

# Financial Crises—Lessons Learned from History(?)

Jeremy Atack

Research Professor and Professor Emeritus of Economics at Vanderbilt  
and Research Associate, NBER  
([Jeremy.atack@vanderbilt.edu](mailto:Jeremy.atack@vanderbilt.edu))

From a long-term historical perspective, several things distinguish the current financial crisis from similar events in our past. The most obvious is its duration—now, almost certainly, the second longest in our history (the Great Depression lasted longer)—but note, it isn't over yet.... Another less obvious (but I believe extremely important) difference is the heavily muted policy response, particularly in terms of reforming our institutions with the goal of preventing a similar event from similar sources in the future (see also, for example, Gordon Brown's opinion "Stumbling Toward the Next Crash" in the 12/18/2013 *New York Times* [http://www.nytimes.com/2013/12/19/opinion/gordon-brown-stumbling-toward-the-next-crash.html?\\_r=0](http://www.nytimes.com/2013/12/19/opinion/gordon-brown-stumbling-toward-the-next-crash.html?_r=0)). This course looks back at the Crisis and tries to see what lessons we failed to learn from (earlier) history.

The readings (and video) supplement and complement the class presentations.

"Course" outline:

- Lecture 1. Refresher on the timeline of the current crisis (see attached) and the mechanics of banking (View the four part (3 hour) Aljezeera documentary. The first two parts are the more important/relevant: <http://www.youtube.com/watch?v=JYTyluv4Gws>, <http://www.youtube.com/watch?v=Bp7c2Wo9YDc>, <http://www.youtube.com/watch?v=L20DhfgPugE> and <http://www.youtube.com/watch?v=osAYMnqZyZc> Alternatively, you might want to page through PBS's "Frontline" offering on the topic: <http://www.pbs.org/wgbh/pages/frontline/oral-history/financial-crisis/>). Overview of economic crises in U.S. history. Current projections on the economic costs of the crisis (<http://www.dallasfed.org/assets/documents/research/eclett/2013/el1307.pdf>).
- Lecture 2. "Too big to fail." Are some banks/financial institutions just "too big" or "too important" to the economic system for them to be allowed to fail? From Knickerboker Trust to WaMu by way of Bank of United States and Continental Illinois. You might enjoy watching HBO's movie "Too Big to Fail" (2011: <http://www.hbo.com/movies/too-big-to-fail>); you certainly should read <http://www.americanbanker.com/bankthink/Continental-Illinois-Too-Big-to-Fail-1045154-1.html> and <http://www.federalreservehistory.org/Events/DetailView/47> (representing an insider view and a Federal Reserve "policy" view).
- Lecture 3. Competition in banking. Who creates banks (and regulates them) and how they interact with each other and with the political system (read

<http://www.occ.gov/publications/publications-by-type/other-publications-reports/national-banks-and-the-dual-banking-system.pdf>). The significance of a name (e.g., Bank, Trust, Credit Union, Savings and Loan)? How Glass-Steagall (1933) tried to solve the problem but “failed” (read <http://www.nerdwallet.com/blog/banking/glass-steagall-act-explained/>).

The global economy.

Lecture 4. Capitalization—illiquidity and insolvency. How and why banks fail now and then (<http://www.youtube.com/watch?v=EY-HYUFICPs> and [http://www.charlotteobserver.com/2008/10/11/246983/5-billion-withdrawn-in-one-day.html#.UtAjH\\_ZZXRm](http://www.charlotteobserver.com/2008/10/11/246983/5-billion-withdrawn-in-one-day.html#.UtAjH_ZZXRm)). Banking panics and the Nashville connection (Read:

<http://tennesseeencyclopedia.net/entry.php?rec=172> and

<http://tennesseeencyclopedia.net/entry.php?rec=171> (in that order)).

Competition, profitability and risk. Externalities and moral hazard. Deposit insurance (and Glass-Steagall of 1933) (watch

<http://www.youtube.com/watch?v=sKjdT8I6TnE&feature=Playlist&p=8F56B911DBF53F48&index=0&playnext=1> and

<http://www.youtube.com/watch?v=EOzMdEwYmDU>).

Lecture 5. Changes in the banking business model. Debt, bonds, bond ratings and the replacement of “fallen angels” with junk bonds, subprime mortgages and Alt-A. The pernicious role of securitization, especially mortgage securitization (read <http://www.dailyfinance.com/2011/04/01/court-busted-securitization-prevents-foreclosure/> and <http://money.howstuffworks.com/mortgage-backed-security.htm>. View: <http://www.pbs.org/wgbh/pages/frontline/oral-history/financial-crisis/tags/credit-rating-agencies/>). You might also want to watch HBO’s movie “Barbarians at the Gate”

([http://www.youtube.com/watch?v=iPhF\\_YwWvoM](http://www.youtube.com/watch?v=iPhF_YwWvoM)) for a refresher on some of the events of the 1980s.

Lecture 6. The role of the central bank as lender in last resort, especially the creation of the Federal Reserve (1913) and its performance in 20<sup>th</sup> and 21<sup>st</sup> century crises, especially during the post-WWI depression, the Great Depression (Glass-Steagall of 1932 and 1935), the 1980s and the current crisis (View: <http://www.pbs.org/wgbh/pages/frontline/oral-history/financial-crisis/tags/federal-reserve/> and

<http://wealthtrack.com/recent-programs/james-grant-richard-sylla-great-fed-debate/>). Volker, Greenspan and Bernanke. If you want to hear

Chairman Bernanke’s own take on Federal Reserve activities in a series of lectures, visit <http://www.federalreserve.gov/aboutthefed/cls-timeline/timeline/>.

The following “rap” videos were commissioned for the annual meeting in Jackson Hole, Wyoming: Round 1--

<http://www.youtube.com/watch?v=d0nERTFo-Sk> Round 2--

<http://www.youtube.com/watch?v=GTQnarzmTOc>). They brilliantly capture the nature of the economic policy debates that are still ongoing.

## The Financial Crisis: A Timeline, 2007-2009.

Timeline of key events	
<b>2007</b>	
9 August	Problems in mortgage and credit markets spill over into interbank money markets when issuers of asset-backed commercial paper encounter problems rolling over outstanding volumes, and large investment funds freeze redemptions, citing an inability to value their holdings.
12 December	Central banks from five major currency areas announce coordinated measures designed to address pressures in short-term funding markets, including the establishment of US dollar swap lines.
<b>2008</b>	
16 March	JPMorgan Chase agrees to purchase Bear Stearns in a transaction facilitated by the US authorities.
4 June	Moody's and Standard & Poor's take negative rating actions on monoline insurers MBIA and Ambac, reigniting fears about valuation losses on securities insured by these companies.
13 July	The US authorities announce plans for backstop measures supporting two US mortgage finance agencies (Fannie Mae and Freddie Mac), including purchases of agency stock.
15 July	The US Securities and Exchange Commission (SEC) issues an order restricting "naked short selling".
7 September	Fannie Mae and Freddie Mac are taken into government conservatorship.
15 September	Lehman Brothers Holdings Inc files for Chapter 11 bankruptcy protection.
16 September	Reserve Primary, a large US money market fund, "breaks the buck", triggering large volumes of fund redemptions; the US government steps in to support insurance company AIG (and is forced to repeatedly increase and restructure that rescue package over the following months).
18 September	Coordinated central bank measures address the squeeze in US dollar funding with \$160 billion in new or expanded swap lines; the UK authorities prohibit short selling of financial shares.
19 September	The US Treasury announces a temporary guarantee of money market funds; the SEC announces a ban on short sales in financial shares; early details emerge of a \$700 billion US Treasury proposal to remove troubled assets from bank balance sheets (the Troubled Asset Relief Program, TARP).
25 September	The authorities take control of Washington Mutual, the largest US thrift institution, with some \$300 billion in assets.
29 September	UK mortgage lender Bradford & Bingley is nationalised; banking and insurance company Fortis receives a capital injection from three European governments; German commercial property lender Hypo Real Estate secures a government-facilitated credit line; troubled US bank Wachovia is taken over; the proposed TARP is rejected by the US House of Representatives.
30 September	Financial group Dexia receives a government capital injection; the Irish government announces a guarantee safeguarding all deposits, covered bonds and senior and subordinated debt of six Irish banks; other governments take similar initiatives over the following weeks.
3 October	The US Congress approves the revised TARP plan.
8 October	Major central banks undertake a coordinated round of policy rate cuts; the UK authorities announce a comprehensive support package, including capital injections for UK-incorporated banks.
13 October	Major central banks jointly announce the provision of unlimited amounts of US dollar funds to ease tensions in money markets; euro area governments pledge system-wide bank recapitalizations; reports say that the US Treasury plans to invest \$125 billion to buy stakes in nine major banks.
28 October	Hungary secures a \$25 billion support package from the IMF and other multilateral institutions aimed at stemming growing capital outflows and easing related currency pressures.

29 October	To counter the protracted global squeeze in US dollar funding, the US Federal Reserve agrees swap lines with the monetary authorities in Brazil, Korea, Mexico and Singapore.
15 November	The G20 countries pledge joint efforts to enhance cooperation, restore global growth and reform the world's financial systems.
25 November	The US Federal Reserve creates a \$200 billion facility to extend loans against securitizations backed by consumer and small business loans; in addition, it allots up to \$500 billion for purchases of bonds and mortgage-backed securities issued by US housing agencies.
<b>2009</b>	
16 January	The Irish authorities seize control of Anglo Irish Bank; replicating an approach taken in the case of Citigroup in November, the US authorities agree to support Bank of America through a preferred equity stake and guarantees for a pool of troubled assets.
19 January	As part of a broad-based financial rescue package, the UK authorities increase their existing stake in Royal Bank of Scotland. Similar measures by other national authorities follow over the next few days.
10 February	The US authorities present plans for new comprehensive measures in support of the financial sector, including a Public-Private Investment Program (PPIP) of up to \$1 trillion to purchase troubled assets.
10 February	G7 Finance Ministers and central bank Governors reaffirm their commitment to use the full range of policy tools to support growth and employment and strengthen the financial sector.
5 March	The Bank of England launches a program, worth about \$100 billion, aimed at outright purchases of private sector assets and government bonds over a three-month period.
18 March	The US Federal Reserve announces plans for purchases of up to \$300 billion of longer-term Treasury securities over a period of six months and increases the maximum amounts for planned purchases of US agency-related securities.
23 March	The US Treasury provides details on the PPIP proposed in February.
2 April	The communiqué issued at the G20 summit pledges joint efforts by governments to restore confidence and growth, including measures to strengthen the financial system.
6 April	The US Federal Open Market Committee authorises new temporary reciprocal foreign currency liquidity swap lines with the Bank of England, ECB, Bank of Japan and Swiss National Bank.
24 April	The US Federal Reserve releases details on the stress tests conducted to assess the financial soundness of the 19 largest US financial institutions, declaring that most banks currently have capital levels well in excess of the amount required for them to remain well capitalised.
7 May	The ECB's Governing Council decides in principle that the Eurosystem will purchase euro-denominated covered bonds; the US authorities publish the results of their stress tests and identify 10 banks with an overall capital shortfall of \$75 billion, to be covered chiefly through additions to common equity.
<small>⁂⁂ See Chapter VI of the BIS's 78th Annual Report, June 2008, for a more comprehensive list of events up to March 2008. Sources: Bank of England; Federal Reserve Board; Bloomberg; <i>Financial Times</i>; <i>The Wall Street Journal</i>. <span style="float: right;">Table II.1</span></small>	

Source: Bank for International Settlements, 79<sup>th</sup> Annual Report, pp. 18-9  
<http://www.bis.org/publ/arpdf/ar2009e2.htm>.

For a more comprehensive timeline with links to Congressional testimony and other materials (some of which may require training as an economist), see  
<http://timeline.stlouisfed.org/index.cfm?p=timeline>