investment banks, rating agencies, insurance companies, hedge funds, the Federal Reserve, and others had in the events that led to the development of America's housing bubble. By reading about items such as collateral debt obligations, credit default swaps, and tranches, students will identify the inner workings of the banking and bond market systems. Thus, they will learn about compound interest rates, fixed- and adjusted-rate mortgages, and down payments. These components allow for students to focus on the roles banking and homeownership play in the United States economy. Due to the deregulation of the banking industry in the decades leading to the Subprime Mortgage Crisis, students will question the role of the government in the economy.

Third, students will investigate the government's role in the economy. Students will survey a brief history of monetary policy in the United States by learning about influential pieces of legislation, well-known periods of economic growth and decline, and the development of the country's banking system. More specifically, students will review the role of the Federal Reserve and the US Department of the Treasury. They will also analyze the role that regulation plays over the shadow banking system. Students will study regulatory measures more closely when inspecting how the Obama Administration implemented measures of monetary and fiscal policy to relieve the United States during the Great Recession.

Fourth, students will examine alternative decisions that the federal government could have made in handling the Great Recession. In this section, students will take a close look at the lobbying effort made by the financial industry in influencing key pieces of legislation such as the Troubled Asset Relief Program. Students will learn about the background of important figures in the Bush and Obama Administrations to understand the decisions taken by the federal government to rescue America's financial institutions using public money.

Fifth, students will take a look at the political ramifications that resulted from the policies the government enacted. The development of major pieces of legislation resulted in significant amounts of public backlash. In many ways, the regulatory policies created by the Obama Administration helps explain the political response in the ensuing general and midterm elections. By studying this, students can understand the nature of the United States' political system and its weak political parties.

Lastly, to teach students how they fit into larger economic forces, students will research their desired occupation to create a monthly budget. In this personal finance project, students must distinguish between options to purchase a mortgage or to rent a home; they also must decide whether to buy a car or to take public transportation. Students will learn responsible investment and savings techniques. Students will also be responsible for reacting to hypothetical financial scenarios such as a trip to the hospital or a car accident. While this project focuses on the individual student and the choices they make, each student's budget will reflect on the Financial Crisis of 2008 when faced with decisions over a fixed- or adjustable-rate mortgage, for example.

Content Background

The Financial Crisis of 2008 impacted markets throughout the United States. Large corporations and small businesses suffered enormous losses and even went bankrupt. Millions were jobless, and economic growth halted. Using public funds to rescue some of the world's largest banks, many criticized the government's decisions to bail out what some viewed as greedy and unchecked investors. These actions were not unique to the American government, as the interconnectedness of global markets and economies resulted in a financial panic of international scale. Neil Barofsky's book title *Bailout: How Washington Abandoned Main Street While Rescuing Wall Street* captured what many expressed. Perhaps climatically, thousands took to the streets during the Occupy Movement to criticize the government's handling of the crisis. Though the economic crash unfolded quickly, the Financial Crisis of 2008 had been brewing a decade before the Great Recession.

The Role of Banking and the Fed in Today's Economy

To understand the economic system in the United States, one must learn the role the financial system plays in the market economy. The banking system evolved significantly from the birth of the United States when the country struggled politically to adopt a national bank and currency. Today's complex financial apparatus provides liquidity to markets and industries in the economy. Large and small financial institutions each serve a purpose for the economy. These organizations range from local commercial banks that provide mortgages to large hedge funds that invest multimillions of dollars in stocks and bonds. Comprehending the role banks play in lending and moving monies is essential for grasping the emergence of the Subprime Mortgage Crisis and the development of the Financial Crisis of 2008.

The Banking System

Commercial banks are the banks that people interact with most regularly. Individuals approach commercial banks to create a checking and savings account, deposit their paycheck, purchase a mortgage, apply for a credit card, and exercise other basic financial options. Commercial banks can vary in size as large, national commercial banks like Wells Fargo and as smaller, local banks that serve a specific region. No matter their

size, commercial banks are businesses, and therefore seek profit.

One of the most fundamental aspects of banking is how financial institutions lend money to individuals by supplying borrowers with loans. In the United States, economic freedom and social mobility are closely tied to homeownership, so individuals often approach a commercial bank to apply for a mortgage. Before approving the application for a mortgage, the commercial bank reviews the applicant's income and credit history. After the applicant pays a down payment (typically twenty percent of the value of the home), the homebuyer begins to pay the commercial bank back in the form of interest over an agreed upon term length, usually thirty years.

Interest payments serve as one of the commercial bank's forms of revenue. "Banks earn profits by charging borrowers higher rates of interest than they pay depositors and other suppliers of funds, and by charging fees for a range of other financial services."[1]   As homebuyers pay off the interest of their mortgage, they accrue equity over time by paying off the principal of the property's worth. When borrowers take out loans, they stimulate the economy by purchasing more goods and services. Investment banks, another fundamental financial entity in the banking system, also provide liquidity to the economy.

Investment banks serve a different role in the financial system and make their profits by trading on the stock and bond markets. As John Goddard and John O.S. Wilson, professors of banking and finance, put it:

> An investment bank specializes in providing investment banking services. Typically, an investment bank comprises an advisory division, specializing in underwriting, stock market flotations, and other consultancy services; and a trading division, specializing in trading on financial markets, and asset management. Most investment banks are also shareholder-owned and therefore profit-motivated.[2]

Together, with hedge funds, money market funds, and other financial services providers, investment banks make up the shadow banking system. Whereas commercial banks are subject to stricter regulatory oversight, the shadow banking system has more relaxed rules, which allows them to invest in higher-risk items, further allowing them to reap greater profits. While commercial and investment banks serve different purposes, they often work with each other to produce more profit for themselves and liquidity for the economy.

Often, investment banks purchase a commercial bank's assets, repackage them as securities, and sell them to investors. The securities, called asset-backed securities (ABSs), that investment banks trade hold the underlying assets as collateral in case a borrower defaults on their loan. This way, if payment stops, the asset changes hands and can be sold on the market. Assets can vary in form from auto loans to credit card debt. Take the example of a mortgage: Historically and throughout the twentieth century, commercial banks held mortgages on their balance sheets and were responsible for the debt if the borrower defaulted. Since banks do not have unlimited capital, commercial banks were limited in how many mortgages they could offer to other potential borrowers. The securitization of mortgages in the last few decades of the twentieth century allowed commercial banks to move the mortgages off of their balance sheets, thereby creating space to lend out more money. Although this financial practice allows for banks to reap more profit and provide liquidity to the market, depositors and investors must continue to view their banks as fundamentally solvent in order for securitization to work. Under the worst circumstances, a bank run can occur when depositors and investors rush to the bank, demanding to withdrawal their funds. Countries with large financial sectors are especially at risk of economic collapse if this happens.

In comparison to other countries, the financial sector in the United States takes up a small portion of the economy. Despite this, the American banking system has an enormous effect on the overall economy. Should the public lose confidence in their bank, the consequences can be devastating. Banks pull back on lending when borrowers and investors lose confidence in banks or when banks grow worrisome over their assets. Since banks loan out money frequently and only have to keep a certain amount of cash in their reserves, they often do not have enough money for their depositors in the event of a bank run. This series of events leads to banks pulling back on lending while raising interest rates, incentivizing people to save their money rather than to spend it.

When credit dries up in a capitalist economic system, less money circulates in the economy, and markets become illiquid. Banks raise interest rates, which leads to less spending and companies lose money, ultimately raising rates of joblessness. Alan S. Blinder, former Vice Chairman of the Federal Reserve, described the importance of the banking system to the overall economy:

> Some people think of the financial markets as a kind of glorified casino with little relevance to the *real* economy—where the jobs, factories, and shops are. But that's wrong. Finance is more like the circulatory system of the economic body. And if the blood stops flowing…well, you don't want to think about it. All modern economies rely on a variety of credit-granting mechanisms to circulate nutrients to the rest of the system, and the US economy is more credit-dependent and "financialized" than most. So when the once-copious flows of credit diminished to mere trickles, the economy experienced cardiac arrest. What had been *far too much* liquidity and credit during the boom years quickly turned into *vastly too little*. The abrupt drying-up of credit, from both banks and the so-called shadow banking system, coupled with the massive destruction of wealth in the forms of houses, stocks, and securities, produced what you might expect: less credit, less buying, and a whopping recession.[3]

The function and importance of the financial system within the American economy are essential to understand the Subprime Mortgage Crisis and the housing bubble. Financial panics such as the Subprime Mortgage Crisis were much more common in the American economy throughout the eighteenth and nineteenth centuries. For this reason, the federal government created the Federal Reserve at the beginning of the twentieth century to prevent bank runs and oversee monetary policy.

The Federal Reserve

Created in 1913, the Federal Reserve System (the Fed) oversees monetary policy for the United States. After the Panic of 1907, the US Congress chartered the Fed to create a more stable economy. Overseen by the Federal Reserve Board of Governors, the Fed promotes high employment, stable prices, and moderate long-term interest rates, while the Federal Open Market Committee (FOMC) is responsible for the conduct of monetary and interest rate policy.[4]   In addition to assigning reserve requirements, the Fed carries out these goals by overseeing the money supply, setting target interest rates, and lending money directly to banks.

The money supply is the amount of money that circulates a nation's economy. In today's complicated economic structure, the Fed oversees the money supply to control for stability in prices and moderate inflation. While it is not the sole method of implementing monetary policy, the Fed influences the amount of money in the economy through the deposit expansion multiplier. Simply put, the Fed will purchase securities from commercial banks to free up capital in their reserves.[5]   This practice incentivizes the commercial bank to

loan money to its borrowers, who will spend the money elsewhere and stimulate the economy. In addition to influencing the money supply, the Fed will also adjust interest rates on interbank lending.

In practice, the deposit expansion multiplier can become unpredictable or unstable, so the Fed instead relies on adjusting interest rates on overnight interbank lending. The Fed sets the interest target rate on the money banks loan to each other overnight. Should the Fed lower the interest target rate, loans become cheaper to borrowers.[6] By using these tools, the Fed can influence the stimulation or sedation of economic activity. In the case of a financial panic, the Fed can lend money directly to banks to stabilize economic activity to achieve a moderate inflation rate.

Events of financial panic threaten banks with the potential of a run. The Panic of 1907 and the Wall Street Crash of 1929 that preceded the Great Depression demonstrated this. Because of the structural importance of banks to the American economy, the Fed may lend money directly to banks to ensure the financial system's solvency. Goddard and Wilson described this process:

> Typically the borrowing bank must demonstrate, by posting collateral, that it qualifies for a central bank loan at the standard rate of interest, known as the discount rate. Distressed banks that fail to qualify to borrow at the discount rate, and are unable to raise funds elsewhere, may apply for an emergency central bank loan at a higher interest rate. In acting in its lender-of-last-resort capacity, [the Fed] needs to ascertain that the distressed bank is fundamentally secure, and that the loan will assist the bank in progressing on a pathway towards recovery.[7]

Because of the volatility of the banking industry throughout the Gilded Age and the turn of the twentieth century, the American government created the Fed to ensure a more sustainable economic structure. The Fed used their ability to lend money directly to distressed banks again in the aftermath of the Subprime Mortgage Crisis, just as they did during the Panic of 1907 and the Great Depression.

The Financial Crisis of 2008

The financial sector of the American economy created a significant amount of liquidity in the first decade of the twenty-first century. The securitization of ABSs quickly unraveled into a complex and opaque method of seeking profit. Ultimately, the securitization of mortgages in the form of mortgage-backed securities (MBSs) led to a housing bubble that burst in 2007 and 2008. The "financialization" of the American economy expanded the shadow banking system, as large companies such as General Electric created financial divisions to participate in stock and bond markets. The banking system's complex, intertwined structure exacerbated the impact of the Subprime Mortgage Crisis on the economy, as companies and global markets were interconnected. The Financial Crisis of 2008 saw the economic collapse of the United States' stock and bond markets, which led to the Great Recession domestically and a series of economic recessions abroad. Often thought of as a safe investment and closely linked to the American Dream, housing became the vehicle that threatened the American economy.

The Subprime Mortgage Crisis

The connection between the American Dream and homeownership is evident throughout twentieth century American politics: the creation of the Federal Housing Administration under Roosevelt's New Deal, Truman's GI Bill, and the establishment of the Department of Housing and Urban Development in Johnson's Great

Society programs. Calls to expand homeownership to low-income and racial minority groups rang again from the White House and the US Capitol during the 1990s and early 2000s. The actions taken by the Clinton and Bush Administrations echoed this message. Through the use of Fannie Mae and Freddie Mac, the federal government influenced markets to create homeownership and entry into America's middle-class for millions of residents.

The federal government expanded homeownership to millions of residents through the establishment of Fannie Mae in 1938 and Freddie Mac in 1970. Known as government-sponsored enterprises (GSEs), Freddie Mac and Fannie Mae purchased millions of mortgages from commercial banks to create liquidity in the bond market. Underwritten by taxpayers, the GSEs purchased millions of mortgages, packaged them together, and sold them as MBSs. After repackaging the MBSs, Freddie Mac and Fannie Mae traded them on the bond market. (It is important to note that these GSEs did not lend directly to borrowers. Instead, they purchased mortgages from commercial banks.) These transactions allowed both commercial and investment banks to become more profitable. Commercial banks wrote the mortgages off of their balance sheets, which enabled them to sell more mortgages to new homebuyers. As the trading of MBSs grew widespread throughout the 2000s, investment banks began to enter into this market.[8]

The securitization of mortgages became much more complicated during the 2000s. Initially, the GSEs and investment banks packaged the MBSs with other forms of securitized debt, such as auto loans or credit card debt. Traders called these bundles of different forms of debt collateralized debt obligations (CDOs). The logic behind packaging different forms of collateralized debt and thousands of loans together served to reduce the risk of all loans defaulting at the same time—a way of diversifying one's investment. Moreover, the compiled loans stemmed from different geographical areas, therefore further reducing the risk of the CDO.

Rather than investing in an entire pool of mortgages, investors purchased portions, or tranches, of pools of assets. The rating agencies rated the tranches of CDOs based on the likelihood of default. The three largest credit rating agencies drove these sales: S&P Global Ratings, Moody's, and Fitch Group. Michael Lewis, a journalist and a former bond salesman, described the packaging of securities best in his book *The Big Short*:

> A giant number of individual loans got piled up into a tower. The top floors got their money back first and so got the highest ratings from Moody's and S&P and the lowest interest rate. The low floors got their money back last, suffered the first losses, and got the lowest ratings from Moody's and S&P. Because they were taking on more risk, the investors in the bottom floors received a higher rate of interest than investors in the top floors.[9]

The rating agencies rated the most secure CDOs with a AAA rating while rating the riskiest CDOs with a BBB rating. The financial industry labeled tranches with low ratings as subprime, as borrowers within these tranches were more likely to default. Lewis explained the metrics of these ratings further:

> For instance, a bond rated triple-A historically had less than a 1-in-10,000 chance of defaulting in its first year of existence. A bond rated double-A—the next highest rating—stood less than a 1-in-1,000 chance of default, and a bond rated triple-B, less than a 1-in-500 chance of default.[10]

The securitization of mortgages grew more popular and profitable in the early 2000s.

Coupled with political pressure to expand homeownership, the government's method of creating liquidity incentivized commercial banks to engage in practices that created millions of subprime borrowers. Traditionally, commercial banks reviewed an applicant's credit history (FICO score), job security, and income. These measures affected the interest rate that the commercial bank charged the borrower. If the research conducted by the commercial bank during the application process signaled that the borrower was less likely to pay back the mortgage, the bank would either raise the interest rate on the borrower or deny them the mortgage altogether. However, with the popularity of the securitization of mortgages on the bond market, commercial banks no longer held the mortgages on their accounts. Additionally, investment banks grew confident in the securities since the GSEs guaranteed the mortgages and the rating agencies rated the securities. This practice incentivized commercial banks to lend out more mortgages, as those investing in MBSs assumed the mortgages' debt.

As a result, commercial banks began to change their lending practices due to these new incentives. Some commercial banks began to approve borrowers for mortgages by requiring little or no documentation during the application process. Borrowers with bad credit, no proof of income, and no down payment received mortgages.[11] Commercial banks also approved borrowers using adjustable-rate mortgages. These mortgages "were fixed for two or three years at an artificially low teaser rate before shooting up to the 'go-to' floating rate. 'They were making loans to lower-income people at a teaser rate when they know they couldn't afford to pay the go-to rate."[12] Borrowers took out adjustable-rate mortgages because they believed that the value of housing—often viewed as a safe investment—would only appreciate. Therefore, when borrowers had to make their balloon payments, they would own equity in their home and would be able to afford it as housing prices across the country continued to rise due to the liquidity of the market. These practices disproportionately affected low-income and racial minority groups, making them overrepresented in the pool of subprime borrowers.[13] The combination of poor incentives, predatory lending practices, and adjustable-rate mortgages created a bubble in housing prices, and the securitization of these mortgages put the entire market at risk. Nonetheless, so long as the credit rating agencies properly examined and rated the loans within each CDO, the bond markets would remain safe, right?

Wrong. As financial institutions bought, sold, and traded tranches of CDOs, the rating agencies had a fundamental issue within their rating system. When grading tranches of CDOs, the rating agencies "asked the loan packagers not for a list of the FICO scores of all the borrowers but for the *average* FICO score of the pool."[14] Additionally, the original bonds that made up the CDOs became less diverse over time, threatening their perceived safety, and putting the entire housing market in danger of collapse. Originally combined with different types of debt, MBSs now almost exclusively defined the CDOs, further decreasing the safety of the pool. In addition to the lack of diversity of debt in each tranche, poor lending practices across the country voided the perceived diversity of the CDOs, making them riskier. As an added precaution to the failure of CDOs, investment firms leveraged against risk by purchasing a form of insurance on their investments.

Investors began to purchase credit default swaps (CDSs) from financial insurance companies. CDSs acted as insurance on the CDOs that an investor purchased. When an investor and a financial insurance company negotiated a trade, the insurance company assumed the CDO's debt in exchange for monthly premium payments made to the insurance company. The investor—often from an investment bank or hedge fund—viewed this as favorable, as they were able to pass on the debt to another party while they stood to reap an enormous profit if the investment succeeded. The financial insurance company viewed the monthly premium payments as free money, as the credit rating agencies rated the CDOs. The complexity and opacity of the Subprime Mortgage Crisis exemplified how quickly money changed hands under the American financial

system to provide liquidity to economic markets. The federal government successfully created a more liquid market; however, they did so through the creation of a housing bubble that would trigger an economic collapse.

Housing prices peaked in 2006. After the housing bubble burst, America's housing market bottomed out in the fall of 2007. A financial panic ensued, and the possibility of a bank run became realistic in the winter of 2008. The financial institutions that invested most heavily in the subprime mortgage market were left prone to a bank run. Bear Stearns and Lehman Brothers were among the banks that had the largest share of their assets tied to subprime loans, making them most prone to financial fallout.[15] Additionally, credit default swap trades left American International Group (AIG), the financial insurance company, prone to a run of their own. Failing on March 16, 2008, Bear Stearns was the first massive casualty of the Financial Crisis of 2008. Lehman Brothers later failed on September 15, 2008. Each firm laid off thousands of employees—a microcosm of the effects of the Financial Crisis of 2008 that devastated the American and global economy.

The Globalization of Debt

Like the American federal government and investors on Wall Street, foreign nations participated in the securities market. As GSEs used their influence to provide liquidity to the United States' housing market, economies in Europe and Asia searched for safe investments. Fueled by trade surpluses, China and OPEC member nations, for example, accumulated considerable savings in the years before the Financial Crisis of 2008. Known as the Global Savings Glut, these economies searched for safe assets for investment purposes. Between 2003 and 2007, China bought large amounts of MBSs from Fannie Mae and Freddie Mac. As a result, the investing countries owned portions of American mortgages. Adam Tooze, an economic historian, summarized:

> China's unbalanced growth path created an excess of savings that needed to be invested abroad. AAA-rated US Treasurys were the reserve asset of choice…The availability of foreign funding negated Fed efforts to raise interest rates. At the same time it reduced the pressure on Congress to tighten fiscal policy. As capital surged in, this pushed down US interest rates, stoking the domestic economic upswing and sucking in imports, above all from China."[16]

As foreign nations invested in MBSs and provided liquidity to the US housing market, investment banks began to securitize mortgages themselves, as they saw an increase in demand. The securitization of mortgages by investment banks added to the demand the Global Savings Glut created, leading to the growth of the housing bubble and the Subprime Mortgage Crisis. In addition to the Global Savings Glut, the nature of bank relationships and the US stock and bond markets contributed to the Financial Crisis of 2008 abroad.

China and OPEC member nations were not alone in investing in US markets. European banks across the Atlantic Ocean also owned MBSs. Tooze described this when he stated, "For nonconforming high-risk MBS, those not backed by Fannie Mae or Freddie Mac, the share held by European investors was in the order of 29 percent. In 2006, at the height of the US mortgage securitization boom, a third of newly issued private label MBS were backed by British or European banks."[17] Nations from across the world invested in MBSs because they thought they were safe assets. After all, if Americans viewed MBSs as safe assets, why should foreign banks examine the underlying loans? The Subprime Mortgage Crisis exemplified the interconnectedness of banks, corporations, and national economies.

The globalization of debt intensified the economic ramifications of the Subprime Mortgage Crisis. The negligence committed by all parties left the United States financial system and the global economy prone to collapse. While the US banking system's relative size to its economy was smaller than several G-20 nations and other economically stable countries—such as the United Kingdom, Spain, China, France, Germany, South Korea, Brazil, the Eurozone, and South Africa—the sprawl of the financial system devastated the American and global economy.[18] After the housing bubble burst in the US, markets became unstable and created economic recessions throughout the world. Domestically, the federal government intervened to prevent another Great Depression.

The Spiraling of the Economy and the Government's Response

By 2008, as the United States entered into an economic recession, the S&P 500 Index collapsed as borrowers defaulted on their loans, and the foreclosure rate skyrocketed. In reaction to this, banks across the world tightened their belts by raising interest rates and cutting access to credit. Meanwhile, depositors and investors quickly lost confidence in their financial institutions. Domestic and global financial panic threatened a run on the banks, so what could the US government do to soften the blow to the United States' and global financial systems?

Reacting to the Great Recession

Initially reacting to the collapse of America's housing market, the Fed implemented traditional monetary policy tools by lowering interest rates to incentive borrowing and spending.[19] Nonetheless, the Subprime Mortgage Crisis created a downward spiral for Fannie Mae and Freddie Mac. The apparent doom of the housing market threatened the structure of the GSEs. Fannie Mae and Freddie Mac absorbed losses, which shrank their capital and raised the cost to insure their assets and borrow money. Appointed by President George W. Bush, Secretary of the Treasury Henry Paulson asked Congress to extend the GSEs' credit, "thereby making the *implicit* government guarantee *explicit*."[20] Using $140 billion, the federal government put the GSEs into government conservatorship, "guaranteeing their creditors but forcing their equity holders to absorb losses."[21] In addition to placing the GSEs into conservatorship, Congress worked to pass a stimulus bill.

The Bush Administration worked with Congress to pass the Economic Stimulus Act into law in 2008. Blinder explained the legislation:

> Most American taxpayers received a one-time income tax rebate ranging from $300 to $600 for single individuals and from $600 to $1,200 for married couples. There were also several business tax breaks, aimed at spurring investment, and, as always, a few stray cats and dogs. The one-year estimated cost of the package was about $150 billion, roughly 1 percent of GDP.[22]

This legislation neither stimulated economic activity adequately nor did the Bush Administration implement the policy quickly enough. Many Americans experienced delays by waiting months to receive their stimulus checks from the federal government. Symbolized by the failure of twenty-four mortgage lending institutions between August 2007 and November 2008, the US economy was in freefall.[23] It was clear that the Fed had to intervene in more drastic ways, especially after the collapse of Bear Stearns, the fifth-largest investment bank on Wall Street. Bear Stearns, the first catastrophic casualty of the crisis, faced an illiquidity issue, and through an intervention by the Fed, sold their assets to JP Morgan Chase. The Fed and the Treasury hoped that this

measure would sufficiently stimulate the financial sector while providing Wall Street with time to prepare for the future.

The policies enacted by the Bush Administration still proved to be insufficient. As Chairman of the Fed during the Bush and Obama Administrations, Ben Bernanke worked closely with President Bush and President-elect Barack Obama's advisors to shop Lehman Brothers to other investment banks between March and September 2008. However, Washington, DC, could not persuade investors, as Wall Street banks worried about Lehman Brothers' ability to remain solvent. Lehman Brothers—another one of Wall Street's largest five banks—was among those most exposed to the housing crisis as they had $8.2 billion in losses, in part, because they pledged forty-six percent of their owned financial instruments.[24] "Lehman Brothers, much more than Bear Stearns, was one of the grand old names of Wall Street. The 158-year-old firm had survived the Civil War, the Panic of 1907, the stock market crash of 1929, the Great Depression, and much else."[25] It would not, however, survive the Financial Crisis of 2008. After a failed attempt to get Barclay's Capital, the British investment bank, to absorb Lehman Brothers, the federal government allowed Lehman Brothers to collapse.[26]

The federal government's decision to allow Lehman Brothers to fail while assisting in saving Bear Stearns was not without controversy. The federal government chose to save Bear Stearns to avoid an economic collapse that could affect the entire United States population. So why not do the same for Bear Stearns? Moral hazard was at the center of the debate: If the Fed continued to bail out the banks, they incentivized Wall Street to continue their poor behavior. Bernanke defended the government's decision to allow Lehman Brothers to collapse by stating that the markets had six months to prepare before their failure.[27] Despite this rationale, the decision rocked the markets.

Panic ensued after the collapse of Lehman Brothers. Though Paulson and Bernanke initially objected to more bailouts, the Fed and the Treasury negotiated other deals to rescue Wall Street using taxpayer dollars. To stop the freefall of the US economy, the Fed oversaw deals, including Bank of America's absorption of Merrill Lynch and the government's decision to label Goldman Sachs and Morgan Stanley as bank holding companies. Additionally, AIG, the insurance giant that insured the securitization of mortgages using credit default swaps, received an $85 billion loan from the Fed.[28]

As banks lost confidence in the ability of individual borrowers and borrowing banks to pay back loans, banks began to hold on to their reserves instead of loaning money to other financial institutions. The Fed used quantitative easing methods to remedy the issue. This method "refers to a central bank policy of purchasing securities from banks and other financial institutions, and supplying reserves beyond the quantity required to reduce the target policy interest rate to zero."[29] The White House and Congress also worked together to pass the Troubled Assets Relief Program (TARP).

To stabilize the financial system and restore economic growth, the Bush Administration put TARP into law. The law provided $245 billion to purchase ABSs and bank stock in order to provide bank security; spent $27 billion for credit availability programs; loaned $80 billion to General Motors and Chrysler; equipped AIG with $58 billion, and contributed $46 billion for the Making Home Affordable programs. Congress initially approved more spending under TARP. However, the exorbitant amount of spending never reached what Congress agreed to provide, in part, because of the "stress tests" the Fed and the Treasury created to monitor how much money banks needed during the recovery process.[30] "[TARP] would never disburse more than about $430 billion of the permissible $700 billion, and never had more than about $360 billion outstanding at any one time."[31] Though it is less known, the federal government ultimately saw a profit of $25 billion years

later.[32] Nonetheless, the price tag was enormous. While the nearly half-trillion dollars spent prevented the Great Recession from turning into another Great Depression, controversy surrounded its passage.

Despite its economic success, taxpayers did not forget the price tag of TARP. To make matters worse, financial institutions paid their executive bonuses after receiving bailout money. While the bonuses banks previously agreed to pay were under their employees' contracts, the scandal infuriated Congress members and constituents alike. Many Democrats believed banks should be willing to accept restrictions in return for a bailout funded with taxpayer money. On the other hand, then-President of the New York Federal Reserve Timothy Geithner "wanted to tread lightly on the compensation issue, if indeed, they had to address it at all. The secretary envisioned the TARP as a facility in which banks would participate willingly, even eagerly; he knew that wouldn't happen if bank executives were forced to take pay cuts."[33] Critics also claimed that despite the return of taxpayer dollars over time, TARP allowed Wall Street to reap profits while the United States population suffered from a suppressed housing market and high unemployment.

To address these concerns, newly elected President Obama and newly appointed Secretary of the Treasury Geithner passed the American Reinvestment and Recovery Act (ARRA). The Obama Administration created a comprehensive fiscal stimulus package with the ARRA. In it, the federal government pledged $787 billion to create jobs. The law included tax relief, spending on infrastructure, expanding health care, and funding education. Critics argued that the law damaged the federal budget too severely, which "ballooned from 3.2 percent of GDP in fiscal year 2008, a pretty normal number, to an astounding 10.1 percent of GDP in fiscal 209—the largest deficit relative to GDP since World War II."[34] Nonetheless, the ARRA began to address issues of unemployment many residents faced, but structural economic issues remained, and the sprawl of the Financial Crisis of 2008 devastated the global economy.

Impacts of the Great Recession and Preventing a Future Crisis

The federal government's decisions reduced the damage of the Financial Crisis of 2008 and improved the economy (see Figure 1). Despite these policies, the consequences of the crash devastated millions of Americans. The country lost $8.8 million in jobs and $19.2 trillion in household wealth. Even after four years, Real GDP had a 5.5% output gap in comparison to what economists expected output to be if the crash never occurred. The housing market and unemployment lagged behind other forms of recovery, affecting racial minority groups and working- and middle-class residents most.[35]

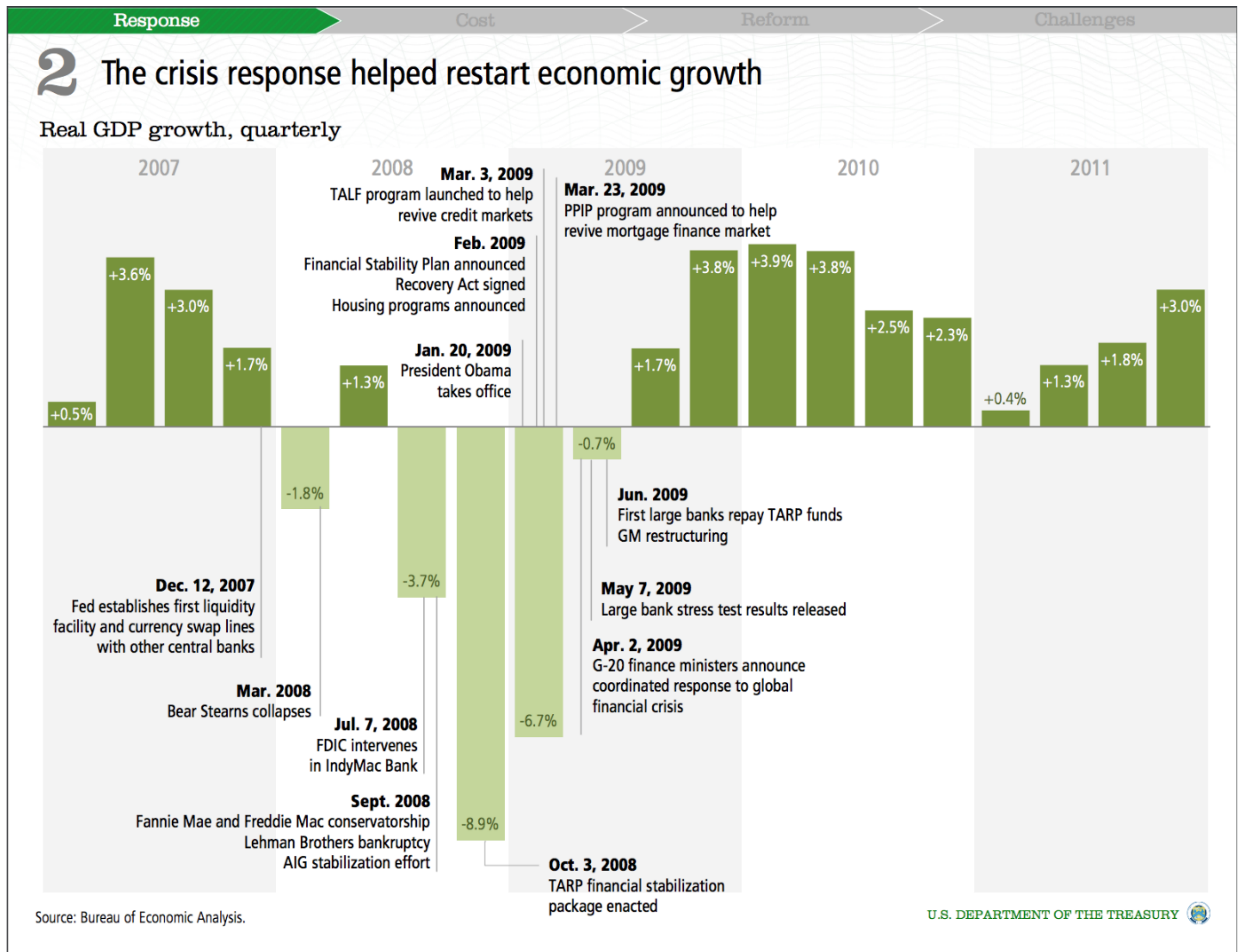


Figure 1: Shown in the graph above, the US Department of the Treasury charts the economic growth made throughout the Financial Crisis of 2008. Though the federal government's policies restarted the American economy, the housing market and unemployment remained as problems that affected the everyday lives of residents throughout the country.

Source: The Financial Crisis in Response Charts" (Washington, DC,: US Department of the Treasury, 2012).[36]

The Financial Crisis of 2008 exacerbated the racial wealth gap, as the very borrowers that benefited most from the liquidity of the market now found themselves to have higher rates of foreclosure, unemployment, and debt.[37] Although the use of GSEs as vehicles to extend homeownership to racial minority groups succeeded, the practices that led to the Subprime Mortgage Crisis put black and Hispanic groups at greater risk, as home values fell most among these groups in the aftermath of the bursting of the housing bubble.[38] In some cases, the US Department of Justice discovered racial discriminatory lending practices among some of Wall Street's largest banks. For example, Wells Fargo settled to pay $175 million over to resolve claims that stated black and Hispanic borrowers often paid higher fees while also being improperly labeled as subprime borrowers.[39] The combination of racially discriminatory lending practices with growing income inequality across the country exacerbated the racial wealth gap, which had already been growing since World War II.

The wealth gap in the United States grew in the decades leading to the Subprime Mortgage Crisis.[40] Since the 1970s, outsourcing and automation have replaced many of the country's jobs. The burst of the housing bubble restricted the flow of credit and resulted in high unemployment rates, which ravaged job rates among the country's working- and middle-class. The resulting economy threatened the livelihood of many laborers. Meanwhile, several upper-middle-class and wealthy earners recovered from the crash quickly because of their ability to invest their money in the stock market. For example, the S&P 500 Index and the country's retirement fund assets rebounded in just three years after the crisis, while unemployment and household debt remained at levels before the housing bubble burst.[41] Since working- and middle-class families often do not have the extra funds to invest their money in the stock market, they did not benefit from the economy's turnaround. These issues were not unique to the United States.

Bank bailouts took place across the world, as the Financial Crisis of 2008 hit countries with large financial systems relative to their economies the hardest. Similar to the Fed, central banks throughout Europe and Asia organized bailouts and acquisitions for failing banks. The Subprime Mortgage Crisis shocked the global economy. In Spain, for example, "20 percent of all adults and 44 percent of young people were unemployed by the summer of 2011."[42] The crash also created political ramifications, as waves of populism still affect global politics today. For example, the crisis ultimately led to Greece's exit from the European Union. Domestically, like elsewhere in the world, constituents vocalized anger over the government's response to the Great Recession.

Analyzing the Government's Response

Like the Roosevelt Administration, the Obama Administration inherited financial panic and a collapsing economy. Voters judged the Obama Administration, in large part, according to the policies it put into law. Critics of the most significant pieces of legislation passed during the crash accused both the Bush and Obama Administrations of being too friendly towards Wall Street.

The backgrounds of key policymakers provide insight into these accusations. Economists and academics proposed alternative solutions to the federal government, although these policies had logistical and political obstacles. To understand any alternative response the US government could have had to the economic crisis, the backgrounds of those that designed policy, as well as the country's political climate at the time, must be investigated.

The Key Players

Several noteworthy figures oversaw the federal government's handling of the Financial Crisis of 2008. Aside from President Bush and President Obama, three individuals within the Fed and the Treasury stood out the most: Henry Paulson, a former CEO of Goldman Sachs, served in the Bush Administration as Secretary of the Treasury. During the Bush Administration, Timothy Geithner first served as President of the New York Federal Reserve—the most important of the Fed's branches—in close contact with Wall Street's investment banks. Once inaugurated, President Obama appointed Geithner as his Secretary of the Treasury to replace Paulson. Then there was Ben Bernanke, a former professor of economics at Princeton University that served as Chairman of the Fed under the Bush and Obama Administrations. Understanding Paulson, Geithner, and Bernanke reveal a lot about the voices that oversaw the collapse of Lehman Brothers and the passage of TARP

After housing prices peaked in 2006 and Bear Stearns collapsed in March 2008, Wall Street and Washington, DC worried about which investment bank would fall next. It quickly became apparent that Lehman Brothers

was fundamentally insolvent, and the federal government attempted to broker a deal with another financial institution to save the company. Though, as competitors, few Wall Street banks eagerly offered to rescue Lehman Brothers. After all, its potential failure only strengthened its competitors' grasp on the market. Andrew Ross Sorkin, author of *Too Big to Fail: The Inside Story to How Wall Street and Washington Fought to Save the Financial System—and Themselves*, captured these motives when describing how Paulson and Geithner oversaw JP Morgan's purchase of Lehman Brother's assets. In the below passage, H. Rodgin Cohen, a prominent Wall Street lawyer, called Paulson and Geithner on behalf of McGee and McDade, two of Lehman Brothers' executives:

> For the next ten minutes the room was a cacophony of different conversations taking place simultaneously, all on the common theme of *They're trying to put us out of business!* Finally they decided that the best step to take was to call Tim Geithner.
>
> When Cohen reached Geithner and put him on speakerphone, he quickly explained the situation to him. Geithner appeared unconcerned, as if he had been expecting their call. McGee shot a nervous glance at McDade, as if to say, *We're fucked.* "I cannot advise a bank not to protect itself," Geithner said unperturbedly.
>
> Cohen, politely hoping to get Geithner to realize that he believed JP Morgan was doing this to undermine its rival, asked, "Do they need that protection?"
>
> "I'm not in a position to judge that," Geithner answered.[43]

Jamie Dimon, CEO of JP Morgan, wished to protect his bank first and foremost, and Geithner understood Dimon's motives. Despite being a lifetime bureaucrat, Geithner understood how Wall Street operated, and he recognized the importance that Wall Street's remaining investment banks must remain solvent. Ultimately, Lehman Brothers failed, but perhaps the federal government could create financial stability by incentivizing banks to rely less on public money—a clear motivation of Paulson's.

After the failure of Lehman Brothers, Paulson worried about the political consequences of another government-sponsored bank bailout. Unlike Geithner's position at the Fed, a publicized political process surrounded the US Secretary of the Treasury's appointment. In the wake of the Great Recession, Paulson was the face of the Financial Crisis of 2008. The deregulation of America's financial system created the Subprime Mortgage Crisis, and Paulson was politically aware that if the federal government asked taxpayers to support the very banks that created the financial disaster, chaos would ensue. Sorkin spoke about Paulson's message to Wall Street following the deal for Lehman Brothers:

> Perhaps most important, Paulson stressed, was that they couldn't afford the political liability of putting up government money for Lehman as they had for Bear Stearns. "I can't be Mr. Bailout," he insisted. He had been getting calls from politicians all week suggesting as much. Senator Dodd had called earlier to tell Paulson, "Fuld is a friend. Try to help, but don't bail Lehman out." Given that everyone on the conference call had already lived through the backlash of the Bear deal, they hardly needed convincing about not wanting to repeat it.
>
> Still, Geithner was a bit hesitant about taking such a severe stance in public, but only because, as he explained, "we don't want to scare people away. We need as many bidders in this as

possible."

Nonetheless, he quickly fell in line, and the four men made a pact: Unless something miraculous happened, they would plan to place calls to the CEOs of the major Wall Street houses late on Friday and have them all come down to the NY Fed, where they'd press them to come up with a private solution.

In the meantime, Paulson instructed them, the message should be clear: *No bailouts.*[44]

Perhaps more shielded from politics, Geithner hesitated at the strength of Paulson's message. Of course, Paulson never fully realized his wish, though this was unknown to Wall Street at the time. Paulson, Geithner, and Bernanke worked together to coordinate perhaps the most controversial policy of the Financial Crisis of 2008: the TARP legislation, otherwise known as the bank bailout. This time, Paulson and Bernanke offered different approaches.

The positions of each policymaker again influenced their ideas for legislation on TARP. Bernanke proposed to inject capital into the country's banking system by purchasing bank shares from Wall Street's largest financial institutions. The Chairman of the Fed believed his proposal leveraged government money through the deposit expansion multiplier. A former academic and economist himself, Bernanke's idea did not account for the political backlash it would have faced, as Blinder detailed:

But the less cerebral, more action-oriented Treasury secretary overruled Bernanke on both political and market grounds. Politically, a proposal to purchase bank shares, thus making the government a part owner of the largest banks in the country, would be decried as socialism by Republicans and vilified as gifts to fat-cat bankers by Democrats. Paulson knew it wouldn't stand a chance in Congress. Furthermore, on market grounds, even a partial nationalization of the banks would scare off private investors, to whom the Treasury and the Fed were still looking to bolster the ailing bank's capital.[45]

After rejecting Bernanke's proposal, Wall Street's danger of becoming insolvent forced Paulson to reconsider his original stance on a bank bailout. Ultimately, the federal government introduced TARP by purchasing toxic assets from banks. When introduced to the legislation by Paulson, Wall Street executives expressed shock at how little the federal government asked of them.

After nervously watching the markets fall after Lehman Brothers' collapse, Paulson, Geithner, and Bernanke invited the CEOs of Wall Street to Washington, DC, without any details as to why they were meeting. The federal government surprised the executives with the TARP law. Sorkin recapped the introduction of the policy to the banks:

Geithner now read off the amount that each bank would receive, in alphabetical order. Bank of America: $25 billion; Citigroup: $25 billion; Goldman Sachs: $10 billion; JP Morgan: $25 billion; Morgan Stanley: $10 billion; State Street: $10 billion; Wells Fargo: $25 billion.

"So where do I sign?" Dimon said to some laughter, trying to relieve the tension, which had not dissipated now that the bankers had learned why they had been summoned.[46]

To their surprise, the federal government would bail out the banks. Dimon's comments captured the mood at the meetings when he sought formal approval from JP Morgan's board of directors:

> In stark contrast, Dimon's tone when he spoke to his own board was bleak. "This is asymmetrically bad for JP Morgan," he said, whispering into his cell phone. In other words, the money would help the weaker banks catch up to them. "But we can't be selfish. We shouldn't stand in the way."[47]

While Wall Street banks understood the potential to strengthen their position in the market, they also recognized the importance of the country's financial system to the rest of the economy. The complexity that Dimon's phone call illustrates the difficult position Paulson, Geithner, and Bernanke had. On the one hand, the federal government had to build confidence in the banking system using public or private measures. On the other, Wall Street understood what its institutions meant to the country's economic state. Navigating this dilemma proved difficult. As Blinder wrote, "The institutional interests of the *political* Treasury and the *technocratic* Fed were not always perfectly aligned, and all TARP decisions were bound to be highly political."[48] Much of the decisions made by Paulson, Geithner, and Bernanke depended on how shielded they were from the politics of Washington, DC,. In hindsight, was there an alternative option to the bank bailout that was economically and politically viable?

An Alternative Response

After the federal government passed TARP into law, individuals still faced large amounts of debt. After the burst of the housing bubble, borrowers paid for mortgages that were no longer worth their value on the market. So, those with underwater mortgages stopped payment and defaulted on their loans. To counter this, the Obama Administration created the Home Affordable Modification Program, which reduced interest rates.[49] Perhaps unsurprisingly, these same borrowers defaulted again on their mortgages just months later, as the issue with an overly inflated principal on mortgages remained. John Geanakoplos, economist and hedge fund manager, testified before Congress to suggest an alternative solution to the Home Affordable Modification Program and the federal government's plan to bail out the banks.

Geanakoplos proposed that Congress and the Fed create a program that reduced the principal on underwater mortgages so that the principal would no longer exceed the house's value on the market. Securitization created an obstacle to this solution because the markets sliced mortgages so thinly, and hundreds of bondholders owned each mortgage. Nonetheless, the proposal carried some weight. Shapiro explained the details of this Geanakoplos' idea:

> [Geanakoplos] reasoned that writing down the principal owed on the loans would mitigate losses as compared to the costs of foreclosing on properties, evicting homeowners, and then reselling what would likely be dilapidated properties subject to accumulated liens. The better course, [Geanakoplos] argued, would be to write down principal to the point where the mortgage was no longer underwater, giving homeowners an incentive to continue making payments on their loans and keep their homes.[50]

In other words, the economically sensible thing to do was to bail out the homebuyers, not the banks. This

way, policy tackled both the depressed housing market and the rising foreclosure problem. Meanwhile, the banks would see some return on the mortgages they loaned out or invested in through securitization. So why did the Obama Administration not go for this idea?

Obstacles to Reform

The weakness of the United States' two major political parties explains much of the Obama Administration's decisions in the aftermath of the Financial Crisis of 2008. Despite efforts made by figures such as US Senator Elizabeth Warren, the Obama Administration ultimately allowed Wall Street and its lobbyists to determine the fate of regulatory policies, such as the Dodd-Frank Act. The shortcomings of the Democrats and Republicans, in part, paralyzed the White House and Congress to implement substantial change that the working- and middle-classes supported. Rooted in economic insecurity and wealth inequality, the country witnessed waves of populism from both sides of the political spectrum after Wall Street influenced the country's political process.

Wall Street's Influence

Populist sentiment on the Left and the Right called for structural change to Wall Street and the country's financial system as the crash unfolded. John C. Coffee Jr., a Columbia Law School professor, explained patterns of voter sentiment in his theory of the regulatory sine curve. According to Coffee's theory, constituents pressure government officials most following a significant event; however, as time passes, the public's rage dissipates, providing the opportunity for industries to lobby the government for more favorable policies.[51] When applied to the calls made by voters to regulate Wall Street, the theory of the regulatory sine curve helps illustrate the policies implemented by the White House and Congress.

After the passage of TARP in October 2008, Paulson's political worries over the bailout payments became real, and public outrage called for a restructuring of the shadow banking industry when voter outrage perhaps peaked in March 2009. Recently surfaced news of Wall Street executives receiving bonuses from TARP bailout money incensed voters, especially after the White House saved Chrysler and GM from bankruptcy. Worried about public demands to restructure the financial system, Obama and Geithner hosted a dinner at the White House with CEOs of Wall Street's thirteen largest banks. Realizing the public dilemma the country's financial leaders faced, Obama addressed the Wall Street executives at dinner when he stated, "My administration is the only thing between you and the pitchforks."[52] Wall Street's investment bankers feared that Obama would threaten to restructure the country's entire financial system—a plan that Geithner opposed. Instead, the White House offered protection by suggesting that the banks propose voluntary limits on compensation until public anger subsided. Ron Suskind, journalist and author of *Confidence Men: Wall Street, Washington, and the Education of a President*, recounted the bankers' surprise to Obama and Geithner's protection:

> "The sense of everyone after the big meeting was relief," said one of the bankers. "The president had us at a moment of real vulnerability. At that point, he could have ordered us to do just about anything, and we would have rolled over. But he didn't—he mostly wanted to help us out, to quell the mob. And the guy we had to thank for that was Tim. He was our man in Washington."[53]

Preferring to avoid revolutionary change, Geithner only wished to establish confidence in the country's banking system, and Obama seemed to agree. While Wall Street had the support of the White House, members of Congress continued to call for systemic reform publicly.

Elizabeth Warren represented one of Wall Street's biggest obstacles in Washington, DC,. Warren criticized Obama for the difference between his public comments and the policies Geithner, Obama's appointed Secretary of the Treasury, created. Suskind chronicled Warrens remarks:

> "You can't run a policy based on a misdirection, on a fiction," she said. "I don't know what the president is thinking. I don't see the president. He meets with bankers. He doesn't meet with me. But if he's involved at all, he's got to know that his angry words at Wall Street, at their recklessness and dangerous incentives in compensation, about how they do their business in ways utterly divorced from what's actually good for the economy—that he can't just say that sort of thing, and then dump money in their laps and be credible. Tim and Larry [Summer's] whole plan is just like Argentina in the 1980s. There was this giant hole marked 'Banks' and the government just dumped money in that hole, as much as they had, while they lied about it. That's what Larry thinks; that the US is Argentina!"[54]

Although figures such as Warren gave Obama advice on how to create regulatory policy, Geithner and other advisors gained the President's attention. Moreover, while several voters shared Warren's view, the executives that ran the country's most powerful banks knew they just had to wait for voter outrage to fade, especially after knowing they had the White House's support.

A year after the White House dinner, Congress passed Dodd-Frank into law. The Dodd-Frank Act served to create regulations for the financial system to prevent a future economic collapse. Of several new policies, Dodd-Frank raised reserve requirements, expanded the Federal Deposit Insurance Corporation (FDIC), established the Consumer Financial Protection Bureau (CFPB), created the Financial Stability Oversight Council, started the Securities and Exchange Commission Office of Credit Ratings, and constructed the Sarbanes-Oxley Act as a whistleblower program. The new law also included the Volcker Rule to limit the amount of risky investments banks could deploy by moving back towards the Great Depression's Glass-Steagall Act, which Congress repealed during the 1990s.

The Obama Administration promised structural change, but the final product of the Dodd-Frank Act delivered less than critics hoped. Voters and politicians argued in support of significant changes to the financial system's structure. Suskind wrote, "Most of those practices, though, remained intact, and the prevailing sense was one of uncertainty. With an already expected backlash in the coming midterms, there were whispers among conservatives over how they would be able to cut down the bill after November."[55] As the Obama Administration worked with Congress to create Dodd-Frank, Wall Street committed billions in lobbying Washington, DC, to have components of the bill changed.[56] Geithner, the same individual that helped bail out the banks with Paulson and Bernanke, was the leading architect that outlined a proposal for Dodd-Frank. Under Geithner's leadership, the White House wrote and sent their proposal for congressional consideration. At its passage, Dodd-Frank looked virtually identical to the proposal put forth by the US Treasury. Figure 2 shows a side-by-side comparison of some of the Treasury's proposal and the final version of Dodd-Frank:

Issue/Provision	**Key Aspects of the Debate**	**Treasury Proposal (2009)**	**Dodd-Frank Act (2010)**

Too big to fail	· New resolution authority or use bankruptcy courts? · Break up TBTF institutions?	· New resolution authority; FDIC as receiver or conservator · No · Living wills	· New resolution authority; orderly liquidation by FDIC · No taxpayer bailouts · No · Living wills
Glass-Steagall barriers	Reinstate them?	No	No
Securitization	How to regulate the market	5% "skin-in-the-game" for originators	5% "skin-in-the-game" for originators
Proprietary trading by banks	Ban or restrict it?	No restrictions	Volcker Rule
Consumer protection	· A new, independent bureau? · Plain-English documents? · Require plain vanilla and good default options	· Free-standing Consumer Financial Protection Agency · Yes · Yes	· Consumer Financial Protection Bureau "within" but independent of Fed · No · No

Figure 2: In his book, Blinder described the topics the White House and Congress debated. He then compared the US Department of the Treasury's proposal to the final product of Dodd-Frank. The two pieces had several similarities. This table shows a few examples of the topics considered by the Treasury and Congress.

Source: Alan S. Blinder, *After the Music Stopped: The Financial Crisis, the Response, and the Work Ahead* (New York: Penguin Books, 2014), 307-309.[57]

Up until its passage, fights within the White House and on Wall Street shaped the law's policies. For example, Warren called for the creation of the CFPB to monitor lending practices and support everyday consumers. In the end, Geithner diluted Warren's proposal for an independent CFPB as he shrunk the agency and placed it under the supervision of the Fed.[58] Geithner became a challenging opponent for reformers. As time passed after the onset of the Financial Crisis, the regulatory policies proposed by politicians like Warren and voiced by frustrated voters proved Coffee's theory of the regulatory sine curve.

It seemed that even the proposals that Wall Street fought against favored them in the end. University of Chicago economist George Stigler studied this dilemma:

> Stigler's insight was that regulations are potentially valuable to players in an industry, and that the most powerful ones will capture regulators, inducing them to supply rules that protect them from competition and otherwise enhance their interests. On Stigler's view, the regulations that large firms in an industry demand might lead to inefficiencies within it, particularly if the costs of compliance create expensive barriers to entry for smaller firms.[59]

When combined, Coffee's and Stigler's observations provided the financial industry with tremendous lobbying power. In other words, Wall Street lobbyists not only held an advantage by delaying the implementation of regulatory policy but the regulations the federal government ultimately put forth likely supported their interests. For example, Dodd-Frank required banks to hold higher amounts of capital in their reserves. Initially, Wall Street strongly advocated against the raising of capital reserve requirements. However, this

stipulation ultimately helped them in the future, as smaller banks struggled to compete with larger banks, thus limiting market competition for the larger banks. Ultimately, Wall Street's lobbying influence proved to be too big of an obstacle for the White House and Congress to enact significant reform.

The Obama Administration's regulatory shortcomings materialized, in part, due to the weakness of political parties in the United States. Known as retail clientelism, weak political parties in a two-party system often cater their policies to large companies or industries, rather than to a large group of the electorate.[60] For example, the Democratic Party adhered to the regulatory proposals Wall Street's lobbyists suggested. As a result, rather than listening to suggestions put forth by those such as Geanakoplos, Warren, or the general public, the White House catered its legislation to the same banks that caused the Subprime Mortgage Crisis. The weakness of the country's political parties and their decision to favor Wall Street led to waves of populism among the nation's liberal and conservative sides of the political spectrum.

The Rise of Populism and the Swing of the Pendulum

The Financial Crisis of 2008 exacerbated issues of economic insecurity and wealth inequality. While voters experienced the erosion of the United States' middle-class, liberals and conservatives viewed the Obama Administration's regulatory policies as a concession to Wall Street. Opinions on the Left pointed to the greed of Wall Street and the nation's growing wealth inequality as the source of economic collapse. These feelings manifested themselves in the Occupy Movement when thousands of protesters took to the streets of New York City and other cities around the world to decry the economic structure of the United States. Perhaps the economically sensible solution that Geanakoplos offered Congress would have alleviated the protestors' anger since his plan prioritized homebuyers over banks. Meanwhile, sentiment on the Right expressed the ridiculousness of Geanakoplos' proposal and outrage over the federal government's taxing and spending habits in the aftermath of the Financial Crisis of 2008.

Politically, Geanakoplos' proposal would have never made it through Congress. Best encapsulated by Rick Santelli's rant on *CNBC*, taxpayers wanted to pay for their neighbor's mortgage *even less* than they wanted to bail out the banks. This belief explains how individuals are likely to compare themselves to local groups.[61] In other words, the average taxpayer did not compare themselves to those that ran Wall Street. Instead, they measured themselves against those within their socioeconomic class. Using the logic behind Santelli's viral clip, taxpayers were likely to resent homebuyers if the government reduced the principal value of their home. The sentiment behind Santelli's rant launched the Tea Party Movement and the worry of "big government"— a concept that dates back to the Declaration of Independence and its list of grievances against the British Empire. While the Fed and Congress implemented unprecedented monetary and fiscal policy measures to rescue the American economy, the Tea Party Movement argued that the federal government overstepped their bounds.

Like Santelli, so many others across the country voiced outrage about the Obama Administration's overspending of tax dollars. The Tea Party grew after Santelli's response to the Obama Administration's Homeowners Affordability and Stability Plan. Although the Tea Party was predominately an anti-tax movement, it also had components of anti-elitism and racism. It also voiced ideas rooted in conspiracy theories, such as the Obama Birther Movement.[62] From the perspective of the Tea Party, the federal government spent too much of the taxpayer's money while also advocating for previously marginalized groups through the implementation of affirmative action policies. Mostly white, working-class citizens resented these government-sponsored policies. The Tea Party viewed affirmative action policies as contributing to the advancement for racial minority groups while leaving their community behind at a time when incomes

stagnated and job opportunities diminished. Members of the Republican Party mobilized this portion of the electorate in the midterm and general elections following Obama's inauguration.

In 2010, the Tea Party helped usher in a Republican-controlled House of Representatives during the midterm elections. In 2012, when Mitt Romney ran against Obama in the presidential election, Romney chose Paul Ryan—one of the Tea Party's most prominent supporters—as his running mate. The emergence of populist politics in the United States put the weakness of the country's political parties on display, as both groups played into the identity politics of today's climate.

Rooted in racism, Donald Trump initiated the Obama Birther Movement, when the Tea Party Movement first started. Using the fundamental components of the Tea Party, Trump campaigned in the 2016 presidential election on a populist platform, advocating for protectionist economic policy and an anti-immigration agenda. Once in office, Trump engaged in tariff duels with China and the European Union. The Trump Administration also fought for the repeal of Dodd-Frank and passed new taxation policies that favored the wealthy.[63] Riled by Trump's policies and rhetoric, the Democrats responded in the 2020 presidential primary by campaigning on several issues that the Occupy Movement initially raised. For example, messages from Bernie Sanders and Elizabeth Warren focused on wealth inequality and economic insecurity. Democratic candidates also campaigned for the expansion of healthcare, reforming the criminal justice system, and providing affordable housing—many policies such as these specifically targeted racial minority voters.

Both Democrats and Republicans lack party leadership and are unable to create a coalition among working- and middle-class voters across racial and socioeconomic lines. Each party still has not adequately protected the middle-class and has, therefore, become susceptible to the swinging of the political pendulum. The stark division across party lines leads to the empowerment of lobbying efforts by industry officials. For example, Washington, DC,'s regulatory policies allowed Wall Street banks to benefit, which exacerbated the ideological divide and set the stage for today's politics. The United States' two-party system is not the sole reason for its political weakness, as countries with historically strong political parties within multiparty systems have also struggled to react to the economic crash.

The Financial Crisis of 2008 also threatened political stability elsewhere in the world. In Spain, for example, the PSOE and PP—the socialist and conservative political parties, respectively—dominated Spanish politics since the 1980s; however, because of Spain's multiparty system, their political system was prone to a rise in popularity among fringe parties, especially after a watershed moment. For example, shortly after the Financial Crisis of 2008, Podemos, a progressive political party, formed and took votes from PSOE. In later years, Vox, a far-right political party, took votes from the PP. The PSOE and PP's inability to maintain strength during the economic collapse threatened the country's ability to govern efficiently, as both parties had to form coalitions with the fringe parties to create a majority in parliament. Multiparty systems—even systems with strong political parties—allow for the rise in support of fringe parties, threatening the country's ability to govern effectively. Both the US and Spain experienced the rise of populism and its harm to their political systems. In many ways, the popularity of Podemos mirrored the support socialist democrats saw in the United States with the candidacy of Bernie Sanders for the presidency. At the same time, similarities in Vox's platform more closely align with that of the Tea Party Movement's interests.

Economic insecurity breeds political extremism, and moments of economic crisis exacerbate this issue further. Countries like the United States and Spain, where political parties and structures are weak, are most susceptible to unproductive politics. In the United States, the power of lobbyists contributes to ineffective government, and multiparty systems with strong political parties are not much better off, as seen in the case

of Spain. In turn, two-party systems with strong political parties are best equipped to handle moments such as an economic recession, which may render political systems paralyzed. The examination of a country's political structure assists in understanding and contextualizing a government's response to the Financial Crisis of 2008, while it also makes the causes of today's political divide more clear. Creating policy that builds a coalition and provides economic security among working- and middle-class voters during a period of outsourcing and automation may be challenging for Democrats and Republicans; however, perhaps it offers a solution to the political gridlock in the United States.

The decisions the Obama Administration made impacted the entire economic and political structure, and the day-to-day lives of millions of residents changed dramatically. In understanding the Financial Crisis of 2008 and the ensuing Great Recession, it is crucial to realize the importance of the federal government's role in the economy as well as the role of the banking system, as the policies the federal government and financial system pursue affects the financial life of individual residents nationwide.

The Importance of Personal Finance

By studying personal finance practices, individuals can best prepare themselves for a safe and healthy financial life. The importance of budgeting is instrumental in practicing responsible spending and saving habits, especially for students that are entering into young adulthood. While economically devastating moments such as the Financial Crisis of 2008 can disrupt an individual's financial well-being, budgeting and saving can prove to be useful tools in today's economy.

(Note: Before reading the section below, it is important to note that the reader should only interpret these sections as guidelines to follow. Since financial situations vary depending on individual circumstances, some of these suggestions may not be realistic, especially to those that may struggle to make ends meet. However, discussing these tips with students provides them with a structure to use in their daily lives. Additionally, it provides an opportunity to speak about the importance of stable job security and well-paying employment opportunities in today's economy and how events such as the Financial Crisis of 2008 disrupts the economic livelihood of so many people.)

Budgeting

Individuals should create a personal budget to monitor their finances. Employment status and lifestyle are some things that determine the parameters for a budget. An adequately assembled budget divides expenses into two forms of spending groupings: wants and needs and fixed, periodic, and variable spending.

Expenses should be divided into wants and needs to discern the degree of necessity for spending items. This way, it is easy to distinguish between things that are essential such as housing, groceries, and utilities versus things that are not as necessary, like entertainment and vacation. If confronted with a financial obstacle, it is better to cut back on wants. This way, an individual is still able to afford the necessities listed in their budget. Spending money on wants may vary depending on a person's financial situation. For example, when facing a period of unemployment, an individual should position themselves to reduce spending on their wants first. If the pressure of joblessness subsides, then the individual may feel more comfortable spending money listed in their wants categories. In addition to separating expenses into the categories of wants and needs, it is important to define each budgetary expense as a fixed, variable, and periodic form of payment.

The nature of fixed, variable, and periodic expenses varies according to the nature of each method of payment. Fixed expenses remain constant between months, such as rent or a phone bill. Periodic expenses

are fixed but do not require payment each month. For example, insurance bills often arrive six months, so it is crucial to create a fixed amount of savings to set aside during each month. This way, when the insurance bill arrives periodically, the individual can afford to pay the bill. Unlike fixed and periodic costs, variable expenses fluctuate between months, so it is necessary to set a limit on each variable spending category. Individuals should exercise financial discipline to avoid overspending in variable expense categories, as well as fixed and periodic forms of payment. Variable spending categories may include groceries, utilities, and entertainment. (It is also important to note that wants and needs and fixed, periodic, and variable spending groupings are not mutually exclusive; they depend on the nature of a budget's list of expenses.) After separating expenses into these categories, individuals should ensure that they are spending the appropriate amount of money in each category.

Before measuring the appropriate limit on each expense category, individuals must first calculate their amount of after-tax monthly income. After doing this, they should separate their income into three categories: wants, needs, and savings. Professionals such as Elizabeth Warren advise that individuals should spend fifty percent of their income on needs, thirty percent on wants, and twenty percent on savings.[64] Figure 3 shows an example of a monthly budget that follows these recommendations. To construct a robust and comprehensive budget, individuals must also understand the importance of interest.

Expense	**Amount Budgeted**	**Amount Paid**	**Description**
Rent	$ 800	$ 800	May rent
Utilities	$ 150	$ 125	Water, sewage, gas, electric, and trash
Groceries	$ 200	$ 150	Supermarket and farmer's market
Transportation	$ 100	$ 80	Public transportation
Cable, media, and other subscriptions	$ 200	$ 200	Cable, Wi-Fi, cell phone plan, and newspaper
Household supplies	$ 50	$ 10	Cleaning supplies and hardware
Personal (clothes, haircuts, etc.)	$ 150	$ 25	Haircut
Discretionary	$ 250	$ 75	Restaurants, movies, and video games
Reserve savings (short-term)	$ 150	$ 150	Monthly amount for short-term savings (e.g. renter's insurance)
Growth savings (long-term)	$ 350	$ 350	Monthly amount for long-term savings

Figure 3: This budget shows the suggestions that Warren advises people to use by showing a sample budget for someone with a $2,600 after-tax monthly income. For example, the above-listed expenses of rent, renter's insurance, utilities, groceries, and transportation make up the needs category and total fifty percent of the budget. The wants category includes cable, media, and other subscriptions, personal (clothes, haircuts, etc.), and discretionary items. Together, these expenses make up twenty percent of the budget. The savings categories of reserve and growth savings, therefore, fulfill the budget's remaining twenty percent. Although the example is not an exhaustive list, it provides a basic breakdown of an individual's after-tax budget.

Source: Eric Whiteside, "What Is the 50/30/20 Budget Rule?," Investopedia, 2020, https://www.investopedia.com/ask/answers/022916/what-502030-budget-rule.asp#:~:text=Senator Elizabeth Warren popularized the,socking away 20%25 to savings.[65]

Individuals should learn the advantages and disadvantages interest rates play in constructing a budget. To understand this, one must realize the role interest rates play in loans and savings. When compounded, interest rates can add tremendous cost to things like credit card debt, as the debt owed on a late payment will compound itself during the next billing cycle. However, if handled correctly, interest rates can be used to save money as well. For example, when an individual deposits their money into a savings account, the amount deposited will accrue interest. This way, individuals can grow their savings, which would not occur if they held onto their money.

Methods of Saving

It can be challenging to plan for the future, which is why individuals should treat saving money as a monthly expense. To best prepare for tomorrow, individuals should save approximately twenty percent of their monthly income each month. Savings should be treated as a fixed expense that the individual deposits into a separate savings account each month. Long-term savings should be held in a standalone savings account so that the money can accrue interest. Ideally, a person would save to at least the point that they have six months' worth of expenses in their savings account. This way, they will have enough money in the case that they become unemployed. Using savings accounts also helps individuals organize their expenses.

Transferring money each month to a short-term savings account for periodic budgeting expenses can also be used as an effective way to organize a budget. When using the previously mentioned insurance example, individuals should divide their biannual insurance bill by six months. This way, individuals can move this amount into a short-term savings account to properly save the required amount for the insurance bill. By separating future periodic payments from a checking account, the individual avoids mistaking that they have money in their checking account that can be used for discretionary expenses. Individuals should feel comfortable using a savings account at a commercial bank because the federal government insures the deposited money.

Opening a savings account at a commercial bank provides individuals with small interest accrual and organizational structure to their budget. It is also safe to open up a savings account at a commercial bank because deposited money is insured. Today, the FDIC insures accounts up to $250,000. However, as mentioned before, traditional savings accounts do not yield high interest rates. Additionally, if a depositor has more than $250,000 in savings and the bank experiences a run, the depositor will lose the difference of their savings and the FDIC's guarantee. For these reasons, individuals must also consider investing in the markets.

Many associate investing in the bond and stock markets with day trading. People often day trade hoping they can beat the average returns of the market. Day traders are highly unlikely to do this. It is necessary to recognize the risks associated with buying and selling individual stocks, bonds, and other financial products. Instead, people can invest in broad-based index funds.

Index funds contain a portfolio of different segments of the market. Investing in index funds allows an individual to purchase an already diversified financial product. Charles Ellis, author of *Winning the Loser's Game: Timeless Strategies for Successful Investing*, wrote that index funds have, on average, "higher returns, lower fees, lower operating costs, lower taxes, lower risk of errors or blunders, and lower anxiety about errors or blunders."[66] In other words, investing in index funds is safer, more profitable, less time-consuming, and more accessible than day trading. Investing in broad-based indexes can be made even easier when working for a company that offers investment plans as a benefit to employees.

Depending on the occupation, many companies offer their employees the ability to invest in mutual funds

through 403(b) or 401(k) plans. These tax-deferred retirement plans allow investors to organize their budget easily. Since employers will deduct an investor's contribution to their retirement plan directly, individuals can quickly build this method of saving money as a fixed expense in their budget. Additionally, 403(b) and 401(k) plans require little maintenance, as investors often review their plans on an annual basis.

Building a personal budget and properly saving money allows individuals to keep track of their finances. Strengthening one's financial literacy can lead to a more predictable and stable economic future. Though these methods are not immune to larger economic forces, they may assist in reducing the impact individuals face from events such as the Financial Crisis of 2008. Because of this, it is crucial to analyze the intersection of individuals, financial institutions, and the federal government in today's economy.

Questions for the Immediate Future

Examining the Financial Crisis of 2008 and the Great Recession has challenged societies into questioning these entities' roles in our economy. This period of economic history confronts the role of housing in the American Dream, the insecurity of joblessness in today's economy, and negotiating a new social contract.

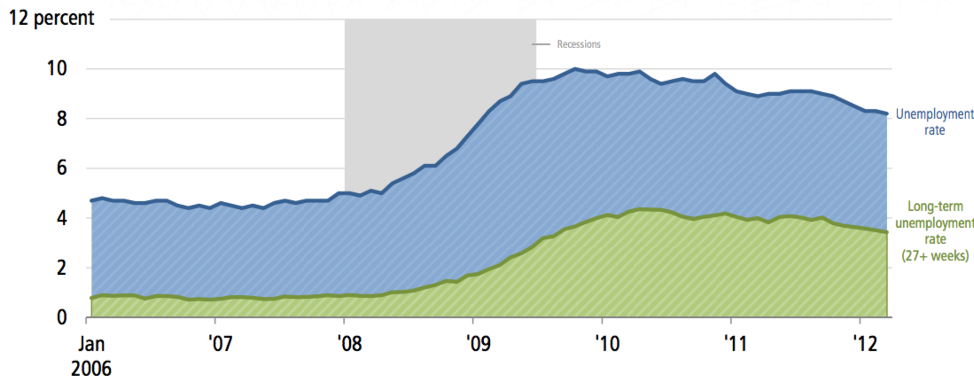
Among the takeaways from studying the Financial Crisis of 2008 is the role housing plays in the American Dream. In the United States, homeownership has typically symbolized feelings of meritocracy and independence. Individuals often view their house as an asset that they worked hard for, fostering a sense of pride. Owning property has always created a feeling of independence for many Americans. Financially, individuals have historically viewed housing as a safe investment. Though, as the Financial Crisis of 2008 shows, it should not be. When adjusting for inflation, real home prices have remained flat throughout American history.[67] Furthermore, housing cannot be a safe asset in today's job market.

Following the Financial Crisis of 2008, unemployment rates lagged behind economic recovery efforts. The economic collapse also delayed growth in GDP, as real GDP measures showed a 5.5% growth gap (see Figure 4). These statistics impacted the financial security of individuals and affected their quality of life. These figures are considerably alarming during a time when many workers can expect to have over twelve jobs throughout their lifetime, as outsourcing and automation have replaced many working- and middle-class opportunities for employment.[68] To tackle the issue of homeownership, governments and markets must first solve the problem of job security. For these reasons, individuals are beginning to question the need to revise the social contract.

Response | Cost | Reform | **Challenges**

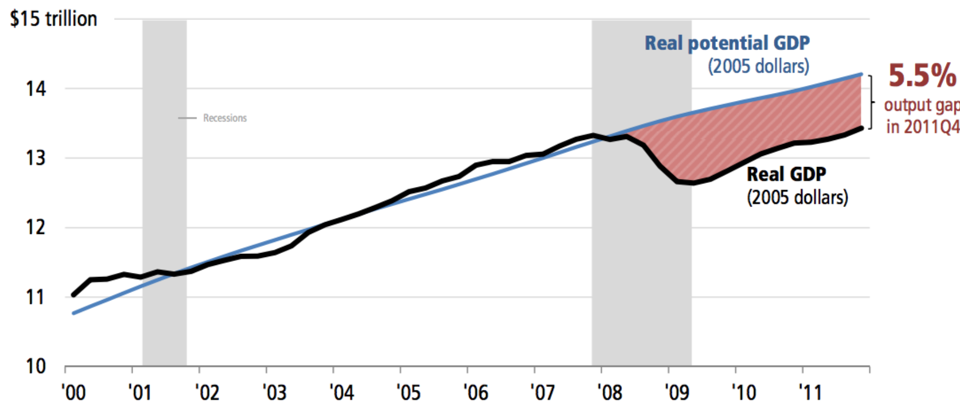
16 The economy still has far to go to fully recover from the financial crisis

Unemployment rate, percent of the labor force



▶ Unemployment has fallen, but it still remains high.

Real output gap



▶ Economic output remains well below its potential.

Source: Bureau of Labor Statistics, Congressional Budget Office.

U.S. DEPARTMENT OF THE TREASURY

Figure 4: The chart above illustrates the gap in Real GDP that existed as a result of the Financial Crisis of 2008. It also shows that while the economy has recovered since the Financial Crisis of 2008, the recovery of unemployment levels was still not attained after four years. Thus, the consequences of the Great Recession affected individuals long after the federal government implemented policy. At the same time, Wall Street quickly generated profit after the federal government enacted TARP and Dodd-Frank.

Source: "The Financial Crisis in Response Charts" (Washington, DC,: US Department of the Treasury, 2012).[69]

Unfortunately, the consequences of the Financial Crisis of 2008 remain visible today, as millions have been exposed to SARS-CoV-2, the strand of coronavirus that has shut down the global economy. COVID-19 has killed millions and has impacted the financial livelihood of many others. The current pandemic has challenged how society thinks about the social contract and today's economic structure. For example, *The Financial Times* argued for a new social contract and an examination of our current economic and financial systems. The newspaper's editorial board wrote:

> The economic lockdowns are imposing the greatest cost on those already worst off. Overnight millions of jobs and livelihoods have been lost in hospitality, leisure and related sectors, while better paid knowledge workers often face only the nuisance of working from home. Worse, those

in low-wage jobs who can still work are often risking their lives—like careers and healthcare support workers, but also as shelf stackers, delivery drivers and cleaners.

Governments' extraordinary budget support for the economy, while necessary, will in some ways make matters worse. Countries that have allowed the emergence of an irregular and precarious labour market are finding it particularly hard to channel financial help to workers with such insecure employment. Meanwhile, vast monetary loosening by central banks will help the asset-rich. Behind it all, underfunded public services are creaking under the burden of applying crisis policies.

The way we wage war on the virus benefits some at the expense of others. The victims of Covid-19 are overwhelmingly the old. But the biggest victims of the lockdowns are the young and active, who are asked to suspend their education and forgo precious income. Sacrifices are inevitable, but every society must demonstrate how it will offer restitution to those who bear the heaviest burden of national efforts.

Radical reforms—reversing the prevailing policy direction of the last four decades—will need to be put on the table. Governments will have to accept a more active role in the economy. They must see public services as investments rather than liabilities, and look for ways to make labour markets less insecure. Redistribution will again be on the agenda; the privileges of the elderly and wealthy in question. Policies until recently considered eccentric, such as basic income and wealth taxes, will have to be in the mix.

Today's pandemic reflects many of the issues from the Financial Crisis of 2008. However, we can remain hopeful, as pieces such as this outline the relationship between economics and the human condition, rather than examining economic forces through charts and graphs. Devastating as they are, the Financial Crisis of 2008 and the COVID-19 Pandemic push us to reexamine the nature of our economic system and how we can improve the lives of all.

Teaching Strategies

This curriculum unit uses the following teaching strategies to teach the content background. While other instructional methods may be included, these listed strategies most effectively teach the content at Bodine High School.

Analyzing Film and Texts

Students will read journals, magazines, government documents, and newspaper articles. Excerpts and video clips from *Understanding the Crash*, *The Big Short: Inside the Doomsday Machine* (the book and the movie), *After the Music Stopped: The Financial Crisis, the Response, and the Work Ahead*, *Confidence Men: Wall Street, Washington, and the Education of a President*, and *Winning at the Loser's Game: Timeless Strategies for Successful Investing* will be assigned. These readings will offer information on the Financial Crisis of 2008 and the Great Recession to learn about economics, banking, and personal finance. By relying on and citing textual evidence from contemporary news sources, debating topics of the Financial Crisis of 2008 will improve

literacy and critical thinking skills.

Occupational Outlook Research

The Financial Crisis of 2008 serves as a reference for students to understand the impact the economic crisis had on the working- and middle-class. Each student will research an occupation of their choice. Using this occupation, they will research their anticipated salary to create a monthly budget. Students will use information from the US Department of Labor to research the type of schooling and training needed in their corresponding job field. Additionally, students will research the job growth rate as well as any benefits that are common for their desired occupation.

Monthly Budget

Using a template, students will create a realistic monthly budget according to a researched salary. They will have to account for issues such as mortgage payments, forms of transportation, methods of saving, and investing in today's market. Ideally, this strategy will help students transition into their first year of adulthood, as many students will take on debt from student loans and will begin to work as young professionals. This strategy both encourages students to remain informed about the country's economic state while also assisting them in learning to become responsible with their own money.

Classroom Activities

The following lesson plans are listed and described below to ensure that students properly understand the unit's concepts. This is not an exhaustive list for this curriculum unit. (Note: SWBAT = Students will be able to; IOT= in order to).

The Subprime Mortgage Crisis

Objective:

SWBAT watch *The Big Short* and read *Understanding the Crash* IOT identify the causes of the Great Recession.

Materials:

- *The Big Short*
- *Understanding the Crash*
- *Understanding the Crash* reading guide

Procedure:

Students will complete a reading guide as they read Seth Tobocman and Eric Laursen's *Understanding the Crash*. The complexity of the Subprime Mortgage Crisis will be scaffolded as students also watch *The Big Short*. By pairing the graphic novel with the film, students will read chapters and watch scenes to facilitate their learning. In addition to reading the graphic novel and watching the film, lectures will provide a detailed

analysis of the development of the housing bubble in the United States. By analyzing items such as collateral debt obligations, credit default swaps, and tranches, students will identify the inner workings of the banking and bond market systems. They will learn about compound interest rates, fixed- and adjusted-rate mortgages, and the importance of credit. These components allow for students to focus on the roles banking and homeownership play in the United States economy.

After reading the graphic novel and watching the film, students will analyze the role players such as commercial banks, investment banks, rating agencies, insurance companies, hedge funds, the Federal Reserve, and others had in the events that led to the crisis. In a one-page short response, students will assign responsibility to at least one of these figures. (To demonstrate a more nuanced understanding, students may select more than one figure.) Students will refer back to this assignment when reviewing the government's response in crucial pieces of legislation such as TARP and Dodd-Frank.

Occupational Outlook

Objective:

SWBAT research a job in five different fields IOT identify different types of income and understand the importance of job security.

Materials:

- Laptop
- US Department of Labor Occupational Outlook website

Procedure:

Using data from the US Department of Labor, students will research an occupation from five different categories: high school diploma, college degree, advanced degree, municipality, and manual labor. They will research the occupation's title, description, the projected number of new jobs, growth rate, median pay, and any training or education needed. Students are encouraged to research a job that they would enjoy pursuing.

After researching five different occupations, students should choose the job that they wish to have in order to make the project more realistic. In several short responses, students will explain their interests in the job, the advantages and disadvantages of the occupation, their plan to attain this profession, how to improve their qualifications, and the experiences desired from this position of employment.

Monthly Budget

Objective:

SWBAT create a monthly budget IOT calculate and track their spending.

Materials:

- Laptop
- Occupational outlook activity
- Google Sheets monthly budget template
- Suggested or Ideal Spending Practices worksheet

Procedure:

Using their salary from the occupational outlook activity, students will create a monthly budget that takes into account taxes, mortgage/rent, transportation, groceries, discretionary spending, savings, and other budget items. Using a series of daily lesson plans, students will examine if they should buy or rent property, where they should live, if they should have a roommate, and more. Students will use the Google Sheets Monthly Budget Template to track their spending. Students will learn the appropriate ratios of their savings and expenses. They will also examine the importance of credit and debit, different types of mortgages, and investing strategies.

After calculating their expenses, students must label each expense as a fixed, variable, or periodic expense. After completing the budget template, students must write a one-page reflection to elaborate on the decisions they made. For example, a student may explain why they chose to purchase a fixed-rate mortgage rather than an adjustable-rate mortgage. They may also wish to describe the reason they chose to take public transportation to their place of work rather than purchasing a car.

Lastly, students will engage in a class discussion that asks them to think about job security and the effects of the Financial Crisis of 2008 on people's financial lives. This way, students will understand how the study of economics affects the human condition. Ideally, this project will also provide a simple method in which students can keep track of their actual money after they graduate high school.

Resources

This unit plan required several resources, and they are listed below by category: for teachers, students, and classroom use.

Annotated Bibliography for Teachers

Ahamed, Liaquat. *Lords of Finance: The Bankers Who Broke the World*. New York: Penguin Books, 2009. Ahamed's account of the United States' financial system during the early 1900s provides a useful perspective on the origins of modern banking.

Blinder, Alan S. *After the Music Stopped: The Financial Crisis, the Response, and the Work Ahead*. New York: Penguin Books, 2014. Blinder, a former member of the Fed, recounts the development of the Financial Crisis of 2008 and the federal government's reaction to it.

Coffee Jr., John C. "The Political Economy of Dodd-Frank: Why Financial Reform Tends to Be Frustrated and Systemic Risk Perpetuated." *Cornell Law Review*, 2012. Coffee discusses how regulatory practices reflect the shape of a sine curve.

Dasgupta, Partha. *Economics: A Very Short Introduction*. *Very Short Introduction*. Oxford: Oxford University Press, 2007. In this short book, Dasgupta introduces the fundamental components of the study of economics.

Ellis, Charles D. *Winning the Loser's Game: Timeless Strategies for Successful Investing*. New York: McGraw-Hill, 2002. Charles Ellis explains the advantages of investing in index funds while providing the reader with

other simple investment strategies.

Goddard, John, and John O.S. Wilson. *Banking: A Very Short Introduction*. *Very Short Introduction*. Oxford: Oxford University Press, 2016. Goddard and Wilson summarize the inner workings of today's financial system.

Graetz, Michael J., and Ian Shapiro. *The Wolf at the Door: The Menace of Economic Insecurity and How to Fight It*. Boston: Harvard University Press, 2020. In this book, the authors describe how wealth inequality, economic policy, and American politics converge.

Kent, Ana, Lowell Ricketts, and Roy Boshara. "What Wealth Inequality in America Looks Like: Key Facts & Figures." Federal Reserve Bank of St. Louis, 2019. The Fed's report examines the crash's effects on income inequality and the racial wealth gap.

Mallaby, Sebastian. *More Money than God: Hedge Funds and the Making of a New Elite*. New York: Penguin Books, 2010. Mallaby recounts the emergence of hedge funds and the extreme amounts of wealth they create for their investors.

Mian, Atif, and Amir Sufi. *House of Debt: How They (and You) Caused the Great Recession, and How We Can Prevent It from Happening Again*. Chicago: The University of Chicago Press, 2015. Together, Mian and Suf present the causes of the Great Recession and strategies on how to prevent a future economic collapse.

Morgenson, Gretchen, and Joshua Rosner. *Reckless Endangerment: How Outsized Ambition, Greed, and Corruption Created the Worst Financial Crisis of Our Time*. New York: St. Martin's Griffin, 2011. The authors of this book discuss the role politics and moral hazard played in the development of America's housing bubble.

Olsen, Skylar. "A House Divided - How Race Colors the Path to Homeownership." *Zillow, Inc.*, 2014. https://www.zillow.com/research/minority-mortgage-access-6127/. Olsen details the effects of the Subprime Mortgage Crisis across racial demographic data.

Shapiro, Ian. "Three Views of Regulation," n.d. Shapiro describes how retail clientelism relates to the United States' two political parties.

Sorkin, Andrew Ross. *Too Big to Fail: The Inside Story to How Wall Street and Washington Fought to Save the Financial System—and Themselves*. New York: Penguin Books, 2018. In exceptional detail, Sorkin depicts the conversations on Wall Street and Washington, DC, during events such as the Lehman Brothers collapse and the passage of TARP.

Suskind, Ron. *Confidence Men: Wall Street, Washington, and the Education of a President*. New York: Harper Perennial, 2011. Suskind analyzes the key politicians and figures of the federal government's response to the crash.

Swagel, Phillip. "The Cost of the Financial Crisis: The Impact of the September 2008 Economic Collapse." Washington, DC,: PEW Economic Policy Group, 2009. In this detailed report, Swagel details the consequences of the crash.

Tooze, Adam. *Crashed: How a Decade of Financial Crises Changed the World*. New York: Penguin Books, 2019. As an economic historian, Tooze contextualizes the Financial Crisis of 2008 by describing the political and economic events that led to and followed the economic crash.

Student Reading List

Clifford, Jacob, and Adriene Hill. “The 2008 Financial Crisis: Crash Course Economics #12.” Crash Course, 2015. https://www.youtube.com/watch?v=GPOv72Awo68. Crash Course’s economic contributors distill the development of the Financial Crisis of 2008 for students.

Hayes, Adam. “Target Rate Definition.” Investopedia, 2019. Investopedia provides an excellent, web-based source for students to research terms related to economics and finance.

Johnston, Matthew. “A Brief History of U.S. Banking Regulation.” Investopedia, 2020. This webpage outlines a basic history of the American banking system at a student reading level.

Lewis, Michael. *The Big Short: Inside the Doomsday Machine*. New York: W. W. Norton & Company, 2011. Lewis, a former bonds salesman, explains the development of the Subprime Mortgage Crisis in vivid detail.

“The Financial Crisis in Response Charts.” Washington, DC,: US Department of the Treasury, 2012. The US Treasury’s report illustrates the federal government’s response to the Great Recession in a series of charts.

The United States Department of Justice. “Justice Department Reaches Settlement with Wells Fargo Resulting in More Than $175 Million in Relief for Homeowners to Resolve Fair Lending Claims,” 2012. https://www.justice.gov/opa/pr/justice-department-reaches-settlement-wells-fargo-resulting-more-175-million-relief. This report summarizes Wells Fargo’s settlement over racial discriminatory lending practices.

Tobocman, Seth, and Eric Laursen. *Understanding the Crash*. New York: Soft Skull Press, 2010. Tobocman and Laursen’s graphic novel illustrates the development of the Subprime Mortgage Crisis and its effects on individual homeowners.

Whiteside, Eric. “What Is the 50/30/20 Budget Rule?” Investopedia, 2020. https://www.investopedia.com/ask/answers/022916/what-502030-budget-rule.asp#:~:text=Senator Elizabeth Warren popularized the,socking away 20%25 to savings. Whiteside summarizes Elizabeth Warren’s advice for creating a budget.

List of Materials for Classroom Use

The Editorial Board. “Virus Lays Bare the Frailty of the Social Contract.” *The Financial Times*, 2020. The newspaper’s editorial board reframes the perspective of the social contract.

Google. “Monthly Budget.” Accessed July 13, 2020. https://docs.google.com/spreadsheets/d/17F8Wl9TfsvsQTFlZva5jstPlcs3srYZWUvJ0EnMSSwI/edit#gid=0. Students can use this template to create their budgets.

McKay, Adam. *The Big Short: Inside the Doomsday Machine*. Paramount Pictures, 2015. McKay recreates Lewis’ book in the form of a movie. This film pairs well with Lewis’ book and Tobocman’s graphic novel.

Metrick, Andrew, and Timothy Geithner. “The Global Financial Crisis.” Yale University, 2020. Metrick and Geithner partner together to provide an online course on the Financial Crisis of 2008.

Shapiro, Ian. “Lecture 19: Crisis, Crash, and Response.” YaleCourses, 2019. https://www.youtube.com/watch?v=uYJLyGoWbzY&list=PLh9mgdi4rNeyViG2ar68jkgEi4y6doNZy&index=19.

In this lecture, Shapiro describes the development of the economic crisis as a culmination of events that create the perfect storm.

Shapiro, Ian. "Lecture 20: Fallout: The Housing Crisis and Its Aftermath." YaleCourses, 2019. https://www.youtube.com/watch?v=5v1EtiEuSEY&t=7s. Here, Shapiro explains how the Financial Crisis of 2008 relates to job security, housing, and the American Dream.

Shapiro, Ian. "Lecture 21: Backlash - 2016 and Beyond." YaleCourses, 2019. https://www.youtube.com/watch?v=-5QM1DBSRLw&list=PLh9mgdi4rNeyViG2ar68jkgEi4y6doNZy&index=22&t=3s Shapiro reports how the global financial crisis led to the consequences and reactions of today's politics.

Appendix on Implementing District Standards

Below is a list of standards from the social studies section of the Commonwealth of Pennsylvania's Department of Education. These standards will be used as a guideline to allow students to think critically about the Financial Crisis of 2008.

Civics and Government

Standard - 5.2.12.C: Evaluate political leadership and public service in a republican form of government. Students will examine the role members of the Federal Reserve, the White House, and the US Congress played in developing and reacting to the Financial Crisis of 2008.

Standard - 5.3.12.C: Evaluate how government agencies create, amend, and enforce regulations. By examining the roles and responsibilities of the Fed and the US Department of the Treasury, students will analyze how monetary and fiscal policy affects the nation's economy.

Economics

Standard - 6.2.12.F: Evaluate the impact of private economic institutions on the individual, the national and the international economy. Students will study the American financial system through the development of the Subprime Mortgage Crisis. More specifically, students will identify the role homebuyers, commercial banks, investment banks, hedge fund companies, financial insurance companies, government-sponsored enterprises, and other key players had in the development of the Financial Crisis of 2008.

Standard - 6.3.12.B: Assess the government's role in regulating and stabilizing the state and national economy. Using critical pieces of legislation and policy, students will learn how the government regulates the economy through both fiscal and monetary policy.

Notes

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[6] Adam Hayes, "Target Rate Definition," Investopedia, 2019.

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[8] Ian Shapiro, "Lecture 20: Fallout: The Housing Crisis and Its Aftermath," YaleCourses, 2019, https://www.youtube.com/watch?v=5v1EtiEuSEY&t=7s.

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[10] Lewis, 51.

[11] Lewis, 96.

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[15] Andrew Metrick and Timothy Geithner, "The Global Financial Crisis" (Yale University, 2020).

[16] Adam Tooze, *Crashed: How a Decade of Financial Crises Changed the World* (New York: Penguin Books, 2019), 38.

[17] Tooze, 75.

[18] Metrick and Geithner, "The Global Financial Crisis."

[19] Metrick and Geithner.

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[29] Goddard and Wilson, *Banking: A Very Short Introduction*, 69.

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[31] Blinder, *After the Music Stopped: The Financial Crisis, the Response, and the Work Ahead*, 205.

[32] Blinder, 206.

[33] Blinder, 188.

[34] Blinder, 234.

[35] “The Financial Crisis in Response Charts” (Washington, DC,: US Department of the Treasury, 2012).

[36] “The Financial Crisis in Response Charts.”

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[41] “The Financial Crisis in Response Charts.”

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[43] Andrew Ross Sorkin, *Too Big to Fail: The Inside Story to How Wall Street and Washington Fought to Save the Financial System—and Themselves* (New York: Penguin Books, 2018), 297.

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