



Team Economy

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The unfolding of the financial crisis is the biggest of its kind since 1929 and may possibly lead to the meltdown of the financial system. The globalized feature of the crisis, and the international position of the dollar would contribute to the crisis' hundreds of billions—if not trillions—of dollars in cost. The huge costs, in turn, raise the question of who bears—and who will bear- the burden? The candidates' positions on these issues will be discussed in this paper.

The financial deregulation over the last 25 years, coupled with liberalization of the international capital market, serves as a background for the housing bubble. This bubble, which started in the later part of the 1990's, accelerated after the burst of tech and stock market bubbles of 2000 and 2001, respectively. These bubble bursts, along with the deregulations of the financial markets, triggered a sharp decrease of interest rate and lowered discipline in lending, thus affecting the real estate sector. The low savings rate and the tremendous and ever increasing income inequality in the US also contributed to the crisis.

Due to deregulation, such as Glass-Steagall, there was an increase in the use of Special Purpose Vehicles (SPVs) within financial institutions. The lowered discipline in lending allowed the regulated institutions (banks) to lend money to many high-risk home buyers, in the form of sub prime loans. The regulated institutions proceeded to take mortgages off of their balance sheets by selling them to unregulated SPVs. The unregulated institutions packaged these mortgages into bonds, which were inaccurately rated and purchased by domestic and international investors, many of whom were unaware of the risk of the repackaged/backing of these bonds.

By purchasing insurance through institutions such as AIG, investors could safeguard their investments which protected them against bond defaults. The insurance which supported these artificially rated bonds was then sold to several brokers. The brokers then bundled the risky securities with the lesser risk insurance packages and resold them as bonds to the public. These packages were also sold to national and international investors.

Previously, while the market was stable and mortgage-backed securities were being sold at a premium, financial institutions leveraged these assets. Companies such as Merrill Lynch made unprecedented profits by, for example, leveraging \$30 billion in equity and borrowing \$1 trillion.

Finally, the decrease in home prices, which had previously risen a great amount in many areas, caused mortgages to no longer be valued by the underlying asset. The mortgage borrowers were given grace periods before their principle and interest payments were due. With the burst of the bubble, in combination with principle on mortgage and interest due on a house purchased a few years prior, many home owners were unable to

meet the requirements. Increasing delinquencies caused many homeowners to experience foreclosures and the corresponding mortgage-backed securities lost their value. These events sent investors scrambling to sell their bad assets (Mortgage Backed Securities), but could not get buyers to pay the original price, if able to sell at all, leading to large losses. Once these financial institutions did not have available liquidity to pay back the interest of the issued bonds, they were forced to ask for government aid or fall into bankruptcy.

The huge financial issues our country is facing have spread beyond our borders and are affecting many banks throughout the world. The lack of liquidity has spread throughout the U.S. economy, leading to a slower growth and recession, leaving domestic and international investors unable to conduct business as usual, which has exacerbated the crisis. The crisis, a United States born disaster, has snowballed into a global problem with international ramifications.