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“DEREGULATION OF THE UNITED STATES FINANCIAL SYSTEM: ITS IMPACT ON THE 2008 FINANCIAL CRISIS”

GRADUATION WORK TO OBTAIN THE DEGREE OF BACHELOR IN INTERNATIONAL STUDIES, MAJOR IN FOREIGN TRADE

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Dedicatory

I would like to dedicate this graduation work first to God who allowed this goal was achievable. Second, to the teacher who knew how to cheer me up when everything was confusion, to the friend who heard all my comments about this work and to the person who has been my biggest support, my mother Eliana. To my family, my grandparents, my friends.

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Abstract

This paper, based on a thorough analysis of the world economic and socio-cultural context, illustrates how the deregulatory process of the financial system, starting in the eighties in the U.S., led to a financial crisis in 2008. This work includes the analysis of the economic and legal policies pro deregulation, the socio-cultural transformations of that nation as a result of such policies, and the case study of the effects of housing bubble. Furthermore, it also indicates the relationship between the financial crisis of 1929 and 2008 in the USA: the lack of financial regulation is responsible for these financial crises, its consequences, and the impact on people, culture, and the international economy.

For the completion of this document, bibliographic and documentary information was employed, like the book *End This Depression Now!* by Paul Krugman, documents of the U.S. Federal Reserve, digital magazines, digital documentaries, among others.

Resumen

Este documento ilustra a través del análisis del contexto económico y sociocultural como el proceso desregulatorio del sistema financiero, a partir de los 80`s en Estados Unidos, llevó a la crisis financiera de 2008. Este trabajo incluye el análisis de las políticas económicas y legales pro desregularización, las transformaciones socio-culturales de la nación consecuencia de estas y el estudio de caso de la burbuja inmobiliaria. Además, establece la relación entre las crisis financieras de 1929 y 2008 en Estados Unidos haciendo responsable a la falta de regulación financiera de: ambas crisis financieras, las consecuencias de esta, el impacto en la sociedad, la cultura y la economía internacional.

Para la realización de este documento se recurrió a información bibliográfica y documental como el libro ¡Acabad ya con esta crisis! de Paul Krugman, documentos de la Reserva Federal de Estados Unidos, revistas digitales, documentales digitales, entre otros.

Introduction

I firmly believe that all human beings have the right to fulfill themselves economically based on their work. But this self-actualization could be truncated if the financial system of our countries is controlled by irresponsible people who seek their maximum economic benefit at the expense of whom they represent. This is why I have chosen financial deregulation as one of the most toxic weapons for national economies. A proof of how dangerous financial deregulation is, are the global economic crises, especially the one detailed in this paper: the 2008 economic crisis in the United States. It is important that people understand that control over financial markets is necessary for the sustainable development of a country's economy.

It is necessary to explain that this is not an economic analysis. It is the analysis of an economic fact that has had a big impact on social, cultural, economic, and financial areas. Such event influenced international relations, the world economy, and foreign trade. This document is intended to illustrate how a process of financial deregulation starts, what economic and legal policies are applied, and what are the social consequences that could affect the population, taking the example of the 2008 financial crisis in the United States. This study was completed based on documentary and bibliographical research. It also features a number of interviews.

In Chapter 1, we can find the origins of the pro financial deregulation thought, the economic and political context of the late twentieth and early twenty-first century in the USA, and the chronological sequence of financial deregulation (1980-2008). On the other hand, for the legislative analysis of the financial system deregulatory laws, I recommend readers to go over annexes 1-4: "Chronological sequence of financial deregulation from 1980 to 2008" and "U.S. Financial System Regulatory Agencies" in 1929, 1933, 1980 and 2008, for a better understanding of the text.

In Chapter 2, an analysis of the 2008 financial crisis in the United States will be presented, focusing first on the economic and legal policies that led to the crisis. Starting from this initial analysis, I will focus on the social transformations caused by consumerism and the increased use of credit in the late twentieth and early twenty-first century. In addition, a case study of housing bubble in the United States will be made as well as its consequences among the population.

Chapter 3 will present a comparative analysis between the financial crises of 1930 and 2008, focusing on its development, consequences, impact on the international economy, and contrast of monetary and fiscal policies. Furthermore, Mandel's business cycle theory will be considered as well as Kondratieff's long wave theory and other theorists in the context of the financial crisis of 1930 and 2008.

Finally, I must say that it is quite important to know about past economic crises as well as to identify processes of financial deregulation at international level so these can be avoided. In the case of the United States, since it is the major economy of the world, its effects were immediately felt by the international economy. But these processes have also been gone through in England, Iceland, Ecuador, Mexico, just to name a few, and in all of those countries the consequences have been catastrophic, as well.

CHAPTER 1: GLOBAL CONTEXT OF THE 2008 FINANCIAL CRISIS IN THE UNITED STATES

In this first chapter I will introduce the reader to the origins of the pro financial deregulation thought; then I will continue with the analysis of the economic and political context of the late twentieth and early twenty-first century in the USA. Moreover, as financial deregulation is a key part of this work, the chronological sequence in the United States from 1980 to 2008 will be analyzed. As it was already mentioned in the introduction, the use of Annexes 1-4 for a greater understanding of the text is recommended.

1.1 Economic and political context of the late twentieth century and early twenty-first century.

The emergence of a new tendency worldwide.

Who should rule economics? The government or the free market? This question has persisted among government leaders, and it has caused an intellectual battle in order to decide what the best theory to maintain a sustainable economic growth is: On the one hand, John Maynard Keynes and his state control of the economy policies which operated for decades; on the other hand, Friedrich von Hayek, who believed that the state interference was a threat to freedom, so the marketplace was able to regulate itself. Keynesian theories were applied during the Great Depression of the 1930's, in times of war and post war, eliminating the economic depression in the United States, while Hayek's theories have been applied since the 1980's.

During the years after World War II, Friedrich von Hayek and Ludwig von Mises, with an ultra-liberal thought opposed to the Keynesian revolution, attracted more and more supporters. In 1947, Hayek and Mises convened a selected group of economists, historians, and theorists who supported the market economy, at the Hotel du Parc in Mont-Pelerin, Switzerland. "At the end of meeting, the Société du Mont-Pèlerin Society was founded -a kind of neoliberal Freemasonry, very well organized and devoted to the dissemination of the neoliberal creed, with regular international gatherings." (Anderson P. , 1976, p. 346)

One of the first products of this society was the notion that democracy is impossible without a free economy. The schools supporting its theories were the Graduate Institute of Development Studies of Geneva, the London School of Economics and the University of Chicago. The American Milton Friedman would eventually belong to this society, he was a deregulation supporter and pioneer in several countries in the early 1980's. "Among the organisation's most active members were von Hayek, von Mises, Maurice Allais, Karl Popper, and Milton Friedman." (Toussaint, La bolsa o la Vida, 2002, p. 346)

Friedman is known for his theories about monetarist policy and his support to market deregulation, privatization of public enterprises, free movement of capital, and his critique to inefficient bureaucracies, among others. In his book "Capitalism and Freedom," he argues in favor of a volunteer army, free flotation of interest rates, medical license abolition, negative income tax, and school vouchers. (Library of Economics and Liberty, 2008) In the early 1950's, this intellectual tendency was gaining supporters worldwide and was in fact applied in the 1980's, especially in the U.S. under Reagan's administration and in the United Kingdom with Margaret Thatcher.

Many of these pro deregulation ideas which had their origin in the University of Chicago were spread to the world; that is the case of Chile during Pinochet's dictatorship. The influence of Friedman and his free market policies were applied in the decade of the 1970's and 1980's by his "Chicago Boys," students who received scholarships by the United States to study economics as well as to swot up on the new economic tendency. These new policies changed the economic model that invested in health, education, industry, and that nationalized several Chilean companies applied by the socialist Salvador Allende in the early 1970's, replaced by the economic blueprint "el ladrillo." The following policies were the elimination of price controls, the sale of state enterprises, the elimination of tariff barriers, and public spending cuts. By the next year, 1974, inflation was 375% and 60.9% in the early 1975. (Chile-America, 1975, p. 6)

Given the tragic results of these policies, we may ask, "What happened to the opposition?" They were silenced, both in Chile and in Argentina by the military juntas which ruled these countries. The economic situation and the dictatorial

governments in that time generated state terrorism among the population to eliminate the opposition, a period of time which featured massive human rights violations and forced disappearances during the 1970's. The application of these neoliberal policies in the Argentinean case, starting with the dictatorship of 1976-1983 and lasting 20 years, plunged the country into debt and deterioration. By 2002 the economic situation was catastrophic: three consecutive years of recession, severe indebtedness, and citizenship in crisis. (Toussaint, La bolsa o la Vida, 2002, p. 377)

Although Keynes and Hayek are precursors of these economic theories, government intervention in the economy and economic neoliberalism, respectively, the one who helped its implementation as a tendency in America was William F. Buckley Jr., who studied at Yale; he was a radical opponent of the New Deal policies and an advocate of the traditional America's right. In 1955, he founded the National Review, a weekly publication that gained a respected voice in the publishing world of Buckley. The speech that was handled in the National Review launched the ideological transformation as well as the political and economic changes of the 1980's in the United States. (Sarias, La ilustración Liberal- Revista Española Americana, 2007)

Economic environment of the late twentieth and early twenty-first century.

We can start the description of the economical context by saying that the economic and legal deregulatory policies of the U.S. financial system started in 1971 with the breakup of the Bretton Woods System. This system, implemented in 1947 in order to restore the global economic order, "established the parity of $35 per troy ounce of gold and the maintenance of the exchange rate within a range of variation of 1% of its gold parity." (Gentico, Duración de los sistemas de tipo de cambio fijo: Bretton Woods, un punto de inflexión. , 2006, p. 3) In other words, all currencies were convertible to dollars because the U.S. economy was the strongest and the dollar was convertible to gold: $35 for a troy ounce of gold.

After World War II and the establishment of the system of dollar exchange standard, the U.S. had 75% of the world's gold. In the two next decades the problems in the U.S. balance of payments, the abuse of dollar printing, and their demand to exchange for gold, flooded the world with this currency and reduced gold reserves. In 1971, the loss of confidence in the US dollar generated the expectation of its devaluation, and several European central banks tried to convert their dollar reserves to gold, causing

the suspension of convertibility and its subsequent elimination. With the elimination of this system, the global financial system was left without an anchor to set the exchange rates of the main currencies. (Kozikowski, Finanzas Internacionales, 2013)

In an attempt to stabilize the monetary system, the Smithsonian Agreement was signed. This agreement devalued the US dollar, revalued other strong currencies, and suspended the convertibility of the US dollar into gold. (Gentico, Duración de los sistemas de tipo de cambio fijo: Bretton Woods, un punto de inflexión. , 2006, p. 3) After the end of the gold standard convertibility, the exchange rates became floating and were set based on a major currency or other exchange reference. The most used currencies as reference were the British pound, the US dollar, and the French franc, being the US dollar the most commonly used throughout this period. (Parache, Sistemas cambiarios: una visión desde la actualidad, 2004, p. 5)

The oil embargo on the countries allied with Israel during the Yom Kippur War, including the United States, joined the 1973 dollar devaluation. The oil prices rise was immediate, along with production costs of manufactured goods, fuel, and energy (Michelle Kleemann Esparza). In 1979, oil prices would be affected again by the Islamic revolution in Iran, which caused the increase in prices of industrial products and in real interest rates.

In the late 1970's, interest rates were around 20%, the annual inflation was 12.5%, the access to credit was limited; therefore, at such high rates, just a few people were interested in loans. In an attempt to curb inflation, the Federal Reserve Chairman, Paul Volcker, limited the amount of money in circulation through greater control over the reserves of private banks. During this period both corporate debt and consumption slowed, causing the Credit Crisis and eventually the economic recession between 1980 and 1982.

In response to this situation, the banking system supported the deregulatory tendency emerging in aviation and railway industries. One of the first financial deregulatory measures appeared in the 1978 law called "Marquett," which prevented the state control over interest rates. Taking advantage of the opportunities that were offered by the 1980 DIMCA law, the financial institutions created "a financial structure for risky mortgage credit, which led to increase the subprime mortgage market." (Patricia A. Mccoy, 2009, p. 6)

By 1983, the annual inflation had fallen to 3.7%, and a period of sustainable growth began in the U.S. economy by the hand of economic policies of the newly elected Ronald Reagan. Policies such as tax cuts were based on the belief that people would be induced to save and invest, resulting in higher production, new job opportunities, better salaries and incentives for the economy. This policy clearly benefited those groups with greater purchasing power; during the 1980's, the difference between the incomes of the upper and lower classes were widely noticeable. Reagan also increased military budget and supported the FED's des regulatory policies (Berkeley University, 2011). In view of tax cuts and increased military spending, the federal budget was obviously affected: it reached a deficit of $221,000 million in 1986 compared to $74,000 million in 1980.

The savings and loan crisis

A clear example of the effects of financial deregulation is the savings and loan crisis in the early 1980's in the U.S. This crisis shocked the financial industry and charged taxpayers $132 billion out of $160 billion of total bailout. This analysis is intended to illustrate the economic and social scenario in which one of the first crises of financial deregulation occurred. It also points out that despite the adverse consequences it brought, the market rules that left the savings and loan institutions almost unattended continued to be blocked.

In the early 1980's there was a clear difference between savings and loan institutions (S&L) and commercial banks. While savings and loan institutions aimed to finance mortgages and provide saving accounts for the general public, commercial banks were more oriented to serving the needs of trade, extending credit to consumption, managing a wide range of services and financial products. Today there is no difference between these two institutions because of legal and regulatory changes as a result of the crisis. (Cohen, zacks.com, 2011)

I think that one of the main causes of this crisis was to consider that the difference between savings and loan institutions and commercial banks was so deep that it was necessary a separation and distinct legal frameworks to control them. While savings and loan institutions were regulated by the Federal Home Loan Bank Board (FHLBB) and insured by the Federal Savings and Loan Insurance Corporation

(FSLIC). Commercial banks were supervised by the Federal Deposit Insurance Corporation (FDIC).

There are several hypotheses about the reason why the FHLBB could not properly regulate the S&L institutions, based on the document "The Savings and Loan Crisis and Its Relationship to Banking" from the Federal Deposit Insurance Corporation we are going to analyze these reasons. It is possible that since the S&L institutions were designed to promote the purchase of real estate, its "examination, supervision, and enforcement practices were traditionally weaker than those of federal banking agencies." (Barth, The Savings and Loan Crisis, 2000, p. 4) Moreover, the examining staff of the FHLBB was not duly qualified to work in the complex environment of the 1980's, and its experience was limited to traditional financial operations. The problem of the staff was also due to budgetary constraints of the FHLBB; therefore, the most qualified examiners worked for commercial banks or other organizations such as the Office of the Comptroller of the Currency, the FDIC and the Federal Reserve. (Barth, The Savings and Loan Crisis, 2000)

Moreover, a major problem faced by S&L institutions, unlike commercial banks, was that the duties of supervision and audit of these institutions were not in charge of the same organization; that is, while the examiners were recruited and they informed the FHLBB in Washington, the audit of the S&L had been divided by regions and it was in charge of the Principal Supervisor Agent (PSA) from each region, which in turn were employees of privately owned regional banks. This system of fragmented information not only created distrust based on clear conflicts of interest, but it also kept actions required from being taken based on information provided by the examiners.

In addition to the ineffective regulation by the FHLBB, the significant changes of interest rates had a significant weight to trigger the crisis. In the early 1980's, S&L were losing money by the upward trend of the interest rates. These measures were taken to compensate inflation, as discussed above. As a result of the financial imbalance of assets/liabilities, "the net income from savings and credit, which totaled

$ 781 million in 1980, decreased to a deficit of $4.6 billion[1] and $4.1 billion in 1981 and 1982 respectively." (Barth, The Savings and Loan Crisis, 2000, p. 2)

In the late 1982, despite 752 supervised and voluntary mergers, 118 savings and loan institutions failed, which meant to the FSLIC $3.5 trillion. At the same time, the tangible net value for the entire industry had changed from 5.3% in 1980 to 0.5% in 1982 due to the fall of the tangible capital[2] of all industries. In my opinion, at this point the answer to why regulatory measures were not taken to avoid a major crisis is that besides the lack of resources of the FSLIC to close insolvent institutions, it was believed that these insolvencies could be corrected by just manipulating interest rates.

In April 1982 in an attempt to attract capital to the savings and loan institutions, the Banking Board authorized the liberalization of restrictions on the stock ownership of these institutions. This meant removing the limit on the ownership of shares of an institution for individuals and groups of 10% and 25% respectively. In these circumstances, the reduction of capital requirements was added, "2.0 million of initial capital investment, and the possibility of leveraging at $1.3 trillion in assets at the end of the first year of operation." (Barth, The Savings and Loan Crisis, 2000, p. 7) Pretty soon, the industry was flooded by new investors and owners who wanted to take advantage of the promise of high profitability.

To understand better the effects of financial leverage and the increases of interest rates in this crisis, we have to stop for a moment and understand how they work. "Financial leverage is an indicator that shows how much of its liabilities a company is employing in order to buy and invest in assets. It refers to situations where a small relative increase in income before interest and taxes may cause a very large increase in net income, and therefore available to distribute as dividends to shareholders of the company." (Bravo María de la Luz, Introducción a las Finanzas, 2007, p. 262)

In other words, assets are purchased in order to increase the profitability of the company, but this purchase will be done without having the money of the transaction at that moment. The debt or financial leverage should be less than the profitability of

[1] As this document is an analysis of financial deregulation in the United States when I refer to a billion dollars, I will be referring to one billion.
[2] See definition in glossary.

the business or the operating profit; otherwise, the investment will not be profitable. Before establishing the degree of leverage in a transaction, factors such as real cost of the debt, fixed or variable interest rate, transaction currency (national or foreign currency), and debt levels must be taken into account.

"Debt can be a good lever to make profitable financed investments with high proportions of debt, but it involves risk. In situations of rising interest rates and risk premiums and decline in economic activity of the company (sales and operating result) a high debt, or leverage, could endanger the survival of the business." (Nou, http://www.finanplan.com/, 2012, p. 2)

As for the rise and fall of interest rates, their relationship in economic crisis is simple. By lowering interest rates or keeping them too low, as in the case of the savings and loan crisis, there is an oversupply of credits which, along with the expansion of leverage, may cause a bubble in the housing market. In a completely opposite scenario, having very high interest rates to the market situation in question, credits are scarce, the companies cannot access credit to fund its normal operations and the population decreases their level of consumption.

A number of deregulatory laws, such as the above mentioned 1980 DIDMCA and 1982 Garn St. Germain, have helped to expand the investment power of the savings and loan institutions, increasing their financial risk. These two laws reduced net equity requirements, eliminated limits on interest rates in deposits, "they increased federal deposit[3] insurance to $100,000 per account, a major adjustment of the previous limit of $40,000 per account" (Barth, The Savings and Loan Crisis, 2000, p. 10). It is also important to highlight the role of these two laws when supporting mortgage lending because the DIDMCA law expanded the power of the S&L institutions to get loans for acquisition, development, and construction (ADC), while the Garn-St. Germain law eliminated the limits on loan-to-value ratio; as a result, subprime loans of 100% of the purchase value of the property were granted.

Although all these measures led to savings and loans institutions to a severe crisis, during 1982-1985 the so long-sought economic growth was achieved. The industry assets increased 56%, from $686 billion to $1,068 billion, compared to the increase of 26% of commercial banks. The new flow of money powered by high paid

[3] See definition in glossary.

interests, little regulation, and the reduction of capital requirements, attracted new entrepreneurs who bought existing S&L institutions or created them. Only in 1984, 133 institutions were created; by 1986, these institutions controlled 64% of the total of industry assets (Barth, The Savings and Loan Crisis, 2000, p. 7).

This accelerated money flow gradually put aside traditional financing of house mortgages and opened a door to new investment alternatives. With no limitations, the S&L institutions invested in everything: direct investment in real estate, securities of variable income, derivatives, casinos, fast food franchises, wind parks, ski resorts, among others. “It is important to note, however, that while wind parks and other exotic investments achieved interesting results, high-risk development loans and the resultant mortgages on the same properties were most likely the principal cause for thrift failures after 1982” (Barth, The Savings and Loan Crisis, 2000, p. 14).

I have left one of the most important issues at the end because I think it is important to highlight the role of the construction industry within this crisis. Since 1981, thanks to certain modifications to the federal tax code for real estate investment and because interest rates on loans for construction were much higher than in other types of loan, a boom in commercial real estate projects occurred, especially in the southwest. But, having a large number of S&L institutions dabbling in commercial real estate loans, generated an oversupply in the housing market, which subsequently resulted in the fall of prices of the construction industry. Just as in the 2008 crisis “the concentration of large volumes of deposits into high-risk institutions that speculated in real estate development did create marketplace distortions” (Barth, The Savings and Loan Crisis, 2000, p. 20).

As prices in the construction industry continued to decline, more and more S&L institutions were declared insolvents. Due to changes in its own policies, the FHLBB was unable to act until the institutions were declared insolvent under regulatory accounting principles (RAP), much more lenient principles than the previously ones. Also, as the value of all institutions in deficit was so high, the FSLIC did not have enough resources to perform its role. At this point, it is important to emphasize that since the FSLIC began to implement a series of deregulatory policies described above, it never had enough resources to act as an insurance company. This fact was

concealed to avoid alarming the market as it was aggravating the situation of savings and loans institutions.

The result of poor supervision, accelerated growing incentives, and risky investments caused 747 S&L institutions to be declared insolvents and a USD 160 billion bailout that left a deep deficit in state accounts. As a result of this crisis, the Congress passed two new laws, the FIRREA "which abolished the FHLBB and the FSLIC and gave the FDIC initial responsibility for managing the Resolution Trust Corporation (RTC) and permanent responsibility for operating the new Savings Association Insurance Fund (SAIF)" (Barth, The Savings and Loan Crisis, 2000, pp. 21-22). In 1991, the Federal Deposit Insurance Corporation Improvement Act (FDICIA) was issued. With the aftermath of this crisis, the preventive measures to take in the years to come were clear, but despite all the financial deregulation, financial and economic policies continued to prevail.[4]

Despite heavy losses in the financial industry, not everything was negative for the U.S. economy. Thanks to the greater access to credit and taxes cut, consumer spending increased, and it caused an upward trend in the stock market. The average gross domestic product growth in the early 1980's was 4.3%, after the 1982 recession was overcome. This was reflected by the decline of the unemployment rate and the creation of 13 million new jobs (Departamento de Estado de Estados Unidos-Programas de información internacional, 2008).

Supporters and the boom of financial deregulation: Bill Clinton and George W. Bush.

With the end of the Cold War, upon the dissolution of the Soviet Union, the world moved from a bipolar system, where there were bipolar forces, to a unipolar system in which the economic power was wielded by the United States. The capitalist system was the winner as the most used among most of the countries and together with this, the Washington Consensus became the basis for modifying many of the world's economies to economic neoliberalism. In this scenario, there was a doubling of world trade through: the theories in favor of the free market supported by leaders like Bill Clinton, the economies of scale of the Asian countries, the highest

[4] For more information see: "History of the Eighties. Lessons for the Future," Chapter 4, The Savings and Loan Crisis and Its Relationship to Banking, www.fdic.gov.

purchasing power in some countries, improvements in logistics chains and infrastructure for foreign trade, and the reduction of tariff barriers, among other factors.

In the early 1990's, the financial system in the United States was dominated by several firms that concentrated all the economic power of the country due to mergers and bankruptcies of several financial institutions. These institutions now could make transactions in real-time buying and selling currencies, commodities[5], property and shares worldwide thanks to the advances in technology. The 1990's were also the years of the financial derivatives, product of the merger between technology and finance; Warren Buffet called them weapons of mass destruction. "It is known as derivative to a set of financial instruments whose value (drift) is determined by the price of other assets, called underlying." (Banco de México, p. 1) These derivatives are derive on the price of other assets and allow to adapt them to an infinity of options to protect themselves from price fluctuations in the markets.

In 1992, Bill Clinton was elected President of the United States; the economic stage was marked by a small recession due to the reduction of real estate prices in the late 1980's, and the increase of public debt as a percentage of GDP. The USA, by becoming the first world power during the Reagan and Bush administration, faced high military expenses which along with tax cuts, increased the government debt. One of the main objectives of Clinton during his period was the reduction of public debt and fiscal deficit by implementing policies such as the reduction of government spending at the federal government level. As a result, the public debt was reduced from 42% of GDP in 1992 to 34.7% by the end of the decade (Munevar, Los Estados Unidos de la desreglamentación financiera a la crisis global, 2011, p. 3).

In this scenario, with Alan Greenspan as Chairman of the Federal Reserve (in the Reagan, Clinton, and George W. Bush administration), Robert Rubin and Lawrence Summers as Treasury Secretaries of the United States, a process of deregulation that encouraged the accelerated growth of the financial industry was conducted. In this deregulatory process the doors to the all-powerful financial institutions that would be consolidated in the 1990's and would dominate financial markets in the following years were open. Quoting Willem Buiter on the documentary Inside Job "Why are

[5] See definition in glossary

there big banks? Because banks like the power of monopolies ... the banks know that if they are very large, they will be rescued." This general thinking was evident with corporate mergers and the longing to grow more and more to become the "too big to fail" companies. Those that, by concentrating much of the market, when falling can have a negative effect on the economy; therefore, the Fed would be on the need to rescue them.

During this deregulatory apogee, several amendments were tested or conducted to the financial laws pillars of the financial system during the Clinton administration. Such is the case of the "Riegle Community Development and Regulatory Improvement Act" in September 1994, amendments to the "Truth in Lending Act - Regulation Z" in 1995 and 1996, as well as the Futures Modernization Act in December 2000. All detailed above. Some of these laws even dated back to the years following the Great Depression of the 1930's, such as the Glass-Steagalls in 1933, which was repealed by the Gramm-Leach-Bliley Act.

The Gramm-Leach-Bliley Act of 1999 (also issued during the Clinton administration) gave a green light to these risky mergers and allowed the affiliation between commercial banks, investment banks, and insurance companies. This is the case of the Bear Stearns investment bank, which was once the fifth largest investment bank in the country and was sold to JP Morgan, borderline bankruptcy in March 2008. When Bear Stearns became a publicly traded company, acquired a lot of capital by selling its shares on the Stock Exchange, actively participated in the mortgage industry that emerged in the early 1990's and trusted most of the percentage of their investments in mortgage-backed securities value. With the collapse of the housing market and amid rumors of the investment bank's financial problems, many companies stopped doing business with Bear, and others withdrew their funds from it. It soon became immersed in a severe liquidity crisis that led to an agreement between the Fed and JP Morgan to acquire Bear Stearns at $10 a share by JP Morgan (Shorter, Bear Stearns: Crisis and "Rescue" for a Major Provider of Mortgage-Related Products, 2008, p. 9).

In 1993, the Congress approved NAFTA, the Free Trade Agreement of North America, between Canada, the U.S., and Mexico. Although the agreement was negotiated by President Bush's father, Clinton defended this new trend toward the

benefits of trade liberalization against democratic electors, unions, environmentalists, among others. This support for the liberalization of world trade was also reflected in its support for the country's membership to the World Trade Organization, leading international organization in favor of world trade.

The boost given by the U.S. economy since 1993 is largely due to the shift from a traditional industrial base to a service economy and generator of new technologies. This technological movement was exploited by investment banking firms, Internet companies, and technology in the dot-com boom in the period 1997 to 2000. During this period it was not unusual that companies triplicated their value in a short time; everyone wanted to be part of this "new economy."

As it was a completely new market that did not provide benefits, the traditional valuations as the calculation over benefits did not apply, and it was replaced by calculations on sales figures or in the number of visits made to these pages. In the rapid growth of the value of these shares, speculation and alterations in the accounts of the owners of these companies had a lot to do. Great fortunes were created in a few months by issuing shares of these companies, to the point that speculation led to the internet bubble in 2000 (Mendieta, albertoarranz.com, 2002).

In this second example of the effects of financial deregulation we can see the regulators who did little or nothing and brokerage houses of Wall Street, who along with investment funds, took advantage of the situation. When the Internet bubble burst technology and internet companies' shares were held by small middle class investors, they were terrified by seeing that 75% of its value was lost by April 14, 2000 and December 22 in the same year. (Mendieta, albertoarranz.com, 2002). This decline is reflected in the NASDAQ Composite index[6], which reflects the values of the technology sector, registered in the New York Stock Exchange. (See table 1)

[6] See definition of stock index in the glossary.

Table 1: Data of Nasdaq index from April to December 2000.

Date	Closing Price
Apr 3, 2000	3.860,66
May 1, 2000	3.400,91
Jun 1, 2000	3.966,11
Jul 3, 2000	3.766,99
Ago 1, 2000	4.206,35
Sep 1, 2000	3.672,82
Oct 2, 2000	3.369,63
Nov 1, 2000	2.597,93
Dic 1, 2000	2.645,29

Source: http://finance.yahoo.com

Made by: Arce B Sofia

The consequences of the implosion of this bubble in the short term entailed a braking to the euphoria of credit, reducing citizen indebtedness thanks to the rising of interest rates imposed by the FED in the late 1990's. But, in the long term, the crisis led the economy into a recession and looking to reactivate it and expand employment led to a reductionist policy of interest rates in the following years, reaching its lowest point of 1% in 2004. The attack to the World Trade Center in September 2001 also played an important role because after this one, the Federal Reserve dropped interest rates from 6.5% to 1.75% in the last quarter of that year. Along with financial deregulation and low interest rates the ideal scenario for more borrowing was created by the public in general and the start of the housing market bubble. We can observe that the manipulation of interest rates is used as a recurrent measure by the Fed amid financial crisis to control credit, inflation and unemployment.

In January 2001, George W. Bush became the president of the United States, amid a clear downward trend in GDP growth. During his presidential campaign, he indicated his support for tax cuts, which that took place in May 2001 and throughout his administration. "It is estimated that overall deterioration in the budget occurred during the Bush administration between 2001 and 2007 exceeded U.S. $ 3 billion" (Munevar, Los Estados Unidos de la desreglamentación financiera a la crisis global,

2011, p. 6). It should be noted that tax reduction marked more economic inequality because it favored to 1% of the richest population with a decrease of 7% for families with incomes over one million dollars compared to 2% to those middle class families (Munevar, Los Estados Unidos de la desreglamentación financiera a la crisis global, 2011).

This government was also highlighted for yielding in to the pressure of financial sector lobbies which supported financial deregulation, especially financial derivatives. "…the administration of George W. Bush opposed in the Congress to the legislation that was offered to regulate and limit the risk in the market for subprime mortgages, while they failed to propose a constructive legislation of its own" (Patricia A. Mccoy, 2009).

The Bush administration is also marked by the increase of military budget in the invasions to Iraq and Afghanistan, which raised the fiscal deficit and plunged the country into a greater debt than the one Clinton had left. As mentioned earlier, deficit reduction was one of the objectives of Clinton during his administration, so that by 2000 the situation was very favorable and predicted that the country could repay its public debt in a decade. Of course, these predictions were supported in an economy with an unsustainable upward trend, since it was based on private indebtedness and in the prices of stock markets (Munevar, Los Estados Unidos de la desreglamentación financiera a la crisis global, 2011). Out of the U.S. $3.4 billion of public debt in 2000, it became $5.8 billion in 2008. The massive debt, financial deregulation, and low interest rates were the foundation on which the new crisis of the financial system broke down.

Political environment of the late twentieth and early twenty-first century.

If politicians are the ones who shape the destiny of the countries they represent, these measurements are formulated on the basis of adverse situations that arise and the power relations with their counterparts. In this analysis of the political environment, we can highlight the partial loss of the hegemonic power of the United States because of its economic crises, tensions during the Cold War and the fall of the communist system in Russia, which gave way to the new political and economic blocs of the late twentieth century. In this context we can also highlight the role of

international organizations with greater power than in previous decades and its influence on a new world order.

Since the 1970's the hegemony of the United States after World War II began to decline due to the economic problems it faced, creating a crisis of political hegemony. Between these are, as already detailed, the end of the Bretton Woods system due to the elimination of the dollar-gold convertibility in 1971 that left the international community in uncertainty. This event opened the door to the possibility that national policies take their countries to excessive inflation and the consequences that arise from this situation. "…the absence of a rule based system for money growth world-wide that left the biggest hole in the international policy framework…" (Adams, Worlds Apart: The North-South Divide and the International System., 1997, p. 109).

Another aspect that profoundly changed the foreign policy during this period was the oil crisis during which the price of this essential raw material to the "first world" economies quadrupled. Between August and December 1973, the OPEC with its increments of the oil price, made visible the situation of dependency of industrialized countries. This event changed the political and economic vision in that time. Oil was not the only product that expected to maximize their profits by increasing prices; copper, wheat, sugar, rice, among others, also did it. And well, what was the purpose of this price increase? The search to restructure international economic relations and greater economic power for developing countries (Adams, Worlds Apart: The North-South Divide and the International System., 1997).

In this unattractive situation, industrialized countries adopted a more conciliatory attitude to the demands of developing countries. But this was altered in the framework of the UNCTAD IV conference with the proposals of set price levels for raw materials. At this point, there is an evident need for block grouping of industrialized countries like the United States, West Germany and Japan to advocate for market forces in the prices determination of the goods mentioned above (Adams, Worlds Apart: The North-South Divide and the International System., 1997).

Soon, these industrialized countries realized that no radical change would happen in the world economic order. Despite being the raw materials located in the developing countries who exploited them, as in the case of oil companies, those were companies

of their own countries. Moreover, industrialized countries took measures to reduce oil and raw materials consumption looking for alternative forms of energy to the first one and economizing the use of the second ones. Meanwhile, the non-industrialized countries were involved in excessive consumption of manufactured products, waste of their recent resources, and corruption, failing to create an industrial base for economic growth in the long term (Adams, Worlds Apart: The North-South Divide and the International System., 1997).

The decade of the 1970's and early 1980's is noticeable by the tensions between the United States and the Union of Soviet Socialist Republics along with the threat of a nuclear war. These tensions were diminished by the policies of openness and transparency, known as Glasnost and Perestroika, introduced by Mikhail Gorbachev, Soviet representative in the mid 1980's. In December 1987, the U.S. President, Ronald Reagan, and M. Gorbachev signed the Intermediate-Range Nuclear Forces Treaty (INF) on destruction of nuclear weapons in both countries. It is interesting the change of positions during this time. The one who one day was "The Evil Empire," as Reagan called it in 1983, would be so weakened by the whole military spending of the Cold War and its internal conflicts that would seek improve its relations with the West.

With the fall of the USSR in December 1991, a new world political order emerged along with the collapse of Communism. This is described in the book International Politics on the World Stage of John T. Rourke "... what exists in the first decade of the twenty century is best described as a limited unipolar system that is struggling to become a multipolar system." Rourke describes it very well when he refers to a "multipolar system struggling" because the United States, despite its military power, need the assistance of third countries for its armed interventions as in the case of Iraq (1991, 2003) and Serbia (1999). It is also clear the fact that countries like India, China and members of the European Union do not entirely support Washington and this one depends on the diplomatic support of certain countries and of the world economically.

When the way to a new world order was opened in the 1990's, the world politics was divided into blocks geographically defined. These blocks were the United States, with its still dominant power in Latin America, Japan along with the Asian Tigers,

and the countries members of the European Union. The U.S. dominance in Latin America came through the spread of neoliberal policies: its trans nationals companies and its intervention in internal affairs of these states.

Based on the book "The Asian Crisis: Lessons for Latin America," we can highlight the importance of Japanese colonialism, the imposition of industrialization and productive investment by a "strong state," and the policy of industrialization by import substitution (ISI) in the so-called "Asian miracle." When South Korea, Taiwan, Hong Kong, and Singapore were introduced to the capitalist development, they became the "Asian tigers" in the late twentieth century due to its rapid economic and industrial growth. Within the spread of forced industrialization, infrastructure and rapid growth, led by Japan, "the darker side of the "Dragon's (tigers)" success lies in its contempt for democracy and participation, human rights and freedom association" (Schuldt Jürgen, La crisis asiática, Lecciones para América Latina, 1998, p. 31).

Based on the previous paragraph and according to Gerschenkron quoted in the book "The Asian Crisis, Lessons for Latin America," the latest is the development successful, the more State intervention is required. This thesis is clearly reflected in the control of these Asian States over the banking system[7], the investments in industries and the imposition of access barriers to other forms of financing. In this way, the growth of industries that the "strong state" considered as essential for the state economic development was potentiated. It is worth mentioning that China was part of the fourth generation of emerging Asian economies along with Myanmar / Burma and Vietnam.

The third large block that was formed in the late twentieth century was the European Union. Its 27 members have achieved economic integration at the moment and have a great political cooperation. Throughout the late twentieth century economic integration they were so successful that the continuous convertibility of currencies led to the adoption of a common currency in 2002, the euro. The economic benefits of adopting the euro were undeniable to the growth of trade between the member countries of the EU in the 1990's, which contributed to the adoption of the Maastricht Treaty that laid the foundation for political integration. Political

[7] Banks were nationalized in Taiwan.

integration has led to the adoption of a foreign policy of defense and a common domestic politics, among other measures, such as the European citizenship (Rourke, International Politics on the World Stage, 2008, pp. 223-225).

A fourth block present in the political context of the late twentieth and early twenty-first century were International Organizations. I consider that the ones detailed below become very important political actors in a more visible and explicit way between the International Community: the International Monetary Fund, the World Trade Organization, and the United Nations. All of them are a prodcut of the new world order post World War II.

In the case of the IMF, at the end of the dollar's convertibility into gold in 1971, its functions as a stabilizer of the exchange rate, based on a fixed rate with reference to the price of gold changed. Its functions are now based on granting short-term loans to countries with deficits in their balance of payments in order to keep the exchange rate stable. Over the last decades, the IMF has played an important role in the financial crises that had occurred as in the case of Mexico in 1985, the Asian crisis in 1997, and Argentina in 2001-2002. In the case of Mexico, the IMF participated "… in the emergency rescue operation mounted to stave off default and avoid serious disruption to the financial system" (Adams, Worlds Apart: The North-South Divide and the International System., 1997, p. 154). But just as the IMF's role in these crises is highlighted, it is also important to mention that its packages of austerity for debtor nations led to negative effects on the social and economic long-term development of these countries.

The WTO, with 159 members, supports the free flow of trade and capital between countries. Within this entity cases of violations to the basic principles of the General Agreement on Tariffs and Trade (GATT) are presented, being sanctioned the countries responsible for different faults. A case that demonstrates the power of the WTO over states is the WTO verdict in favor of Brazil against the United States in 2005 due to American's subsidies to cotton plantations, clearly lacking to GATT rules. The pressure caused that reductions to U.S. subsidies for cotton in the Congress were approved; otherwise, the WTO sanctions would have affected other branches of trade (Rourke, International Politics on the World Stage, 2008).

As the UN is one of the agencies of greater power in the world, I see no need to detail their duties and their achievements throughout the twentieth century, but I would like to mention a significant example of their role in world politics. In the framework of a UN Security Council meeting in 2003 about the Iraq invasion, France and Russia, both with veto power, opposed the U.S. invasion. Thus, they disagreed with the UN support for the military invasion of the Muslim country. In this event, it is not only evident the role of the UN in the middle of the struggle between the interests of each country, but the search for a multipolar system against the American hegemony.

Within this political context summary, I have found losses of hegemony, struggles to recover them, and new configurations of the world order within a multipolar system. These situations happened surrounded by a sequence of economic crises, power struggles: US-USSR, East-West, block formation, and fortifications of international organizations. It is within this changing political context, new actors, and adverse situations that the political scenario for the deregulatory trend that would mark the beginning of the 2008 crisis will be set.

1.2 Chronological sequence of deregulation in the United States (1980's, 2010).

After the Great Depression of the 1930's the United States maintained a policy of regulation for 40 years, but since the alleged unsatisfactory results and slow economic growth, deregulatory policies were applied sequentially in several agencies of the country. Although this chapter limits to the description of the deregulatory policies since 1980, they began to be applied several years before.

"Indeed, many of the changes in economic deregulation began during the Carter administration and were initiated by the Liberal Democrats named by him in economic regulatory agencies" (Noll, REGULACIÓN ECONÓMICA, DESREGULACIÓN Y REFORMA REGULATORIA DURANTE LA DÉCADA DE LOS OCHENTA, 1999, p. 9).

It is important to point out that deregulation in all the areas that it was applied was not only the result of a change in the executive management of the country, but the result of many other influences. The contribution of academics, journalists in editorial pages, along with theoretical and empirical studies of economists (with some exceptions) during the 1960's and 1970's were the basis for the policy change.

Thanks to the policy change, each sector that was under control until 1975 underwent major changes in the structure of their industries, price levels, costs and productivity. Among the industries that were affected by these changes are airlines, heavy transport, public transport, railways, telecommunications, production and transportation of natural gas, cable TV, banking and financial services, electricity and property insurance, and liability insurance. This paper will focus only in those deregulatory policies affecting banking and financial services.

Banking regulation is the control of a bank investment portfolio, imposition of limits to loans and interest rates, restrictions on savings and loan institutions, as well as limitations on mortgage loans leverage. In addition, the Federal Government was in charge of specifying accounting to be used by banks to measure their financial well-being and reviewing its credit histories (Noll, REGULACIÓN ECONÓMICA, DESREGULACIÓN Y REFORMA REGULATORIA DURANTE LA DÉCADA DE LOS OCHENTA, 1999, p. 33).

In the early 1980's some economic situations in the United States established the framework over which the subsequent deregulation of the financial system would be based on. Situations such as the rising of oil prices, the economic recession of 1974-1975, and productivity growth reduction resulted in an average inflation of 7.7% and an annual growth of 8% over the last decade. The situation was aggravated because in March 1980 inflation predicted that if the same upward trend in the price index continued, this would come to 19.6% compared to 13.2% in 1979 (Vilaro, Elpais.com, 1980) (Annex 1).

Among the main measures to control the rising inflation was the anti-inflation program announced by President Jimmy Carter on March 14, 1980. This program included restrictive credit policies such as control of money supply and high interest rates. This anti-inflationary program exercised more control over those consumer loans that were not intended to purchase homes, cars, and other durable goods. In addition, it exercised voluntary control in the growth of loans issued by large banks and other financial institutions (Díaz, El programa anti inflacionario del presidente Carter en perspéctiva teórica e histórica, 1983, p. 28).

On March 31, 1980, President Carter signed the Depository Institutions Deregulation and Monetary Control Act (DIDMCA). This act covers several transcendental

subjects for the changes that will be seen in the years to come in the U.S. financial system, such as the determination of deposits and loans interest rates by the market, and elimination of limits on interest rates over a period of six years; it allows savings and loan companies to provide many more financial services and use their savers resources in riskier investments. It also eliminates the maximum mortgage limits of states and other restrictions with respect to residential mortgage loans (Federal Deposit Insurence Corporation, 1980). The removal of interest rates limits and its determination by the market took place with the establishment of the Depository Institutions Deregulatory Committee (DIDC), which allowed the gradual elimination of Regulation Q by 1986.

Popular discontent with President Carter was increasing due to the country economic situation and the uncertain situation of U.S. officials from the U.S. embassy in Iran. These circumstances meant that in the presidential elections of August 4, 1980 Jimmy Carter lost the reelection, giving way to the Republican Ronald Reagan. At the beginning of Reagan administration in January 1981, the economic situation was not the best, with an unemployment rate of 7.5% and an inflation of 13.09% (Bureau of Labor Statistic, 2013).

In 1982, the Alternative Mortgage Transaction Parity Act (AMTPA) was signed; it can be found in Title VIII of the Garn-St Germain Act. This act, in order to encourage mortgage lending, allowed to depository institutions and all those who offered housing loans to make alternative mortgage transactions. It also authorized the application of various types of residential loans previously prohibited, among which are adjustable rates mortgages, balloon payment mortgages, negative amortization loans, and only interest mortgage (Senate and House of Representatives of the United States of America, 1982).

The Federal Trade Commission Act (FTCA), Section 5, Regulation AA of the Federal Reserve Board from January 1, 1986, is a law that prohibits unfair or deceptive acts and practices affecting trade. In section 5 of this Act, it “grants broad authority to the Federal Trade Commission (FTC) and – in the case of banks and thrifts, the Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), and the Federal Deposit Insurance Corporation (FDIC) – to make rules defining and enjoining unfair and deceptive acts and practices” (Joseph M.

Vincent, Federal Trade Commission Act (FTCA) Section 5 – Federal Reserve Board Regulation AA, 2010). It is important to note that it is limited only to the judgment of these entities that they declare illegal and prohibit acts and practices that may be considered unfair and misleading.

Amid the Savings and Loan Crisis, on August 9, 1989, the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) was approved. The purpose of this act was to "reform, recapitalize, and consolidate the Federal deposit insurance system, to enhance the regulatory and enforcement powers of Federal financial institutions regulatory agencies, and for other purposes" (Senate and House of Representatives of the United States of America, 1989). One of the main objectives of this act was to seek a solution for the Savings and Loan Crisis along with the restoration of public confidence in the Savings and Loan industry.

Among the actions that led to the implementation of the FIRREA Act are the abolition of the Federal Home Loan Bank Board (FHLBB) and the Federal Savings and Loan Insurance Corporation (FSLIC), making responsible to the FDIC for the administration of the Resolution Trust Corporation (RTC)[8] (Barth, The Savings and Loan Crisis, 2000). With the FIRREA Act the responsibilities of the FHLBB and the FSLIC passed to the Office of Thrift Supervision (OTS) and the Federal Deposit Insurance Corporation (FDIC) respectively. In addition, it amended the 1933 Homeowner Loans Act (HOLA) which allowed the "creation of a system for the chartering and regulation of federal savings associations to facilitate consumer savings and home construction and purchases through affordable mortgage lending" (Vincent, Conference of State Bank Supervisors, 2010).

On September 23, 1994 the U.S. Congress passed the "Riegle Community Development and Regulatory Improvement Act." The purpose of this law was to "reduce administrative requirements for insured depository institutions to the extent compatible with safe and sound banking practices...." (Senate and House of Representatives of the United States of America, 2004). This Act contains provisions that intervene on the criteria on which the non-bank lenders segment to homeowners of low and moderate income, to minorities and elderly for mortgage predatory

[8] The Resolution Trust Corporation (RTC) was established in 1989 and its responsibilities were granted to the FDIC in 1995 so it does not appear in the introductory pictures as a regulatory agency.

lending. It lowers capital requirements and other regulations to encourage lending to small businesses. This law also contains more than 50 provisions to reduce bank regulatory burden and documentation requirements (Shaheen, Conference of State Bank Supervisors, 2010).

During this period, important changes were introduced in regulatory laws such as the Act of loans veracity of 1968, "Truth in Lendig Act"- Regulation Z. This law was intended to protect consumers in their interaction with lenders and creditors. In 1988, Regulation Z was amended to introduce disclosure requirements for adjustable rate mortgage loans; in 1995, this Act was once again amended to include tolerances for real estate secured credit. In 1996, one of the most contradictory reforms was introduced with the main purpose of the TILA, the limitation on lenders' responsibility in the errors by the disclosure of loans secured by real estate clearly left consumers unprotected (Consumer Financial Protection Bureau, 2013).

Economic Growth and Regulatory Paperwork Reduction Act of 1996. This Act was drafted so that "The Federal Financial Institutions Examination Council (FFIEC) and its member agencies (the FDIC, OCC, FRB, OTS, and NCUA) were required by EGRPRA (Economic Growth and Regulatory Paperwork Reduction Act) to review their regulations at least once every 10 years to identify any outdated, unnecessary or unduly burdensome regulatory requirements imposed on insured depository institutions" (Federal Finacial Institutions Examination Council, 2005).

In 1998, Citicorp acquired Travelers to form Citigroup, which became the world's largest financial company. This merger violated the Glass-Steagalls Law product of the Great Depression that separated deposit banks from investment banks. The following year, the U.S. Congress passed the Gramm-Leach-Bliley Act, which repealed the Glass-Steagalls Act and gave a green light to these risky mergers. The Gramm-Leach-Bliley Act provided a weakening in the regulations and the resolution process between the SEC and the Federal Reserve about new hybrid products[9]. By amending the Bank Holding Company Act, in section 4, they allowed the creation of a new financial securities company authorized to "underwriting and selling insurance and securities, conducting both commercial and merchant banking, investing in and

[9] See definition in glossary.

developing real estate and other “complimentary activities” (Shaheen, Conference of State Bank Supervisors, 2010).

In the late 1990’s there was the Internet Stock Bubble, when its burst in 2001 caused investment losses for five billion dollars (Ferguson, Inside Job, 2010). This was one of the first alarms for regulatory entities: self-regularization was not fulfilled and showed several major investment firms involved in money laundering, corruption and fraud. Given this, the systemic risk[10] growth the Congress, the Federal Reserve and the Government did not take corrective actions, indeed, deregulated more the financial system.

This is the case of the credit default swaps or CDS, because the Congress prevented that compulsory reserves were required for these financial products issued by insurance companies. Hence the inability of the system to reveal the danger of these instruments that played an important role in the contagion to the global financial system during the economic crisis that would begin in 2008. By way of clarification, the swaps are insurance contracts that protect the holder of an underlying asset in case of losses caused by credit default, usually due to bankruptcy or fee nonpayment (Houweling, Credit Derivatives, 1999, pp. 2-3).

In May 1998, one of the few attempts to regulate the derivatives[11] market occurred. Brooksley Born, as chairman of the Commodity Futures Trading Commission, proposed measures to regulate derivatives; this proposal never came to be enforced by the pressures of bankers who viewed threatened the business profitability of derivatives. In addition, to end with the proposal of the CFTC (Commodity Futures Trading Commission) Robert E. Rubin, Secretary of the Treasury, Alan Greenspan, Chairman of the Federal Reserve Board and Arthur Levitt, Chairman of the Securities Exchange Commission, issued a joint statement recommending not to regulate derivatives, rating their regulation as unnecessary (Ferguson, Inside Job, 2010).

Alan Greenspan, an expert in the financial world and former Chairman of the Federal Reserve, has made clear his refusal to regulate financial derivatives for decades. Greenspan said “what we’ve seen over the years in the market is that derivatives

[10] See definition in glossary

[11] See definition in p. 13

have been an extraordinarily useful vehicle for transferring risk from those who should not assume this one, to those who are willing and able to do so. It would be an error to regulate these contracts in a more strictly way" (Goodman, elpais.com, 2008).

In order to promote U.S. competitiveness in the global financial system through the support to financial innovation and the use of electronic commerce, President Clinton signed the Commodity Futures Modernization Act in December 2000. This law allowed to deregulate the legal framework of futures markets, allowing to trade futures contracts on individual stocks and to apply other financial innovations. This Futures Modernization Act is actually an amendment to the "Commodity Exchange Act" (CEA) in 1936, which was a product of the Great Depression. Besides setting standards for the creation, organization, control and function of financial markets, the CEA provides the legal framework under which operates the CFTC, Commodity Futures Trading Commission, which is the one that establishes regulations for financial markets.

In July 2008, amid the real estate markets in crisis due to the defaulting subprime mortgage, Ben Bernanke, the new FED chairman, enacted a law that prohibited abuses in a limited group of loans. This measure is a reaction to the crisis and recalls one measure of the 1994 Owner and Heritage Protection Act (HOEPA) that was not implemented by then-Fed Chairman, Alan Greenspan. This measure allowed the Fed to prohibit unfair or deceptive loans and refinance those loans that may be abusive or against the interest of the borrower (Patricia A. Mccoy, 2009).

The gradual but constant deregulatory process of the system began as a measure to promote economic growth. Fueled by new theorists pro deregulation, it reached several industrial areas, as the financial one. In this way, the determination of interest rates on deposits and loans by the market, the adoption of greater risks by the financial system, the risky mergers, among others measures already detailed, were allowed. This chronology gives us an idea of the support of politicians and bankers to this new trend that set the stage for the financial crises to come.

Conclusions

This first chapter works as a framework for understanding that economic, political and ideological conditions in the world lend themselves for the deregulatory tendency gained strength. Now, although the progressive financial deregulation experienced in the United States since the late twentieth century laid the foundations for the financial crisis of 2008, there were several previous financial crises that were a warning that something was wrong in the system. But of course, the economic benefits brought by deregulation were the engine that led to continue the dismantling of Keynesian policies in a very clear demonstration of excessive ambition.

Finally, I consider that the establishment of a deposit insurance institution such as the Federal Deposit Insurance Corporation (FDIC) can be very beneficial for the users' confidence in the financial system. After all, it is essential for the economic development of the people within it. But its counterpart has proven that these deposit insurance encourages the taking of greater financial risks and the creation of powerful financial institutions, thus, the belief and confidence that big financial companies will be bailout by the Government if fail. The key to avoid it would be regulation, control over financial leverage limits, limits on mergers among financial institutions, investment supervision with depositors' money, etc.

CHAPTER 2. - ANALYSIS OF THE 2008 FINANCIAL CRISIS AND SOCIO CULTURAL CONSEQUENCES OF THE FINANCIAL DEREGULATION IN THE UNITED STATES IN THE EARLY XXI CENTURY.

The second chapter will analyze the 2008 financial crisis in the United States. I will focus on the economic and legal policies that led to this crisis. I will continue with the analysis of the social transformations caused by consumerism and the increased use of credit in the late twentieth and early twenty-first century. This chapter will also include a case study of the housing bubble in the United States, along with the analysis of its social consequences.

2.1 Economic and Legal Policy in the United States that led to the 2008 financial crisis.

In this chapter, the 2008 financial crisis will be described as well as the economic and legal policies that caused it. In the early twenty-first century, the U.S. economy was fueled by the housing construction and the heavy spending of its inhabitants. Both behaviors were due to low interest rates maintained by the Federal Reserve, which led to new funding mechanisms for the growing real estate market through the subprime mortgages. Subprime mortgages were those granted to borrowers who did not meet the traditional standards of financial solvency.

By becoming real estate credit so attractive for the growing trend of home prices, low interest rates and the eagerness of buyers to access to housing, financial institutions devoted to happily spread the subprime mortgages. These were then sold to other mainstream financial institutions that in turn grouped them into packages, made them qualify based on its creditworthiness and probability of default with ratings of even AAA, being later sold to the international financial market. These assets (MBS mortgage back securities and collateralized debt obligations CDO)[12] will become known as the toxic waste by the bad business and the damage them caused in finances.

[12] See description in the glossary.

In the early 2006, with rising interest rates the Federal Reserve tried to stop the inflationary processes that had began, but it was the device that ignited the financial meltdown that would follow. The rise of interest rates popped the housing bubble causing thus the drop of the demand of this sector and with it, the prices started to fall. The financial system was severely affected due to the strong leverage it had with subprime mortgages, as these were subject to an adjustable mortgage interest rate with the rise of interest rates; defaults on these mortgages occurred in the whole country. Thus, the subsequent collapse of financial institutions began as well as the direct intervention of the Federal Reserve to rescue them from bankruptcy; one of the first ones was the Bear Stearns investment bank.

In the early 2008, the U.S. economy had entered in recession due to the decline of house building, credit reduction caused by distrust of the financial system, and the decline of the citizen's consumption in response to the two reasons above. Soon the crisis was reflected in unemployment rates[13] and the major stock indexes of the country and the world. During spring and summer it is believed that the crisis was controlled with the monetary policy of the Fed, but the bankruptcy of Lehman Brothers on September 15 and the collapse of the world's largest insurance company, AIG, were the first indicators of the magnitude and imminence of the financial crisis.

As a result, the stage for the financial crisis detailed was set by the dismantling of several regulatory policies, result of the Great Depression of the 1930's (as detailed in the previous chapter), the failure to update the regulations that remained, and new financial instruments. Also, it should be considered that the high degree of financial leverage, simultaneously with the low interest rates potentiated massive borrowing, limiting the ability to respond when the crisis exploded.

In my opinion, the phasing of the 1933 Glass-Steagall Act caused the greatest damage to the U.S. financial system. "The Glass-Steagall Act established what amounted to a dykes system to protect the economy against financial floods" (Krugman, ¡Acabad ya con esta crisis!, 2012, p. 36). This law is so important because it created the Federal Deposit Insurance Corporation, which guaranteed the deposits of savers in the case of bankruptcy of a financial institution, it covered up the financial system with security. This institution is still maintained and is one who

[13] From 2007 to 2009 the unemployment rate increased from 4.6% to 9.3%. (Moffitt, 2013)

has given the face in several occasions. As a counterpart to this bankruptcy insurance, this law also established the risk limits that banks could assume and prevented them to participate in investment businesses with their deposits savings. By eliminating the risk limits and the prohibitions to investments, a race to elevate the financial efficiency levels started.

In regard to the updating of regulations, it would be more correct to say “lack of adequate regulatory update.” In December 2000, the Commodity Futures Modernization Act prohibited regulation of financial derivatives because it considered it as unnecessary.[14] In 2004, by intervention of Henry Paulson (who became Secretary of the Treasure in 2006), the SEC (Securities and Exchange Commission) reduced financial leverage limits allowing banks to borrow more money (Ferguson, Inside Job, 2010). This extension of the financial leverage allowed to investment banks to buy more derivatives to the point that in the case of having a small decrease, the asset prices liquidity would be seriously compromised. And that is exactly what happened.

One of the policies that largely influenced the 2008 financial crisis was the excessive financial leverage in most economic sectors. When the crisis arose, most banks were not in a stable condition to afford it, so it led to many of them to try to reduce their expenses to repay their debt at all costs. But this measure, which is the most obvious in these circumstances, only worsened the situation of the country’s economy. If all are engaged to reduce their household expenditure, delay investments and reduce consumption to pay debts, the previous demand of the economy contracts and along with this, jobs are eliminated, production is reduced and the circulation of money decreases. In summary, the overall economy weakens more and the way for later retrieval is obstructed (Krugman, ¡Acabad ya con esta crisis!, 2012, pp. 25-29).

Thanks to the almost zero regulations, technological advances and huge profits made by negotiating with derivates, the boom of financial derivatives[15] was prompted, creating new financial instruments such as CDO and MBS. These last ones operated and obtained incomes in base of the subprime mortgages. Moreover, Credit Default Swaps (CDS) functioned as compensation in case of losses in an investment; in the

[14] More information about Futures Modernization Act on p. 27.
[15] Concept of financial derivative on p. 13.

words of Nouriel Roubini in the documentary Inside Job “they were compensating people for running giant risks.” In fact, the CDS led to the insurance company AIG to be rescued by the Federal Reserve as it was incapable to afford the CDS that backed subprime mortgages.

With the elimination of interest rates restrictions, the banking offer (due to better yields in deposits) increased so much that it became a more attractive business make risky loans. The higher the investment risk, the higher the interest paid was. Soon, the market was flooded by risky loans without conditions. This was the case of the real estate market where in many cases a loan was granted for the total property value, the buyer’s investment was zero. With the excessive credit offer for the real estate market, home prices kept an upward trend, reaching its price increase to 194% between 1996 and 2006.

Deregulation had set the stage for the financial chaos that ruled in 2008. A scenario exploited by bankers, speculators and opportunists who took their companies to the risk limit causing deep cracks in the financial system. The Federal Government saw itself in the urgency to intervene saving several financial institutions that were important actors of the crisis as the insurance AIG, Fannie Mae and Freddie Mac. [16] As it is known, economic crises are next to financial crises. Unemployment increased, the percentage growth of the economy contracted, being -0.4% in 2008, and the social crises would soon appear.

2.2 Social transformations and the progress of savage capitalism.

In regard to the social transformations experienced in the early twenty-first century in the USA, I think it is important to establish a before and after the financial crisis of 2008. First, during the mid-1980’s, and especially in the 1990’s, there was a burst of companies’ marketing spending that along with the increase of the consumption framework transformed the society into a devourer of goods and services. It became a savage capitalism[17] whose slogan was “Spend now and pay later;” as the credit was so affordable, the entire society cheerfully dedicated to live beyond their incomes spending what they could not pay.

[16] See definition in glossary.
[17] The term savage capitalism was first used by Pope John Paul II in 1991 and refers to the prevailing financial and economic system in the world.

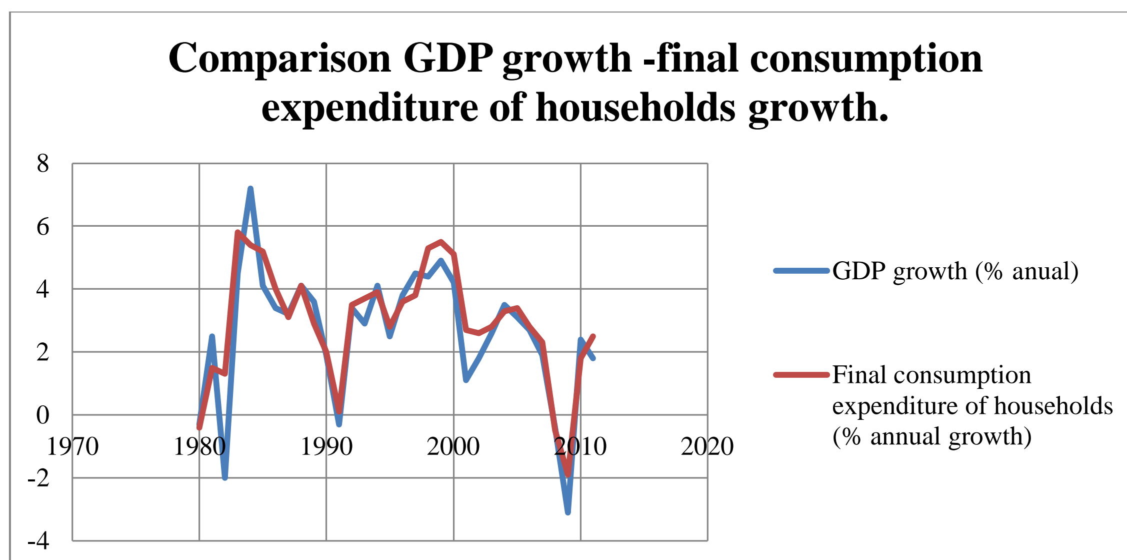
"This new version of capitalism, expresses without controls of any kind, without being subject to the principles of ethics, solidarity and respect for life in any place on earth. In this way, it imposes its economic, mercantile, commercial, industrial, military, and political conditions to the rest of humanity, without complying to standards or values, except those who dictate their own and huge interests" (Mejía, Elpaís.cr, 2013).

The deregulation becomes a paradigm or model that transforms all sociocultural branches. Financial deregulation in the early 1980's causes social deregulation and once the society has assumed this model, feeds much more this financial phenomenon becoming a spiral that leads to excessive consumption with borrowed money. The boom of access to credit and the apparent[18] increased purchase power of families result of financial deregulation propitious the strengthening of the mechanisms of consumption. Consumption is of course closely linked to the image that we want to project, becoming part of all spheres of life and in daily use products, film, fashion, and art (Rojas, Decano de la Facultad de Artes de la Universidad de Cuenca, 2013).

The consumption beyond the average incomes becomes part of the American culture that fueled by the social imaginaries forms a new cultural device. In graphic 1 we can see that the household consumption, when it is not parallel to the percentage growth of GDP, is always higher than this. People live beyond their income. We entered into a world where image and consumption are everything and credit becomes the easiest way to access to that image (Bojorque, 2013). In recent years, most of this consumer credit has been financed at low interest rates by China, one of the U.S. major lenders (Laffaye, Evolución reciente de la economía internacional, 2009, p. 62).

[18] Apparently, due to the stagnation of real wages in the U.S. since the 1970's.

Graphic 1: Comparison between the annual percentage growth of U.S. GDP to the annual percentage growth of final consumption expenditure of households.



Source: www.bancomundial.org

Made by: Arce B. Sofia

The image of the brands that build big companies like Nike, McDonalds, and Marlboro, what they sold are no longer products, but concepts, lifestyle; they sell an image. Their business is no longer based on production, but in the commercialization of their companies' image. The weight and power of the image is very clear with the example of the purchase of KRAFT in 1988 by Philip Morris at $ 12,600 million, up to 6 times greater than its total assets and sales. The price difference was the intangible value of the brand, the image representation of KRAFT in the society (Klein, El poder de las marcas, 2001, p. 36).

Thus, a global culture was born through cable television or other mass communications media and, that powered by marketing makes us long for and acquire more and more. The marketing seduces at all levels of life supporting the consumer culture to greater financial deregulation to encourage the acquisition of new images. And, of course, these images are part of the logic of consuming the latest, the contemporary, what is fashionable, etc. Investment in marketing becomes the most lucrative businesses passing total advertising spending from 50 billion

dollars to 200 billion in just the last two decades of the twentieth century (Klein, El poder de las marcas, 2001, p. 46).

As the best sell is what is best advertised and not the best product, the marketing logic takes over the movies, fashion and even political campaigns. Searching to influence the purchase of products have been designed very subtle marketing campaigns for movies and others (campaigns) not so. For example, the 1988 film My Friend Mac by Stewart Raffill, is full of allusions to its sponsor Mc Donald's, from the filming locations to the name of the star. The marketing also advances from the economic area to other areas such as the political in the construction of a candidate's profile. One of the pioneers in the construction of image using advertising agencies was Margaret Thatcher for the 1979 elections in the UK. Today political marketing campaigns are more elaborate, such as the one of Barack Obama in 2008, which included the use of social networking, TIC's, and communication strategies from the private sector.

In the case of fashion, this was very influenced by the influx of money into the market, the representation of fashion brands, and political figures like Margaret Thatcher. With the huge influx of money since the mid 1980's, several luxury brands were created for that market niche that want to spend a lot of money. "It was just before the fall of the New York Stock Exchange before the Gulf War, before the recession and everything was easy ...luxury was not embarrassing." Christian Lacroix (Worsley, Décadas de Moda, 2004, pp. 670-671) According to Worsley in the book "Decades of Fashion" the slogan was "dress to impress" and the market was flood with logos and labels "which became the ultimate symbol of prestige" in a society that has learned to distinguish at first sight the Lizard of Lacoste, the crisscrossed C of Chanel and the check of Nike. Prominent public figures such as Margaret Thatcher imposed the "fashion power" in female clothes with broad shoulders and more masculine styles for this new generation of successful women who were insert in the corporate labor market.

Art, on the other hand, echoing deregulation, no longer has rules; these have lost authority; it no longer depends on techniques or galleries, but on the market demand. Performance in the streets, installations in audio or video, and graffiti in the subways of New York multiplies as an explosive form of expression. Contemporary art now

without rules, without aesthetic parameters, what gives us is the opportunity to question ourselves and make us part of the work of art, as in the case of installations, where we are no longer simply mere spectators in front of a painting. If we look at picture 1 we ask, “Is this art? Yes it is,” (“Woman with shopping cart,” 1969, Duane Hanson in a scathing critique of consumerism). There it is: art is inviting us to question ourselves where we are by been guided by the sociocultural transformations of the late twentieth century.

Image 1 “Woman with shopping cart,” 1969, Duane Hanson

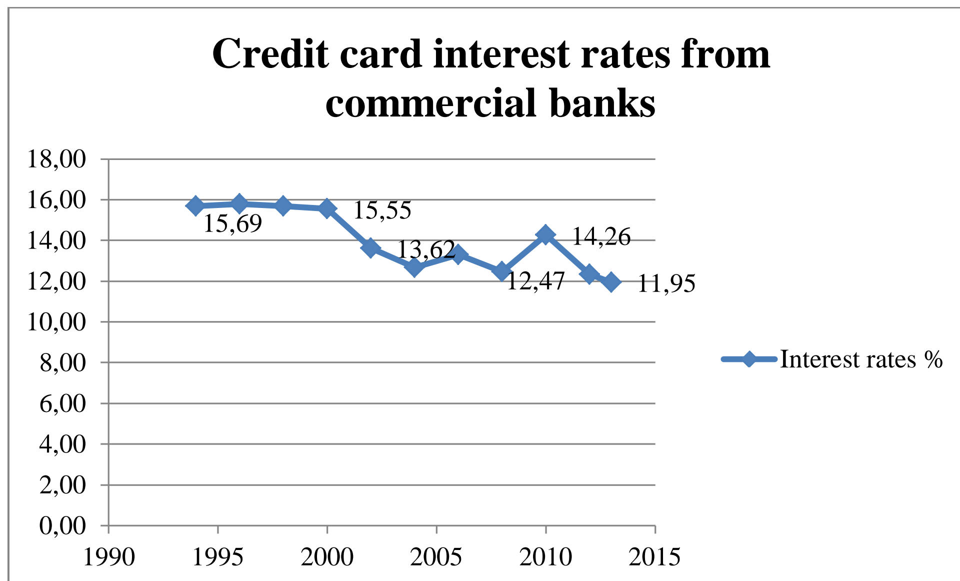
Source: www.studyblue.com

Relations between economic changes and socio-cultural practices.

With the arrival of the financial crisis in 2008, new practices and a clear inconsistent trend was evident in society. Now, while consumer credit from commercial banks had low interest rates, the same thing did not happen with credit cards interest rates (See Graphic 2). The average interest rate for credit cards between 1994 and 2008 was 14.34%; it was a high interest. If it was not the access to credit at low prices what motivated the consumer avalanche and the dependence on credit cards, what was it? Well, there is the socio-cultural change motivated by the desire to fulfill those American dreams that are projected by marketing and the expansion of consumption reference framework. There is no longer a consumerism power imposition on people; this is already a part of them. There is no need of brand; marketing seduction

becomes something natural, part of the culture. They become agents of power, agents of consumption who practice it, defend it and spread it. It is their lifestyle that is how they live; it becomes such a common practice that they will live with it for the rest of their lives.

Graphic 2: Credit cards interest rate from commercial banks.



Source: Federal Reserve Bank of St. Louis

Made by: Arce B. Sofía

In addition to marketing of products and services, marketing use by credit cards is so well thought that in it they never talk about money or credit; they directly attack values, desires, and need for recognition that are invaluable for customers. This is the case of MasterCard because those experiences are "priceless" or Dinners Club that is "a world without limits." The value as person begins to be measured by the quota of the credit card, by its gold, platinum, or black color, by what you can have access through it and the status you get with it. In their search to achieve the American dream the citizens get involved in this constant bombardment of advertising, entering into a consumerist spiral, becoming slaves of the banks, tied to them by their debts.

The dependence on credit cards among the population is immense and is present among the youngest poeple. This trend is clear among college students who consume hands full without being aware that a bad credit record limits their roles in the years to come. The fact that students without an income of its own and without a job

receive credit cards with high quotas is not a fact only in the U.S. but also in countries like Ecuador. It is a constant bombardment of credit cards that we can find in Internet advertising, television, street vendors and even in children's toys such as Barbies with tiny credit cards. The consequences are clear: the average debt of those who come out of college in the United States is $20,000 (Barnett, 2006). If the credit card debt is added to the student loan, what financial future awaits for those citizens?

The average population has transformed the productive matrix into one of consumption where people survive by paying the minimum to continue living beyond their limits and buying things they do not need. "Somehow we have created an economy that encourages excessive consumption to feed the economy" (Barnett, In debt we trust, America before the bubble burst, 2006). Factories had been replaced with malls as engines of the economy, as well as the society has changed from teaching children to enjoy saving to enjoy spending. It is a whole socio-cultural change pushing towards savage capitalism.

Credit and therefore debt so present in American culture are due to the desire to satisfy its infinite desires in the shortest possible time and to the so ingrained confidence in the buy now pay later. Here it should be noted that I do not consider credit as bad. It is and will be essential parts of the economy allowing families and business have access to needs that would be impossible to acquire paying cash; or putting money to pay lending it to those who can make better use of it. In fact we would be much poorer and both the economy and production would be stagnant in the absence of credit, but it is clear the danger of abusing of it.

In the documentary "In debt we trust" by Danny Schechter on which I have based for this subject of credit dependence, one of the points that impressed me the most was the following: thanks to the reform to the bankruptcy law signed by President Bush in 2005, those who declare in bankruptcy would be in greater difficulties to suppress their debts in a clear benefit to credit cards issuing companies. How can a Congress pass this law and then be signed by the President? There it is again, the immense influence of the lobbies and the pro financial deregulation finance companies over Washington to the detriment of voters.

And after the 2008 crisis...

When the housing slump infected the financial sector and the crisis was undeniable, new practices appeared and a clear trend toward neo Keynesianism became apparent. These new practices in the society were spread across many areas such as: the generalization of moral hazard across the population, changes in public pension plans, in the social security, in the time parents spend with their children and social manifestations such as the Occupy Wall Street movement.

Moral hazard is a common practice that we can detect in the U.S. population with the purchase and sale of properties financed with subprime loans. On the one hand, we have the financial institutions that distributed these loans handfuls without being interested on the borrowers paying or not because they sold it to other institutions with the name of MBS. On the other hand, it is the population that takes advantage of these mortgages, speculated in real estate market making big money, and when house prices began to decline, as they had not invested at all in these ones had no qualms to leave the mortgage. For the market generalized moral hazard was devastating as it had to assume all the negative consequences of other risky decisions.

"A few years ago, researchers of the Federal Reserve Bank of Boston examined the determinants of mortgage defaults, where borrowers cannot or were unwilling to pay. They found that while house prices were rising, it was rare to stop paying even borrowers who had lost their jobs; simply they sold the house and canceled the debt" (Krugman, ¡Acabad ya con esta crisis!, 2012, p. 28).

Mortgage foreclosures and abandonment, which until 2010 amounted to $6 million, have created ghost towns throughout the country, especially in California, South Florida, Arizona, and Nevada. It is exasperating to think of all this investment in empty houses that are rotting due to lack of maintenance, meanwhile there are families who desperately need them living in tents. According to a study by members of the University of Michigan "between 2007 and 2011, a quarter of American families lost at least 75 percent of their wealth, and more than half all families lost at least 25 percent of their wealth" (Fabian T. Pfeffer, WEALTH DISPARITIES BEFORE AND AFTER THE GREAT RECESSION, 2013, p. 2). The real estate social crisis has helped to mark the distance in the distribution of wealth. This is the result of the culture of speculation and greed.

With the economic crisis of 2008 the state and local governments' budgets were affected so that they turned to major changes in public pension plans. These changes were designed to generate higher contributions from employees and to reduce benefits for new employees. "Employer contributions to accruing benefits for new employees were cut in half, sharply lowering compensation for future workers" (Center for Retirement Research at Boston College, 2013, p. 2). Based on the study of the Centre for Retirement Research at Boston College that was made between 32 states, it was also determined an increase in the age for formal retirement, among other changes to cut costs after the hard blow to their budgets by the crisis.

But not all the consequences of the crisis are negative; the social safety net has responded promptly and was very helpful during the recession. The aggregate per capita expenditure on social security has grown significantly and equitably integrating various demographic groups like families with and without children, single-parent or two-parent families and to those with members employed or not. This increase took place mainly in programs such as: SNAP, EITC, UI and Medicaid. The recession officially ended in June 2009 and the economy is slowly recovering, but in terms of employment and production, the recovery has been slower. So now the question is whether the progressive withdrawal of social security funds as the economy recovers is opportune as it directly affects those with the lowest incomes (Moffitt, russellsage.org, 2013).

In addition, based on a study by Ariel Kalil of the University of Chicago and Kathleen M. Ziol-Guest of Cornell University about married parents' use of time, it can be deducted positive effects of the recession in this case for the children of these families. As a counterpart to the reduction of the fertility rate and of the increase in the rate of serious psychological distress, family life and child development has been promptly benefited by the time parents spend with their children at home.

The study delimited over the period 2003-2011showed that "the recession had the overall effect of increasing the amount of time fathers spend in child-care by about 30 minutes per week" (Ariel Kalil, russellsage.org, 2013, p. 3). While in the case of mothers' time dedicated to their children did not change after the recession. The most obvious reason for the increase of fathers' time spends with their children is the reduction of the time of these in the labor market.

Other cultural outcome of the crisis is the social force that gained social manifestations like the Occupy Wall Street movement that began on September 17, 2011 in Manhattan, New York. It denounced the abuses of the financial system and the corruption of the political power. This movement has been replicated in other U.S. cities, Canada, and Europe, encouraging large groups of people. Its aim is to raise awareness about corporate abuses, lack of regulation, promoting greater social equality, transparent democratic participation, as well as to make technology, knowledge, and culture more accessible to the general public (Occupy Wall Street, 2011).

Now as for the neo Keynesian trendy, this is reflected in the hope of businessmen and bankers that in the event their companies collapse the Government rescues them. These hopes are based on clear precedents as the state intervention in the economy during the Great Recession and the bailout of the Savings and Loan Institutions in the late 1980's. But this privileged rescue is only reserved to the companies too large to collapse or "too big to fail." That is why the collapse of the Lehman Brothers was a hard blow to the economy, not only for the economic losses, but for the frustrated hopes of state rescue.

This change from neo liberalism to neo Keynesianism is only momentary and at the necessary measures to rescue the capital. As Jose Soto describes it in his article *From neo liberalism to neo-Keynesianism...* it is a "lifesaver in time of the system." So, after the speculative tendency of the financial capital over decades comes to rescue the economy the Emergency Economic Stabilization Act in October 2008. This act created a Troubled Asset Relief Program with a fund of $700 billion. Along with this financial bailout, it is worth recalling the Federal Reserve intervention in the sale of the Bear Stearns investment bank, the rescue to the AIG insurance company and Fannie Mae and Freddie Mac. To these bailouts, I must mention the bailout package given to General Motors.

I consider that the General Motors case is important to mention as rescue packages that were originally intended only for the financial sector were granted to the automotive industry. Why? As for the high number of GMC employees that would have become unemployed, as General Motors CEO, Richard Wagoner, pointed out in November 2008. This package was complemented with incentives to encourage the

production of automobiles in which a sum of money was given to consumers in exchange for their used car to buy a new car. I think we can again show the economy supported by the consumerism of its population.

2.3 Case Study: the housing bubble in the United States.

I have already discussed about the housing bubble burst being the process that triggered the 2008financial crisis. In this part I will describe in what consisted this toxic process. But, what caused this bubble? What policies aggravated its development? Who won in this incident? And who were the most affected? These are some of the questions that I will try to answer in this case study based on the book *End this depression now*! by Paul Krugman.

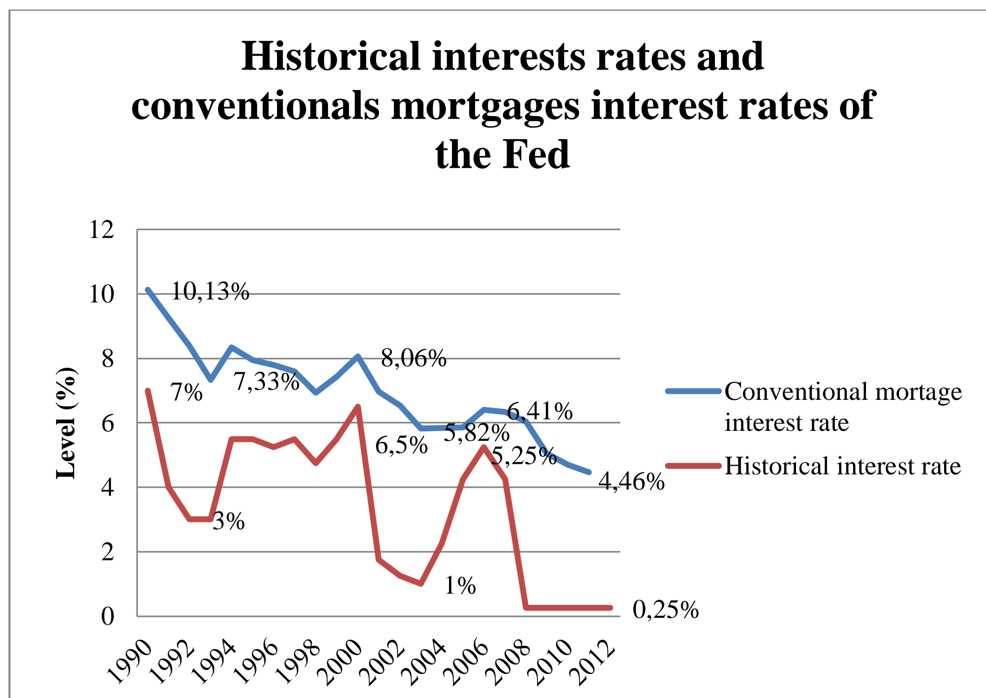
A bubble can be identified by symptoms such as abnormal upward trend in prices; confident that prices will not fall, consumers rush to buy before prices rise further and much speculation. This housing bubble started to grow with a policy that promoted affordable housing and with the decreasing of interest rates as policy to boost demand together with consumption that after the internet bubble had fallen. Nationally there was an explosion of prices in the housing market because of the strong demand from those who had not been able to access housing as owners. By the summer of 2005 in states such as Arizona, Florida, and California housing prices had increased by 150%, compared to 2000.

As discussed earlier, the business of granting mortgage without the past restrictions to people who could not afford them became a common business. For much of the 2000's the highest number of subprime mortgages was granted by private lending institutions that took advantage of the lack of regulation and not by Government institutions designed to promote housing credit. "In fact, during much of the housing bubble, Fannie Mae and Freddie Mac were losing market share rapidly because private lenders accepted customers that the government-sponsored organizations rejected" (Krugman, ¡Acabad ya con esta crisis!, 2012, p. 39).

In the mid-2004, interest rates began to rise; as a result, mortgage interest rates increased too (See Graphic 3). Those who could not access another loan to cover their first mortgage had to leave their homes. This wave of evictions for lack of payment throughout the whole country and the fall of housing demand, caused the sector's prices to start to fall. "The cities that had experienced the greatest ascents

during the bubble years now saw the largest declines: about 50% in Miami, almost 60% in Las Vegas" (Krugman, ¡Acabad ya con esta crisis!, 2012, p. 66). Other scenarios are the one of those buyers who purchased their homes at very high mortgages and when the prices of the sector went down, the value of their homes was less than the amount of debt, keeping them trapped by indebtedness. And of those ones who simply stopped paying at the decreasing up to 50% of the value they had paid for the house.

Graphic 3: Historical interest rates and conventional mortgage interest rates of the Fed from 1990 to 2012



Source: Federal Reserve of the United States

Made by: Arce B. Sofia

The precipitous drop in housing construction across the country began to affect the banking sector in the summer of 2007 by the strong relationship that held both industries.[19] The MBS (mortgage backed securities) that were the link between these industries caused huge losses to the banks and the international financial system, as these that once were AAA investments became bad debt. A wave of mistrust came to significantly reduce credit, preventing business investment and citizen's

[19] "In 2006, at the peak of the bubble, the builders laid the first stone of 1.8 million households; in 2010, only 585,000 began (Krugman, 2012, p. 20).

consumption. As the U.S. economy is highly supported by the consumption of its inhabitants it did not take long to fall into depression.

Bad policies, bad ideas, and some actors.

In order to make housing more affordable for families with low resources, a series of laws that created new departments of government, injected money through mortgage finance companies and encouraged housing loans, were approved. The 1992 Housing and Community Development Act created the U.S. Department of Housing and Urban Development (HUD) that since that date would regulate Freddie Mac and Fannie Mae; it also relaxed entry criteria for assisted housing. Three years later the Community Reinvestment Act allowed Fannie and Freddie to receive affordable housing credit for buying subprime securities. The 1997 tax cut legislation also influenced the growth of the bubble, allowing families to pay no taxes on the gain on the sale of a home up to $500,000 (Legal Information Institute, 2013).

Policies supporting access to affordable housing had a long-term vision in the governments of Bill Clinton and George W. Bush. For example, in July 1999 the Department of Housing and Urban Development announced the delivery of $2.4 trillion to Freddie Mac and Fannie Mae for the purchase of mortgages for affordable housing for 28.1 million families in the next 10 years (U.S. Department of Housing and Urban Development, 1999). In the Bush administration there were similar examples in order to reduce the gap that separated Anglo Americans from Afro Americans and Hispanic homeowners. The aim was to increase minority homeowners by 5.5 million by 2010. This was carried out through tax credits, support to Fannie and Freddie with $440 billion for mortgages to these minorities, and the deregulation of the home buying process, in what Bush called “make the rules simpler” (Bush D. d., 2002).

I believe that one of the main factors that allowed the housing bubble continued to grow was the belief that the invisible hand of the market had everything under control. For several years the consequences of the Great Depression were becoming a distant dream that everybody believed was not going to repeat. Financial theorists continued fostering the efficient market hypothesis influencing to those who determined real economic and legal policies. And there were those who fully trusted in these models to the point that today, they look for any cause of the bubble to not

look back at the decisions they made in the past. Aren't Conservatives the staunchest defenders of the free market and deregulation as an economic success? Yes, it was an economic success but only for 0.1% and 0.01% of the population.

Who benefited? Well, at first everyone distributed the earnings' pie of the housing bubble: new owners of 5 or more houses, builders, speculators, but no portion were compared to the banker's one. Bankers, politicians, and economic theorists fed their bank accounts with financial deregulation, and hence their support and proclamation of the benefits to the economy. By means of the already mentioned derivatives (MBS, CDO) they had huge profits through the massive delivery of mortgage loans and its subsequent sale to investors worldwide. "In 2006, the twenty-five best paid managers earned 14,000 million dollars, three times the sum of the salaries of the eighty thousand school teachers of city of New York" (Krugman, ¡Acabad ya con esta crisis!, 2012, p. 43).

The closeness between Washington and bankers led to greater corruption and to an exchange of work positions between the Government and the boards of financial institutions. Politicians, as in the case of Senator Phill Gramm, known as the father of deregulation, by being the promoter of the Gramm-Leach-Bliley Act, after leaving the Senate worked for the UBS financial services company. Or George W. Bush's Secretary of the Treasure, Henry Paulson, former chairman and CEO of Goldman Sachs. Financial institutions, on the other hand, have financed several political campaigns in Washington, while financial theorists have been influenced by politicians and bankers to support financial deregulation in their academic work. How to stop financial deregulation if their salaries depend on it?

Now if we talk about the affected ones, the housing bubble has obviously affected those who stayed indebted and those who lost their homes; but what about the increasingly marked inequality and rising unemployment? Fortunes made through financial deregulation since the 1980's had extended the economic distance between the U.S. population since it benefited from the 0.1% and 0.01% only. Krugman in his book *End this depression now*! provides a very accurate hypothesis: the 0.1 and 0.01 of 100 of the population had spent a lot more because they had money left over to do so. This changed the consumption framework for those who share their social circles, but have lower incomes. In the same way, this system is imitated in other social

strata, reaching to the lowest income and in order to cover the expected demand uses credit, filling up with debts.

Inequality is also present in the access to quality public education. Many families incurred in debts beyond their possibilities to seek neighborhoods with good schools. The same is true for hospitals and other nearby services that increased the value of the properties. This situation left them vulnerable in the event of job loss or illness. Inequality, on the other hand, continues putting pressure on policy; for example "politicians are rewarded for maintaining certain postures, and this makes them to more firmly defend it, and even be convinced that actually they have not been bought; ... (Krugman, ¡Acabad ya con esta crisis!, 2012, p. 52)," unlike the common citizen who does not have the resources or means to access to the offices of politicians or clubs like the National Republican Club as a renowned banker would.

The lack of jobs is one of the first indicators of an economy in recession, and in the United States, this situation occurred indeed. First, with the lower housing demand since 2006 unemployment for those who worked in construction was offset in other industries, but when the economic situation got worse it became increasingly difficult to find employment. "In December 2011, U.S. unemployment amounted to over 13 million, compared to 6.8 million in 2007" (Krugman, ¡Acabad ya con esta crisis!, 2012, p. 6). The long-term consequences for those who lose their jobs do not apply only to the economic part but to the emotional and the possibility of being hired again.

Apart from the loss of income, is the loss of confidence in the job skills and the psychological burden of the families of those who are unemployed. This is deeper in times of economic crisis because even though there is a little rate of unemployment in any economy, downtime is much greater causing anxiety and psychological depression. For example, out of nearly 7 "million Americans unemployed before the crisis, less than one of five spent more than six months without work, less than one of ten spent more than a year without work" (Krugman, ¡Acabad ya con esta crisis!, 2012, p. 7). This situation changed a lot in 2012: families that before the crisis came to the end of month with two jobs and now only had one, professionals who have been compelled to take jobs in which they do not apply their professional formation,

loss of health insurance, household savings depletion, loss of homes, among many other cases.

Unemployment among young people is even greater as it is the first time they are looking for a job. This is reflected in the new graduates of which “one in four recent graduates, approximately, is unemployed, or is in a part-time job” (Krugman, ¡Acabad ya con esta crisis!, 2012, p. 8). The damage to the careers of these young people in the long run is irreversible if compared to young people graduated in strong economic periods that had greater opportunities. Another consequence of unemployment among this group is the increasing number of young people between 24 and 34 years old who still lives with their parents due to lack of opportunities to leave the home of their families. The frustration for them should be huge if we add the high cost of college education assumed to obtain a profession that they cannot practice in this economy.

Finally, I think it is interesting to note a point that Krugman in his *book End this depression now!* says. The usual process when a buyer cannot satisfy his mortgage payment is that he loses the home through foreclosure. But it was precisely this mechanism the one that brought U.S. economy to crisis by the massive foreclosures that led to greater reductions in real estate prices. Foreclosures affect the borrower, the lender, society, and in this case the real estate industry. “The most beneficial to each other, would be have a program that would offer some assistance to troubled borrowers, while saves lenders from execution costs” (Krugman, ¡Acabad ya con esta crisis!, 2012, p. 75). Although a program on these grounds was conducted by the Obama administration in 2009, it had very few good results by the terms of the debt re negotiations.

The speculative tendency of financial capital together with corruption and greed created the financial crisis that so many losses and consequences have brought to American and the world. But the ones who created the structure for this to happen, bankers, theorists, and politicians, today look for any factor or excuse to not assume their responsibility in this disaster. Being them who allowed financial engineering to work in for excessive speculation and greed in financial products such as CDOs, CDS and MBS. Temptations like this make financial regulation so necessary, so the

financial system not only serves as a tool for the benefit of a few people, but for the benefit and safety of everyone.

Conclusions

I have no doubt that financial deregulation promotes the deregulator phenomenon of society and culture. And this sociocultural deregulator model based on the image and consumption encourages more financial deregulation, leading us to an uncontrolled consumerism that when we cannot supply with our own resources, we decided to use the borrowed ones. It is undeniable the brilliant role played by marketing in all areas to which it has led our longings and need of images satisfaction. As it is also undeniable the use and abuse of this one by companies to boost their profits.

Moreover, consumption beyond incomes and the incorrect use of credit cards is not a problem only of Americans. In Ecuador it is also present but in a lesser degree: over-consumption with the excuse that we are deferring the purchase or paying the minimum. We fall into the consumerist spiral that in the long run makes us slaves of the banks. I also believe that the enslaving debt threat is even greater for young people eager to make those images projected by marketing and media fall more easily into the consumerist spiral. Being aware of the trap set by advertising and banks through credit is the main weapon against the consumerist spiral and lifelong interest payments.

It is shameful to think that policies that were addressed to facilitate the access to housing for those who could not access it before, were used in the framework of financial deregulation for speculation and greed. Mass evictions, family suffering due to unpayable debts, thousands of houses rotting while a few kilometers families live in tents, are products of a savage capitalism that has no respect for ethics, solidarity and life itself.

With the collapse of the financial system in 2008 neo-keynesianism policies were seen as a lifesaver for those big financial companies that for almost 3 decades were dedicated to dismantle it. Government intervention cannot be seen as a lifesaver to disasters caused by greedy; it is a structure that must set clear boundaries for different economic circumstances. I want to conclude this chapter by referring to a comment by Andrew Shengen in the documentary Inside Job: “Why should a

financial engineer be paid from four to one hundred times more than a real engineer? A real engineer builds bridges, a financial engineer builds dreams. And when those dreams turn out to be nightmares, other people pay them."

CHAPTER 3. - ANALYSIS OF CAUSAL LINK BETWEEN FINANCIAL DEREGULATION AND THE RECURRENT FINANCIAL CRISIS IN THE UNITED STATES

In this final chapter I will perform a comparative analysis of the 1930 and 2008 financial crises. This analysis will cover the development of both crises, its consequences impact on the international economy and contrast of the monetary and fiscal policies implemented. I will also make a brief analysis of Mandel's business cycles theory, that will be complemented by Kondratieff´s long waves theory in the context of the 1930 and 2008 financial crises.

3.1 Comparative analysis between the financial crisis of 1930 and 2008.

After analyzing the 2008 financial crisis and all the economic and social consequences that resulted from it, I cannot help but wonder if not it is a replica of the Great Depression of the 1930. Is it the lack of financial regulation the cause of both crises and of the small recessions before experienced? In this part of the document I will focus primarily on describing the events that triggered the Great Depression of 1930 and later I will specify the links between both crises.

During the 1920's in the United States, an era of wealth and prosperity was experienced due to industrialization and the growth of world trade. This atmosphere of prosperity and confidence that surrounded the new economic power of the decade was spread through all the social classes that now were able to access the products of industrialization, giving way to mass consumption. This is the case of the new born automotive industry which thanks to the huge amount of consumption credit awarded by local banks allowed the automotive fleet of the United States to grow almost 5 times in 10 years (1929) (Karell, 1929- La Gran Depresión, 2009).

From the easy access to credit as banks requested not guarantee, the middle class began to buy cars, participate in the stock market, and use credit to pay their pleasures and consumption. The attractiveness of this growing economy and the desire for easy money attracted millions of Americans who invested all their savings in the stock market. According to the documentary 1929 - The Great Depression by

director William Karell, a third of American families invested their savings in the stock market in an effort to easily fill their pockets and in many cases accessed to loans to buy shares. The confidence that stocks prices would continue rising generated a general speculation; therefore, large credit risks were taken to invest in the stock market. A common citizen could go to a bank that lent him 60%, 80% of the investment without requiring assurances while he contributed with a minimum.

In general, they were ordinary citizens, from housewives to office workers, all those fascinated by the performance of Wall Street and the prosperity dream that it represented. As consequence of this general trend, the Dow Jones index grew rapidly, the vast majority of economic experts at the time ensured that this growing trend will continue, but the high degree of financial leverage and speculation made this growth unsustainable.

In October 1929, this house of cards began to fall apart due to loans granted irresponsibly, excessive stock price and mass hysteria. The actual decrease in the New York Stock Exchange activity was 80% from its highest point in 1929 and the lowest during the crisis. The collapse of stock prices caused great losses, deep indebtedness, lack of liquidity, loss of confidence in the economy, hurt the trade, the real estate market, led to the bankruptcy of several financial institutions and social problems. Finally, the inability of the president Herbert Hubert to conduct economic and social policies to control the economy and the society led to the Great Depression of 1930, leading to the social crisis of unemployed people and eventually to the political crisis of 1932 (Karell, 1929- La Gran Depresión, 2009).

Although I consider that in the late 1920's there was no concept of financial deregulation[20], we can identify elements of this such as lack of control over excessive financial leverage, no control on market speculation, and apparent lack of banking legislation (deposit insurance) to prevent withdrawal of funds in masses. Other factors that intervene and make a difference between both crises are liquidity, gold standard, and international cooperation.

In many ways both crises have the same causes; in fact, I consider that the detonator between the two crises were over-indebtedness, prompted by mass consumerism, loss of risk perception, and consumer credit without warranties. The phenomenon of

[20] The lack of regulation would become patent with the 1930.

mass consumption begins to be seen for the first time in the 1920's, so that the increase of consumer credit increase by big leaps, leaving the economy highly leveraged by the purchase of securities in this first case. This increase of debt started again in the 1980's when the ghost of the Great Depression's remnants had been left behind together with its financial regulations. "Over time, the perception that debt is safe leads to relax the criteria for granting loans, both businesses and families develop the habit of borrowing and the overall level of leverage in the economy rises" (Krugman, ¡Acabad ya con esta crisis!, 2012, p. 29).

In this part, it should be mentioned the Minsky Hypothesis or financial instability that by the over-accumulation of debt in relation to the assets or income during periods of economic stability is caused. This over leverage[21] creates economic instability and provides the basis for an economic crisis. As an obvious measure to settle debts, consumption decreases in general terms among the population, causing a further contraction of the economy, generating a downward spiral that has consequences in industrial production, employment, and society. Irving Fisher describes this situation that occurred in the Great Depression and it might be of the current crisis, "the U.S. economy entered into a recession with a debt level without precedent, which made it vulnerable to a downward and self -forcing spiral" (Fisher, FRASER Federal Reserve Archive, 1933).

I believe that one of the most sensitive points in a market economy is to pose a control to speculation. And it is not a matter that concerns only to legislators or to bankers; the average citizen has a conflict of interest because despite of having lived several bubbles by speculation, thanks to them he has had profits. "Speculation is the assumption of the risk of loss in return for the uncertain possibility of a reward" (Miguel Robles, 2009). In the case of the real estate industry (the 2008 crisis), as the risk was considered as nonexistent the growing trend of the price of these assets doubled in some states although it was not solidly supported. While financial speculation involves the buying and selling of stocks, bonds, commodities of which its holder benefits by the prices fluctuations of these in the financial markets. This case is present in both crises but we will focus primarily on its role in the crisis of 1930.

[21] See definition in glossary.

As with any novelty, Americans were unable to resist the trend of the moment: make easy money by participating in the stock market in the 1920's. Wall Street along with what it represented, became such an attractive image mainly in large cities that "in 5 years the stock prices were multiplied by 4 and the Dow Jones index rose from 100 to nearly 400" (Karell, 1929- La Gran Depresión, 2009). It had become a market with prices so high that stocks' value was incomparable with the actual values of the companies in which they were based on. The rapid growing trend and the advice of financial experts encouraged speculation among the general masses that relied on an uninterrupted upward, but of course bubbles never act like that.

The 2008financial crisis made evident the market risk due to speculation, leading the U.S. Congress to take action on the matter. Despite legal measures to control financial speculation such as the Dodd-Frank Act, specialists like Eric Posner of the University of Chicago believes that this only transfers the authority to various agencies and do not solve the main problem. Posner has proposed an evaluation of new financial products before these are allowed on the market based on their usefulness to society (Posner, A Proposal for Limiting Speculation on Derivatives: An FDA for Financial Innovation, 2012). Measures like this should necessarily be performed, as speculation goes beyond financial matters. It is in fact considered as the main cause of the worsening of the food prices crisis between 2007 and 2008. [22]

Liquidity contraction by bank failures had a lot to do with the collapse of the economy in 1930, which did not occur in the 2008 crisis due to the injection of capital into the financial industry and due to the Federal Deposit Insurance Corporation (FDIC) and the Glass-Steagall Act of 1933. "Some of the thirty's regulations are still in force, which explains why, in this crisis, has not been many traditional bank runs, with the massive withdrawal of funds" (Krugman, ¡Acabad ya con esta crisis!, 2012, p. 34). Based on a document of the League of Nations of 1933-1934 we can determine the percentage change in commercial banks deposits volume during the Great Depression in the U.S., being the years 1931, 1932, and 1933 the most affected by variations -8 , 4%, -22.8,% -11.8% respectively. While between September 2007 and August 2009, the average percent change was -8.5% in bank deposits' variation.

[22] More information on the food prices crisis in:
http://www.ifpri.cgiar.org/sites/default/files/publications/ib57.pdf

In the case of international short-term credit, it suffered a contraction, passing from $70 billion in 1930 to $45 billion in 1931[23], a reduction of 36% in one year, reflecting the decline in world trade and world stock exchanges. In the case of the 2008 crisis, despite the higher volume of international short-term loans, the percentage reduction was a lot lower, 15.01% between the late 2008 and the late 2009 (Moessner, Scielo.org.co, 2011). Highlighting the importance of deposit insurance used in various countries, we can see that they avoid mass withdrawal of funds, providing trust and ensuring greater liquidity to the economy. But as a counterpart to these deposits insurance should be an effective financial regulation that does not allow risky investments with depositors' money.

Talking about liquidity injection, the Federal Reserve (so did other banks) took care not only to provide liquidity to the U.S. economy during the crisis of 2008, but also to those economies that had shortages of foreign currency, in this case, dollars. This strategy was conducted through exchanges networks that allowed establishing currency exchange facilities among Central Banks through which a Central Bank provided its own currency or of a third party to another Central Bank, and vice versa in response to the general lack of liquidity (Moessner, Scielo.org.co, 2011). "... on December 17, 2008, the exchange network of the Federal Reserve provided 583.1 billion dollars to other Central Banks" (Moessner, Scielo.org.co, 2011, p. 28).

This strategy is completely contrary to the one that took place during the Great Depression when the Government decided to repatriate capital loaned to Germany cutting the flow of money. Germany, a ravaged country by WWI and exhausted by the conditions of the treaty of Versailles, saw its economy collapse and the Nazi extremism made its way to end democracy. With this background, when WWII ended, the authorities relied on donations rather than loans to rebuild Europe with the Marshall Plan.

Another aspect that differentiates both crises is related to politics and international leadership. Resentments among European countries originated during World War I, as in the case of France and Austria, limited the possibility of international cooperation to contain the liquidity crisis. Thus the patron of gold convertibility

[23] Data obtained from The Banking Crisis and the International Monetary System in the Great Depression and the Richhild Moessner and William A. Allen. 2011.

restricted the provision of international liquidity as in the case of the loan to Austria in 1931 where the amount was insufficient to make a significant change. While in the crisis of 2008 there was more international cooperation, as already mentioned, exchanges networks were used having the Federal Reserve a central role by the volume of dollars it provided to other Central Banks (Moessner, Scielo.org.co, 2011).

Although in the Great Depression of 1930 and the 2008 Crisis there were excessive financial leverage, excessive market speculation and lack of banking regulatory legislation, we can determine that in 2008 the economy was not as affected as in the 1930 crisis. The involvement of factors such as lack of international cooperation and the gold standard that were an obstacle that prevented an appropriate monetary policy (liquidity provision) during the Great Depression of 1930 had disappeared by 1971. In addition to these factors we must consider that the international economic structure had changed dramatically in 78 years as well as the engines of the economy.

Consequences of the 1930's Great Depression in the United States

The Great Recession of 1930 globalized the economic disaster and its social consequences. These crises that start in the U.S. financial markets found the perfect conditions to slow the economy, especially industrial production, world trade, employment, and society. In this part I will compare the consequences product of the Great Depression with its counterpart in the 2008 economic crisis.

In terms of industrial production, the decline was a lot more pronounced and longer lasting in the Great Depression than in the 2008 crisis. If we take as a benchmark the highest peaks of industrial production in both crises, July 1929 and December 2007, the average industrial production index shows that this had fallen -16.9% in 1930 and -3.4 in 2008 (See Table 2). Similarly, in the following years the industrial production in the decade of the 1930's was very unstable with major ups and downs until it stabilized in 1939, the beginning period of World War II.

Table 2: Average industrial production index in the U.S.

1929-1933 and 2007-2011.

Year	Average industrial production index
1929	11,0
1930	-16,9
1931	-17,2
1932	-21,9
1933	18,4
1934	8,4
1935	15,8
1936	18,0
1937	9,5
1938	-20,9
1939	22,7
2007	2,5
2008	-3,4
2009	-11,3
2010	5,7
2011	3,4

Source: Federal Reserve Bank of St. Louis

Made by: Arce B Sofia

Industrial production's instability in the decade of the 1930's was a factor that directly influenced long-term unemployment. In the same way, industrial production's decline influenced unemployment in the 2008 crisis, but not in the same way as in the Great Depression where unemployment was as high as 25% among the working population, while in the current crisis the maximum has been 10%. Unemployment among families leads to the reduction of expenses and investments. If industrial products such as automobiles are not bought, factories no longer have for whom to produce, close their plants and lay off workers. While the growing

distrust in the economy delays investment in businesses or in homes, the lack of liquidity in the market makes diffcult the delivery of loans by the financial system.

What about foreign trade? Foreign trade, as being so tied to industrial production considerably in both economic crises, was weakened. “It fell by almost 20 per cent in the nine months from April 2008 through January 2009, or by more than half as much as during the three full years 1929-32” (Almunia, From Great Depression to great credit crisis: Similarities, differences and lessons, 2009, p. 7). Now, despite the decline of industrial production was higher in the 1930’s, world trade was the most affected in the 2008 crisis. This was due to the largest number of manufactured goods in 2007; in 1927, 44% of global goods were manufactured compared to 70% in 2007.[24] Moreover, increased quality requirements and low tariff taxes the increased of vertical specialization have facilitated. This is to exclusively dedicate to the performance of tasks or manufacture of specific products in order to complement them with others and reduce costs.

Facing employment loss and industrial production reduction, social problems soon appeared in the 1930’s. The lack of resources to pay the mortgage of their homes or to pay rents led to thousands of families to live in tent cities of homeless located in parks like Central Park in New York. These tent cities were called Hoovervillages due to the damage that President Hoovert had made to the economy by his lack of intervention in the crisis. As a counterpart, the social consequences of the 2008 crisis, though serious were not as deep as those of 1930. They have been already detailed in the previous chapter.

[24] International Trade Statistics 2008, table II.6, source: http://www.wto.org/english/res_e/statis_e/its2008_e/section2_e/ii06

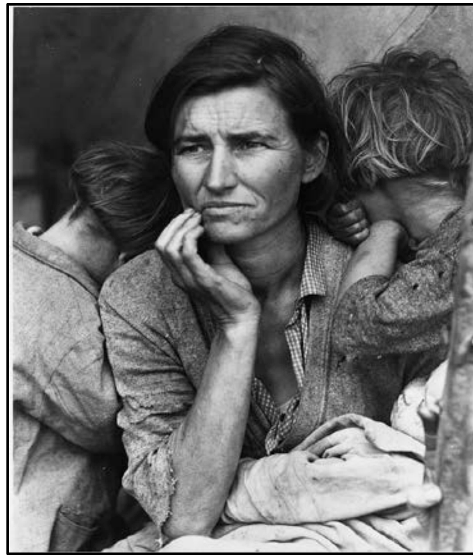
Image 3: Hooverville in Central Park, New York, 1931.

Source: authentichistory.com

The situation in the countryside was not the best; the reduction of wheat price (-50%) and other agricultural products led to the ruin of farmers. In an attempt to increase the prices of their products, farmers in many cases did not get to harvest their crops and even destroy them, "there were millions of tons of food, but no one could buy it" (Karell, 1929- La Gran Depresión, 2009). While hundreds were dying of cold and hunger, there were stores crowded with clothes that did not hit the market due to the prices offered or milk and crops destroyed by their producers.

As consequence of agricultural products' price reduction hundreds of thousands of farmers, especially from the central part of the country, left their farms in search of jobs; many of them were evicted. These would be the famous emigrants from the agricultural states captured in a series of photographs taken by the photographer Dorothea Lange (1895-1965) during the Great Depression. "Her photographs helped to sensitize the public of the conditions faced by migrants and helped to generate support for government aid programs" (Biblioteca Digital Mundial, 2013).

Image 4: California indigent vegetables Collectors: mother of seven children, Dorothea Lange, 1936.



Source: www.loc.gov

The impact of the 1930 and 2008 crises in the international economy

Thanks to the close relationships maintained with the world's largest economy, the international economy would soon be splashed by the American crisis of 1930 and 2008. In this section of the present work, the impact and the implications of both economic crises in the international economy will be discussed. This brief analysis will focus on Europe, Asia, and Latin America, highlighting the situation of some particular countries.

We must emphasize the importance of the geographical scope of both crises, as although its origin is in the U.S., its implications reach the global economy. Let's begin with the 1930 crisis. The direct contagion in this crisis was due to the first signs of economic crisis, the United States began to withdraw its capital invested in Europe, Central America, and South America. With the withdrawal of these capitals, mainly Germany and Austria, as being the most dependent on U.S. capital to rebuild its economy after the World War I, were affected.

Amid a scenario of economic desperation and unemployment as the one of the strong German depression of the early 1930's, a place to extremist regimes like the Nazi, as

already mentioned above[25], took place. Now, is it possible that given the serious economic situations of some countries were these pushed to choose extremism? Krugman suggests that "it would be foolish to minimize the risks that a prolonged recession represents to democratic values and institutions" (Krugman, ¡Acabad ya con esta crisis!, 2012, p. 13). This was precisely what happened in Germany with Hitler's rise to power with 33% of the votes in 1933, compared to 2% in 1929.

In both cases, the German and the Italian, the economic recovery in the late 1930's came by the hand of an autarkic policy, which is the self-supply of a variety of products and a strong weapons industry. "Hitler placed almost all unemployed people that decreased from 6 million to 400,000, the re-launch of the military industry made it produce 35% of Germany total income" (Instituto Bachiller Sabuco Albacete, 2009). Both policies, the autarkic and the rearmament ones, laid the way for the expansionist campaigns in search for raw materials outside Germany and Austria.

From this first blow to the German economy, the economies of the rest of Europe adopted policies of restriction of money in circulation, restrictions on imports, limitation on capital flight, freezing, or reducing wages. These policies, however, were unsuccessful by reducing unemployment or recession. The country with the lowest unemployment rate was France with 3% because its economy was more agricultural than industrial and as it was so diversified, the fall in the price of a single product did not mean a huge economic blow. However, depression was evident in France with the bankruptcy of some banks.

On the other hand, Britain, thanks to its colonies could continue getting products and trading them without being affected by the reduction of international trade. But in "June 1931, due to the banking crisis in Germany and Austria, a large amount of foreign capital of British banks was withdrawn, which together with the block of many British bank accounts overseas, lowered the reserves of gold and put in danger the stability of the British pound" (Instituto Bachiller Sabuco Albacete, 2009). Among the actions of the government to control the economic crisis were the devaluation of the pound, increase of import taxes, support to the steel and mining industry, as well as the promotion of the consumption of British products under the

[25] See p. 53

slogan "Buy British" and the establishment of a preferences system with the Commonwealth. In Britain, as well as in other countries, the economic recovery would come from the hand of the arms industry between 1938 and 1939.

In the Latin American case, the country hardest hit by the Great Depression of 1930 was Chile according to a report by the League of Nations. But the 1930 crisis affected in general the export of raw material of Latin American countries. The heavy borrowing at the late 1920's in Chile under the government of President Carlos Ibanez del Campo, created a sense of economic prosperity that ended abruptly when loans in dollar ceased with the fall of the New York Stock Exchange in October 24, 1929. In the case of Chile the exports of saltpeter, copper, and other raw materials fell drastically, severely affecting the economy, reducing gold reserves to a minimum, and forcing the suspension of payment of the foreign debt in July 1931. By 1932, exports were reduced by 85% compared to 1929 (Biblioteca Nacional de Chile, 2013).

Apart from the devaluation of the Chilean peso, appeared the abandonment of the gold standard and the rising inflation that strongly affected the Chilean society. Thousands of workers lost their jobs and dedicated to wander in streets and parks. "The soup kitchens proliferated in the neighborhoods, and many people ended up living in caves in the hills around the city" (Biblioteca Nacional de Chile, 2013). The most affected sector was mining, reducing its product by 45% and causing high unemployment.

By the end of 1932, the first signs of economic recovery in almost all industries began to be seen. The recovery of the world economy after 1933 influenced in the international price of copper, increasing mining exports by 26.8% and total exports by 18.3%. In addition, with the election of a new government, stimulus policies for the industry through development banks and protective tariff were initiated (Toso Roberto, Banco Central de Chile, 1983).

In the Asian case, the turbulences of global economy were present by a crisis of growth and excess installed capacity in Japan. After this growth crisis in 1930, it was decided to develop the light industries (textiles, food, wood) in Japanese colonies, particularly in what today is South Korea. Along with the Japanese rearmament since 1933 heavy industry will start again with force by the hand of the industrialization

process led by the Japanese State in North Korea and Manchuria[26] (Schuldt Jürgen, La crisis asiática, Lecciones para América Latina, 1998, pp. 24-25).

Now, if we look at the 2008 financial crisis we can find other elements in terms of the speed with which the crisis spread, the impact pathway for economies depending on their size and the implications for the different regions. In addition, based on a study done by the International Monetary Fund, I will briefly discuss the correlation in the economic performance of the world's economies as a consequence of the 2008 financial crisis.

Contagion of the 2008 financial crisis from the United States to the world economy was faster than during the 1930 crisis due to the tight integration of international financial and trade markets, as well as the fact this crisis had the technology to speed financial operations and instruments such as MBS, CDO and CDS, key pieces of the crisis. Furthermore, the sudden worsening of the financial uncertainty played a very important role because it "altered the perceptions of global investors" by cutting off the investments flow (Pescatori, Fondo Monetario Internacional, 2013).

In fact, this crisis reaches both developed and developing countries, but in different ways. This occurs through the infection with the already mentioned MBS, CDO and CDS to European and Asian banks filling the global financial system with this toxic waste. While the effect for developing countries comes mainly from the reduction of international trade in raw materials, credit, investment, and remittances.

In the case of the European Union, the effects of the crisis begin to be noticeable in the mid-2008 with the slowdown of the economy and the exports reduction that directly affects the drop in industrial activity and unemployment. "GDP growth in the EU-27 was negative during the last trimester of 2008 (-1.5%), while industrial production fell in December (-2.6%) for eight consecutive months" (Laffaye, Evolución reciente de la economía internacional, 2009, p. 60). Specific examples of the crisis's impact is the case of Germany that reduced its exports by more than 7% and its industrial production by 5% in the last trimester of 2008. This pattern is also found in countries such as Britain, Spain, Italy, and France where the recession and unemployment reached highest levels than those predicted. Thus, the crash of 2008

[26] In 1910, Japan annexed Korea, and in 1931 Manchuria also became part of the Japanese empire.

in the U.S. had a direct effect on the euro crisis and show out the weaknesses of this coin.

With the reduction of the main worldwide consumers' purchasing power, Latin America and the Caribbean have been affected depending on its trade and financial linkages. To a greater or lesser degree, the crisis affected Latin American exports, reduced remittances, while the uncertainty of the financial markets reduced credit and investment. The most affected Latin American country could be Mexico due its close business relationship with the U.S. economy. In the case of Argentina and Brazil in the late 2008, they were affected by the reduction of exporting raw materials price and the 35% retention of them imposed by the government in the Argentine case. Raw materials that encompass industrial inputs, petroleum, food, and beverages, from the late 2007 showed a very high volatility, with a sharp decline of these in 2008, according to the IMF.

In the case of Ecuador the crisis affected the level of inflation during 2008, the increase of unemployment, the reduction of migrant remittances, the reduction of exports and oil revenues. In 2008, prices ended with an inflation rate of 8.83% compared to 3.32% from the year before. According to the study "Determinants of inflation in a dollarized economy: The Ecuadorian case" (2008), it was determined that the main factors for this inflation were international commodity prices, exchange rates in Colombia, Peru, and the Eurozone and the increase of wages, freight costs, transport, and public spending (Gachet Iván, Banco Central del Ecuador, 2008). The unemployment rate increased from 7.3% in December 2008 to 8.6% in the first trimester of 2009; this represents 320,000 unemployed ecuadorians.

As result of the world economic crisis on the main countries where Ecuadorian migrants reside, remittances were significantly reduced from the third trimester of 2008, reaching its lowest level in the first trimester of 2009 with 608.8 million dollars. This decrease represents a reduction of 25.8% over the first trimester of 2008. The year 2009 was when the country was more beaten by the crisis due its exports declined: 26.3% compared with the previous year. In regard to the reduction of oil revenues, this is the result of oil prices fall from late 2008 until mid-2009 and the contraction of the international demand (Falconí, Impacto de la crisis económica internacional en el Ecuador, 2013).

Although Asia was not directly affected by the financial and real estate bubble in the United States, its heavy reliance on exports to the West has led to the contraction of many of their economies. In the case of Japan, in the words of Finance Minister Kaoru Yosano, Japan faces "the worst crisis since the Second World War." The Japanese economy "contracted in the last quarter of 2008 at an annualized rate of 12.1%, according to data released by the Government ..." (Laffaye, Evolución reciente de la economía internacional, 2009, p. 61).

The case of China is very similar to Japan in terms of exports reduction[27] as a result of the reduction of the international demand. The big problem that face both countries is that with a so weak domestic demand, industrial production should be reduced by closing factories and leaving hundreds of thousands jobless. China's interest in the economic recovery of its key markets is not its only concern; in recent years due to the low interest rates this country has become the largest lender of the United States. "China is interested not only in having guarantees that the money in Treasury bonds will be recovered, but also to avoid a scenario in which the US dollar devalues a lot, since it depends the value of its assets and its exports on, pillars on which the recent economic expansion are based on" (Laffaye, Evolución reciente de la economía internacional, 2009, p. 62).

Finally, I would like to refer to an IMF paper that argues that global financial crises lead to the product synchronization of the world's economies. The study is based on the dramatic increase of the correlations between the GDP growth rates of all countries during 2007 and 2009. After the turbulent years of the crisis, this correlation has decreased approaching to its pre-crisis levels. "Trade and financial linkages are the most likely explanation why to other countries specific shocks of a country may be transmitted." Other options for this synchronization are the strong common shocks that affect groups of countries at the same time or the size of the economy where the crisis occurs because the worldwide product synchronization will be greater (Pescatori, Fondo Monetario Internacional, 2013).

Financial deregulation caused crisis in the world's largest economy; this one in turn due to its financial ties with developed countries infected them with a problem that was born outside its borders and highlighted others. Now these developed countries

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[27] Between February 2008 and February 2009, exports contracted 25% and imports 24%.

in a greater or lesser degree have been amid serious economic problems that have affected its industrial production, employment, society and have reached developing countries due its commercial links. It is undeniable the influence of the 1930 and 2008 crisis in the societies and economies of the world when trade and financial ties are becoming stronger. When thinking about the impact of global financial crisis on the global economy we can evoke the image of a domino when a piece falls and causes an immediate effect on all those pieces aligned to this one.

Contrast of monetary and fiscal policies in the 1930 and 2008 crises.

In response to both economic crises, many theories as a solution have been posed. For example, can be it supported the IMF idea that monetary policy is less effective in financial crisis, while fiscal policy becomes more effective?[28] On the other hand, others support the theory that the increase in public spending has no effect on production (Almunia, From Great Depression to great credit crisis: Similarities, differences and lessons, 2009, p. 14). I think it is better to stick to the facts. This part will contrast the monetary and fiscal policies of both crises trying to prove its effectiveness and the importance of conducting them together in times of economic crisis.

As it has been already mentioned the gold standard was an impediment to take necessary monetary policies due to the fact that Central Banks of each country emitted their currency in terms of gold reserves. In 1930, both liquidity and interest rates were affected by this instrument that so well for decades had worked, but in 1930 th emonetary policy hindered. The gold standard represented the impossibility of injecting liquidity through loans to commercial banks in need if the gold reserves of the Central Bank were close to the minimum. Due to the lack of state support, over 4,000 commercial banks closed (Rotger, liberalismo.org, 2004) .

In addition to this constraint, the Fed allowed that the money supply sharply was reduced between 1929 and 1933 (Almunia, From Great Depression to great credit crisis: Similarities, differences and lessons, 2009, p. 12). Taking as reference the liquidity problems and obstacles to monetary policy the gold standard convertibility finally ended in 1971. Moreover "in 2008-2009 floating exchange rates prevailed, and internationally coordinated monetary policies were not needed and interest rates

[28] International Monetary Fund (2009), World Economic Outlook, Washington, DC: IMF (April).

could be determined by considering domestic economic objectives" (Moessner, Scielo.org.co, 2011, p. 65). With more freedom to maneuver, the Federal Reserve promptly avoided a second Great Depression in 2008.

A similar consequence of the gold standard was the rise of interest rates between 1931 and 1932 in the United States, Britain, Germany, and Japan in an attempt to protect their currencies. The contraction of money supply further weakened the economy by reducing the consumption of the population, cutting the resources to hire employees for factories and invest in business. Taking as basis the Great Depression and Keynesian policies of state intervention in the market, major Central Banks of the world did not take long to act. Both, the Bank of England and the Federal Reserve, aggressively decreased its interest rates to encourage consumption and thereby stabilized the economy in 2008. This was well known by President Bush or his advisers in the speeches after the terrorist attacks of September 11, 2001. In them he called Americans to continue participating and relying in the economy the attacks as they had done before.

Now one of the weight elements for the recovery of the U.S. economy in the 1930's were the actions taken with respect to the gold standard. In 1933, President Franklin D. Roosevelt imposed a ban to exchange gold for dollars to citizens, as well as the prohibition of the possession of more than 155.5 grams of this metal (five troy ounces), while gold convertibility to currency of the Federal Reserve to governments and Central Banks was limited. The prohibition of gold ownership responded to the necessity of the Federal Reserve to increase its gold reserves; due to this measure the Government could revalued the currency at $35 per ounce of gold when it re adopted the gold standard in 1934. In this way the US dollar was given more purchasing power for international transactions and the output of U.S. dollars was limited (Rotger, liberalismo.org, 2004).

The increase of fiscal policy is another measure widely used in periods of economic crisis. At the first signs of the crisis in 1929 the Government, as already mentioned, did not understand the magnitude of the problem and had a passivity that led to the Great Depression of 1930. For example, one of the reasons in the early 1930's for not supporting fiscal policy was the fear that this could lead to an outflow of reserves through imports. Later, the "New Deal" of President Roosevelt in 1932 contemplated

the increase of fiscal policy as a measure to boost the economy. Within the New Deal in infrastructure, roads, jobs for the unemployed was invested (for 1934 were 4 million), the minimum wage was defined, the social security was established and the most important point, the financial system was regulated. “It is time for the government to spend more, not less, until the private sector is again prepared to boost the economy. However, to establish policies of austerity and job destruction, it has been usual” (Krugman, ¡Acabad ya con esta crisis!, 2012, p. 3).

As well as during the Great Depression, similar measures were also taken in the latest crisis; on February 17, 2009, the “American Recovery and Reinvestment Act" was approved. This consisted of a stimulus package for the value of 787 billion dollars that were distributed throughout the country to make or repair infrastructure such as roads, airports, or on education and unemployment matters. Defense spending as fiscal stimulus also proved to be an enhancer of the economy. According to fiscal policy the percentage of government spending by the GDP is determined, whereas defense spending by exogenous factors is. An example is the increase in defense spending in the 1930’s against Hitler’s rearmament program or after the terrorist attacks of September 11, 2001.

I think that the problem is not that the government spending in fiscal policy has no expansionary results for the economy, but in not knowing locate the right elements in which to invest. Similarly, the effectiveness of monetary policy in the midst of an economic crisis will depend on how appropriate it is to the circumstances of the crisis. Monetary and fiscal policies adapted for each economic reality, working hand in hand can undoubtedly stop the downward spiral of economic recessions. And although the background errors that led us to two world economic crises repeated, there is no excuse to repeat the mistakes of 1929.

3.2 Recurrent financial deregulation strategies.

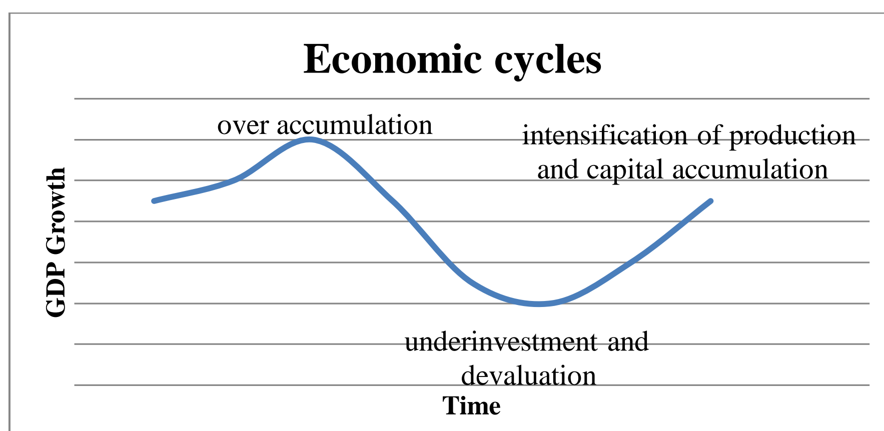
In this last section, I will discuss the theory of business cycles and the presence of economic crises within long waves. However, I considered important to mention these capitalist economic crises from another point of view, I will not delve into the issue by the fact that these theories date back to decades ago and to other economic realities. Therefore, I will use material from the socialist theorist Ernest Mandel in his book Late Capitalism. Mandel’s theories will be supplemented with Kondratieff’s

to understand the dynamics of the economy and how these theories from the scope of the crises of 1930 and 2008 are analyzed.

“Business cycles are recurrent fluctuations in economic activities. A cycle consists in a period of expansion and another of recession or contraction. This sequence of changes is recurrent but not periodic; the cycle time varies” (Blas, Univ. Carlos III de Madrid, 2011, p. 2).

These cycles consist of the acceleration and deceleration of capital accumulation, that is, economic boom or crisis. The peak of these cycles is reached when the rate of profit or surplus begins to fall. Accumulated equity thus can only be invested at an inadequate rate of profitability and at lower interest rates. This situation in which capital is no longer invested in production is known as over accumulation. On the other hand, crises by devaluation and partial destruction of capital are particularly important. Crises give way to underinvestment, which is insufficient capital investment to market needs. Underinvestment and devaluation once again raise the rate of the return to capital allowing the intensification of production and capital accumulation. “The entire industrial cycle arises as a result of the accelerated accumulation of capital, over accumulation, the slowdown in capital accumulation and underinvestment” (Mandel, Las "ondas largas" en la historia del capitalismo , 1979, p. 107).

Graphic 4: The economic cycle



Source: “Late Capitalism,” Ernest Mandel

Performed by: Arce B. Sofia

According to Marxist academic theories, the capitalist crisis of over production or the oscillations of the economic cycles are the result of the internal laws of the capitalist mode of production. The problem is the structure and its components; for example, Mandel argues that the course of the capitalist cycles of production is determined by surplus production of them. Due to the development of technology, the labor force is reduced, although it leads to the increase of production and surplus and causes the contraction of the market. Whenever there is someone who buys goods, there will be cycles' expansion, but when consumption falls, these economic cycles contract and will be followed by crises of overproduction. "All capitalism crises are crises of over production" (Rojas, Decano de la Facultad de Artes de la Universidad de Cuenca, 2013).

A good example of these crises of overproduction is the one experienced recently in the United States in the automotive industry. The installed production capacity was a lot greater than car demand; this situation later caused crisis in Detroit and a bailout package for General Motors Company and Chrysler in the late 2008. This is the reason for having granted the bailout package and incentives for the automotive industry; the bankruptcy of these giants would have led to almost a million people into unemployment and to a greater contraction of the economy by the consumer crisis. According to Dr. Carlos Rojas, Master in Economic Development for Latin America, overproduction contracts the economy in a vicious circle that cuts the consumption cycle, contracting the domestic market and the world market.

And what about the accumulated capital that is not invested in production? (Over accumulation) This capital becomes idle money; it turns speculative. "Idle money (lending capital) is characteristic of all crises" (Mandel, Las "ondas largas" en la historia del capitalismo , 1979, p. 134). Since it is no longer profitable to invest money in production, it is lent for investments such as stocks, bonds, or real estate speculative pyramids. Does it remind the reader the beginning of both the 1930 and the 2008 crises? Once again, these crises are consequence of the structure of capitalist production, which leads to over production.

In real life, business cycles in an economy like the U.S. directly affect those countries that maintain strong business relationships with them. This is the case of China, the largest exporter to the U.S., which upon seeing the reduction of this

market, has chosen to form a huge middle class, so their production could be consumed in the domestic market (Rojas, Decano de la Facultad de Artes de la Universidad de Cuenca, 2013). I would also say that those countries that maintain free trade agreements are greatly affected due to the largest volume of bilateral trade. For instance, Chile has experienced a decline of its copper exports by 43% between 2007 and 2009 according to trapemap.org.

Within the economic cycles we have “the long waves” which is a theory that explains the processes of growth and economic depression. This theory by the Russian Marxists, Alexander Helphand and Parvus, in the late nineteenth century, was developed and deepened by Nikolai Kondratiev in 1926. According to these authors, long waves of expansion are followed by long waves of economic depression. In these long waves, factors such as technology, external market conditions, and super structural order are involved.

Technology creates long waves by directly influencing in productivity, transportation and communication. “Every period of radical technological innovation is a period of sudden acceleration of capital accumulation” (Mandel, Las "ondas largas" en la historia del capitalismo , 1979, p. 110). These periods of technological revolution in an industry lead to the mass accumulation of capital that will gradually decrease as the rate of growth of the industries declines. With the decline of the profit rate, greater investment in technology are interrupted, which leads to underinvestment and again to the appearance of idle capital.

Within the framework of these business cycles theories we can recognize some similarities and differences between the crises of 1930 and 2008. Both crises had their origins in crises of over production and consumption that were aggravated by idle capital, which led to speculation in the stock market in 1930 and to real estate speculation in 2008. Unlike the 1930 crisis, in 2008, due to the size of the economy the collapse would have been a lot more severe if the government had not intervened with bailouts. But in both crises there was unemployment, fall of production, and underinvestment. The most striking point is that, despite the precedent of the dangers of allowing over-production, massive indebtedness, over accumulation of capital and speculation, financial deregulation continued and until today no one has taken any serious measures to correct it.

Just like the Keynesian followers who forged the New Deal in the 1930's, neoliberals and deregulation also needed an economic crisis to gain access to the spheres of power. Theories of business cycles can be very useful for understanding the dynamics of the economy; however, even though they affirm there will be crisis, those who are in positions of power are the ones who must set rules to avoid them since markets can only survive with rules.

Conclusions

After the analysis of the financial crises of 1930 and 2008: their origins, development, consequences, and effects, we are aware of the recurrent deregulatory errors. We can point out the following points: First, unlike 2008, in 1930 people did not know the serious effects that the absence of rules could bring to the market. If we fail once, we can blame it on ignorance; if we fail twice, it is only our fault. Second, I consider that the detonator of both crises were over-indebtedness, prompted by mass consumerism, loss of risk perception, and consumer credit without warranties.

Third, we can be evidence the effectiveness of the Federal Deposit Insurance Corporation (FDIC) to insure bank deposits and thus avoid massive withdrawals of funds, followed by bank failures, liquidity contraction, and economy collapse. Fourth, it is undeniable the harmful effect of the economic crises of 1930 and 2008 emerged in the United States in the economies and societies of the world due to strong trade and financial linkages. Fifth, although low industrial production, unemployment, and decline of world trade are present in both economic crises, the social consequences are a lot deeper in the 1930's crisis.

Although both economic crises started in the U.S. and spread to the world, international cooperation proved in the 2008 crisis to be an important factor to provide liquidity to the international financial system through trade networks. This is one of the lessons that we can learn from contrasting both economic crises: international cooperation is an ally to the injection of liquidity of foreign currency along with the coordination of appropriate policies. Besides, the necessary adjustment of monetary policy and fiscal policy during an economic crisis will depend on its circumstances as well as on its resources. Both policies working together can slow down the economic des-acceleration and reduce consequences for citizens. Finally, I consider important to know different economic theories, like the

theory of business cycles, to extend our analysis framework and be able to focus on financial and economic crises from another point of view.

Conclusions

The deregulatory process in the U.S. financial system has been explained so far. Therefore, we can see it as an unstable structure that has expanded over the years thanks to economic and political conditions and the acceptance that neoliberal theories had in the fields of power. There is no doubt that this progressive deregulation was the one which set the stage for the 2008 financial crisis and that the several earlier financial crises were a warning for the system. In spite of the economic benefits brought by deregulation, the dismantling of Keynesian policies continued in a clear demonstration of excessive ambition.

This deregulatory sequence along with the speculative financial capital trend, corruption, over financial leverage, and greed originated the 2008 financial crisis. The responsible ones for the creation of this time bomb were bankers, theorists, and politicians who now look for excuses to avoid their responsibility for the creation of financial derivatives, for allowing banking institutions run such huge risks, and for the dismantling of regulations. The regulation of a financial system is a way to get benefits and safety for most of people, not as a tool of profit for a small group.

This deregulatory financial model expanded into society and culture that now are based on appearance and consumption. Thus, culture and society have entered into a downward spiral that encourages more financial deregulation, leading us to rampant consumerism and finally to massive indebtedness. As consumers, we must be aware of the role of marketing in the creation of these images and that as a consumption promoting agent it has been excellent at the moment of correctly identify our desires.

In regard to the economic cycles, we can detect over capital accumulation since 2001 thanks to low interest rates that encouraged mortgage demand and caused the housing bubble. But in the case of consumption through credit cards, the motivation was not the low interest rates, but the consumer way of life that had settled over of society. Facing the explosion of images that offers marketing and the mass media, the desire to perform these images or desires are satisfied through progressive credit card indebtedness. Living beyond limits has become such a common practice that we are turning credit cards into an eternal debt fed by our poor management of them; we have also become slaves of banks. The main defense against the consumerist spiral and lifelong interest payment is to be aware of the trap set by advertising and banks.

Among the consequences of the 2008 economic crisis I have to mention the millions of uninhabited houses by abandonment and foreclosures. Although economic losses were immense, we cannot put a price on the sorrow of hundreds of thousands of families who saw their dreams of having their own home frustrated. Yes, many speculated with the housing price and many more accepted mortgages that were beyond their possibilities; but isn't it the responsibility of financial institutions to evaluate their payment capacity?

Furthermore, the period before the Great Depression of 1930 cannot be called financial deregulation, but a lack of market regulation on the issues of financial leverage, speculation, and deposit insurance for financial institutions. In many ways both crises have the same causes; in fact, I consider that the detonator of both crises was over-indebtedness, prompted by mass consumerism, loss of risk perception, and unsecured consumer credit.

The difference between the two crises is the reaction of authorities. Of course, in 1930, the structure of the world economy was very different, and there was not an idea of the magnitude of the crisis or a precedent upon which to act. What we can draw from both crises is how opportune international cooperation can be as well as the coordination of monetary and fiscal policy to deal with these crises and the dangerous effects on the world economy.

Finally, I consider that both theories, the business cycles one and the long waves one, allow us to expand our analytical framework for understanding the dynamics of the system that we have chosen to rule the world economy. As members of this economy, we must demand regulations to our financial and economic systems so that if there are crises we can have the mechanisms and resources to avoid sinking into their downward spiral.

Recommendations

- I believe that the establishment of a deposit insurance institution such as the Federal Deposit Insurance Corporation (FDIC) can be very beneficial to improve users' confidence in the financial system and the stability of that system. Of course, the regulation of financial institutions should be supervised by this entity to avoid taking financial risks with depositors' money.
- The vulnerability of a financial system is too big if it does not have rules and limits to protect it and protect users. A financial system can only work for the general benefit with unambiguous rules, especially if they agree with the conditions of each country.
- We shuld learn to identify priorities and simple consumption, the marketing power over the media, and the power of those ones over us. But above all, we should identify the economic power corrupting our legislators and the damage that they can cause.
- Finally, I would like to warn the reader about over indebtedness because interests can consume too much of our income and we can get stuck economically.

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Glossary.

Tangible capital: tangible capital shall be understood as all goods of material nature, susceptible of being perceived by our senses, such as goods, money, furniture, vehicles, machinery, land, buildings, and all other tangible property subject to suffer deterioration due to use, obsolescence, destruction, or by the action of time and the elements (Tributaria, www.seniat.gov.ve, S.a.).

CDOs: Collateralized Debt Obligation. A type of asset-backed security that is secured by a portfolio of fixed income assets that makes payments based on the asset performance. (Board of Governors of the Federal Reserve System, 2012)

CDS: Swaps or credit default swaps. It is a contract that provides protection against the risk of default by borrowers. The buyer of the credit default swap (CDS) makes periodic payments to the seller, and in return the buyer will receive a payment in the event of default by the borrower, similar to an insurance contract (Board of Governors of the Federal Reserve System, 2012).

Commodities: The term commodity is of English origin and is used for many products. Its literal translation would be "raw material or unprocessed goods." A first classification could divide commodities into three major groups or categories: agricultural, energy, and metals (Casado Francisco, centro de postgrados de la Universidad Pompeu Fabra, S/a).

Fannie Mae and Freddie Mac: They are mortgage finance companies that even though are privately owned, their transactions are guaranteed by the government. Their aim is to facilitate access to housing through their support to the flow of mortgage credit granted (Fannie Mae, 2014).

Stock Index: "Indicators expressing the average trend of the most representative values of a stock market. Among the best known stock indices worldwide are Standard & Poors 500, Nasdaq Composite, Dow Jones, NYSE Composite" (Banco Central de Reserva de Perú, 2014).

MBS: Mortgage-backed securities. A security that is collateralized by a discrete pool of mortgage loans and that makes payments that are based primarily on the performance of those loans (Board of Governors of the Federal Reserve System, 2012).

Economic policy: General strategy established by governments with regard to the economic management of a country (Sabino, sisman.utm.edu.ec, S/a).

Fiscal policy: Changes or variations in government spending and taxes, designed to influence the type of economic model, on one hand, and on the level of activity on the other (Universidad de Valladolid, S/a).

Monetary policy: The monetary policy of a country is responsible for formulating objectives and identifying appropriate instruments for the control exercised by the state over money and credit. The primary objective of monetary policy is to ensure the economic stability of a country (Lugo, Introducción a la economía, 2004).

Hybrid products: Hybrid instruments are a form of financing that combines features of equity and debt. (Arellano, Los instrumentos híbridos en los recursos propios de las entidades , S/a)

Systemic risk: It is the risk of a widespread collapse of a system or market. In this situation the financial instability of a main actor endangers the functioning of the whole system as a consequence of the ties and relationships present across all intermediaries. In this situation the failure of a single agent jeopardizes the sustainability of other market participants (república.com.co, 2009).

Security deposit: The Deposit Insurance System is a mechanism that, in the eventual liquidation of any financial institution, guarantees depositors or savers the full recovery, or at least part of their money (Fondo de Garantía de Instituciones Financieras, 2013).

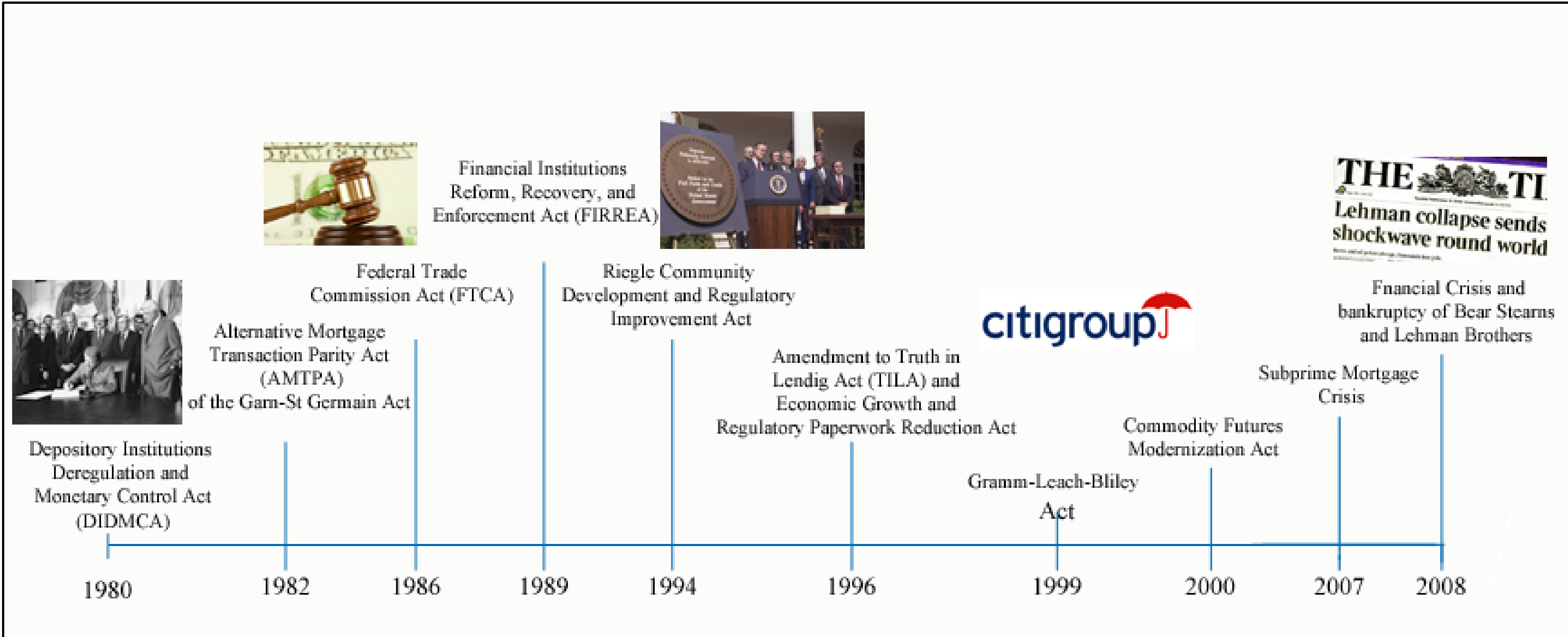
Over leverage: "The relationship between credit and equity invested in a financial transaction. By reducing the initial capital that is necessary to provide, the profitability obtained is increased. The increased leverage also increases the risks of the operation, as it indicates less flexibility or increased exposure to insolvency or inability to make payments" (Banco Central de Reserva de Perú, 2014). Consequently, over leverage is the abuse of this financing tool.

Over production: Situation generated in the expansion phase of a business cycle and involves an excess of supply over demand. Overproduction leads to lower prices

and reduction of investment, which contributes to restore the balance between supply and demand, thus leading to a recessive phase of the cycle (Sabino, S/a).

Annexes

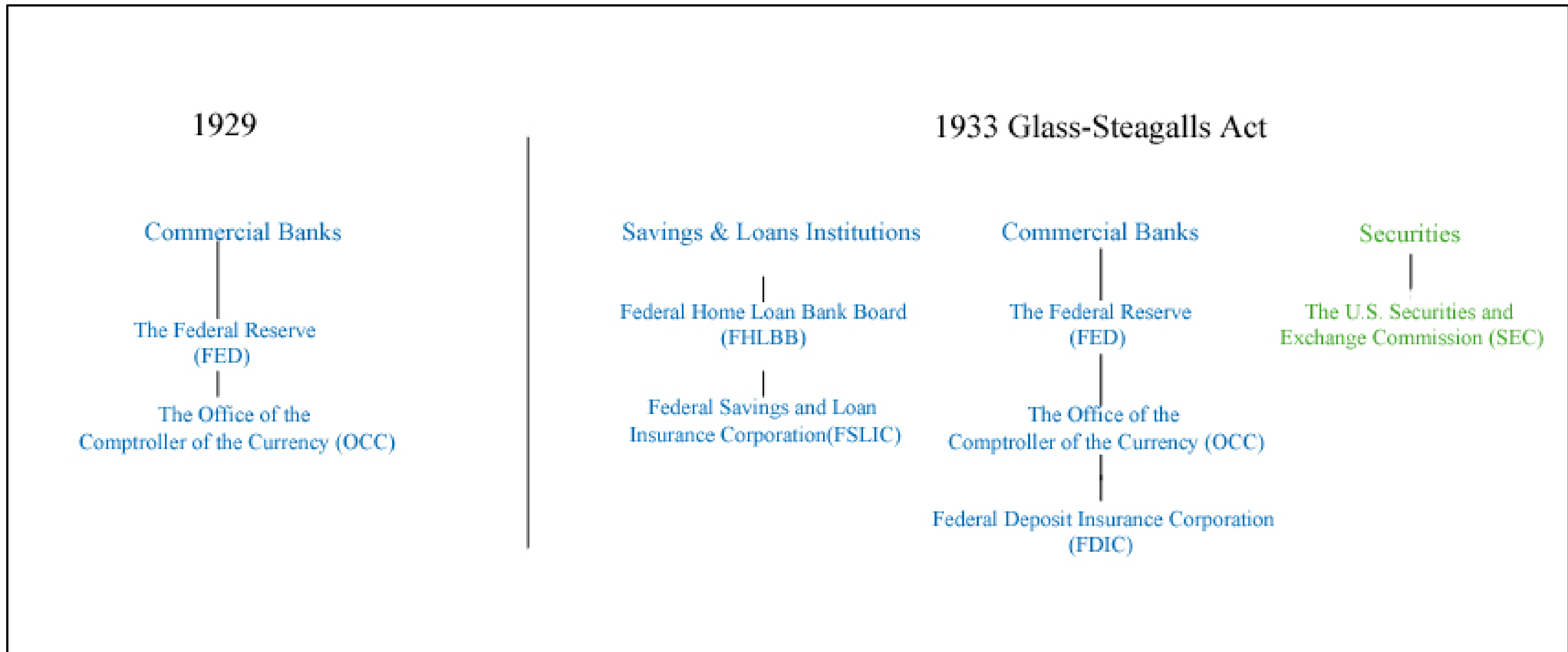
Annex 1: Chronological sequence of financial deregulation in the United States from 1980 to 2008.



Source: libraries.rutgers.edu, media.insidecounsel.com, fdic.gov, noticiasbancarias.com, arkadiansystems.com

Performed by: Arce B. Sofia

Annex 2: U.S. Financial System Regulatory Agencies, 1929 and 1933



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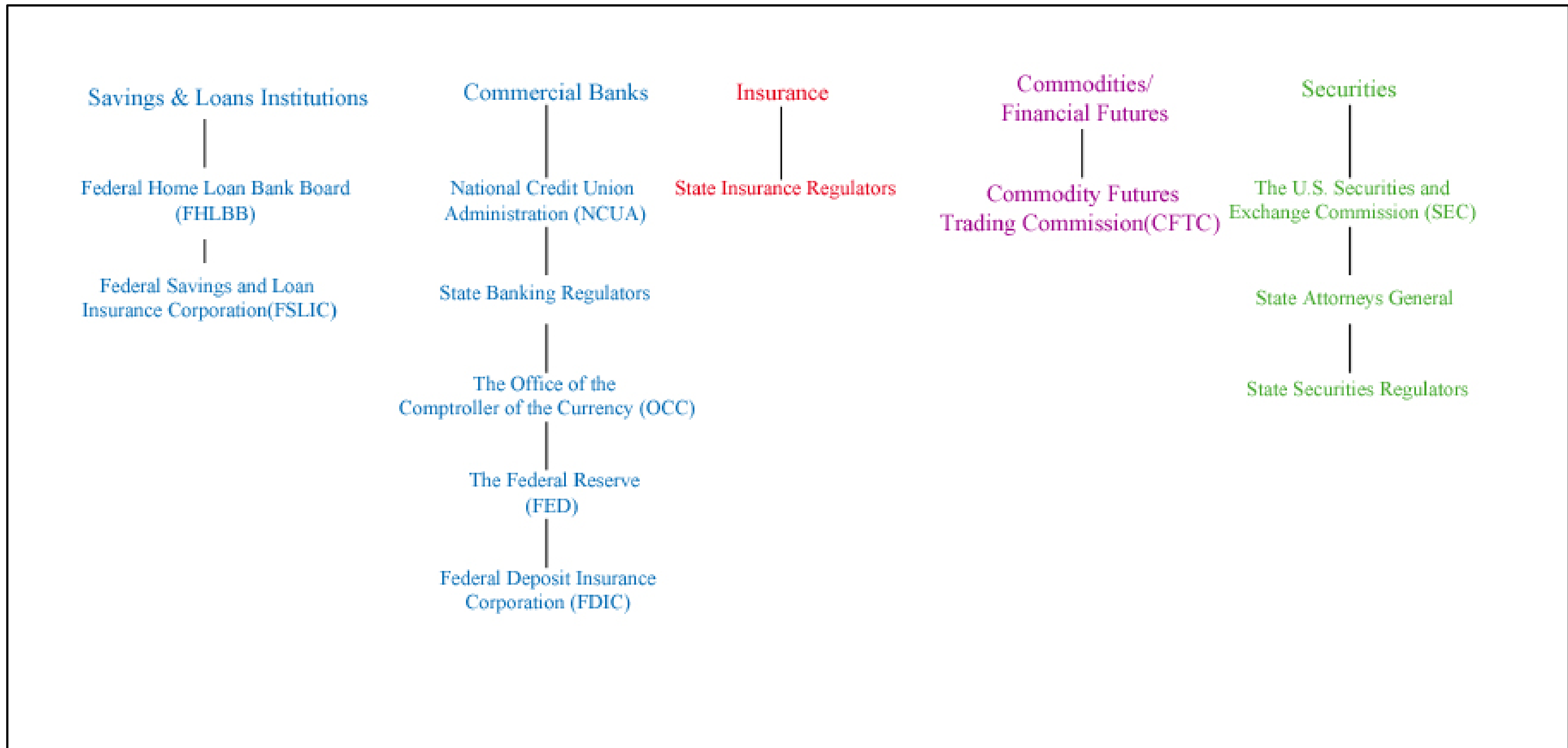
Annex 3: U.S. Financial System Regulatory Agencies, 1980



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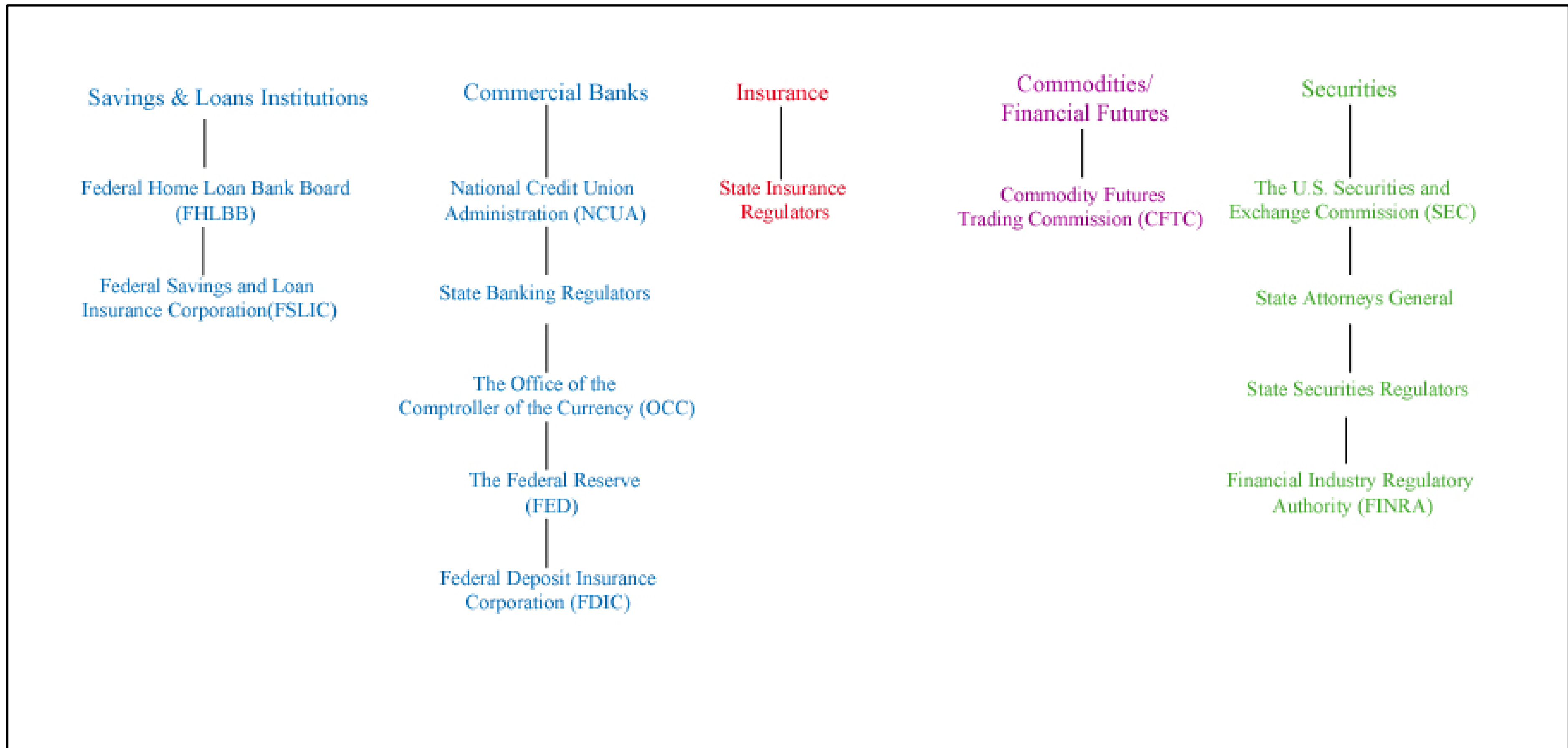
Annex 4: U.S. Financial System Regulatory Agencies, 2008



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Annex 5: Estados Unidos puede alcanzar un 20% de inflación en 1980

Autor: Ramon Vilaro

Fecha: 9 mar 1980

Fuente: elpais.com

La crisis económica se radicaliza en Estados Unidos, tras el anuncio del crecimiento del 1,5% del índice de precios en el pasado mes de febrero, lo que supone una proyección anual del orden del 19,6% de inflación para EEUU en 1980 (contra 13,2% en 1979). Paralelamente a la espectacular subida de la inflación, los grandes bancos norteamericanos reaccionan con un incremento -segundo en la misma semana- del prime rate, tipo de interés preferente, que se eleva actualmente al 17,75%. Los créditos para compra de bienes de consumo, incluida la vivienda, suben también al 15,50% en algunos bancos. Frente a todas estas cifras inéditas y peligrosas para la economía de la primera potencia del bloque capitalista, la Administración intenta reaccionar, sin que se sepa todavía exactamente con qué medidas. El presidente Jimmy Carter anuló su tradicional fin de semana en su residencia de Camp David para quedarse en la Casa Blanca, en Washington, donde prepara con sus más directos colaboradores económicos, un programa de acciones antiinflación, que podría anunciar a mediados de la próxima semana.

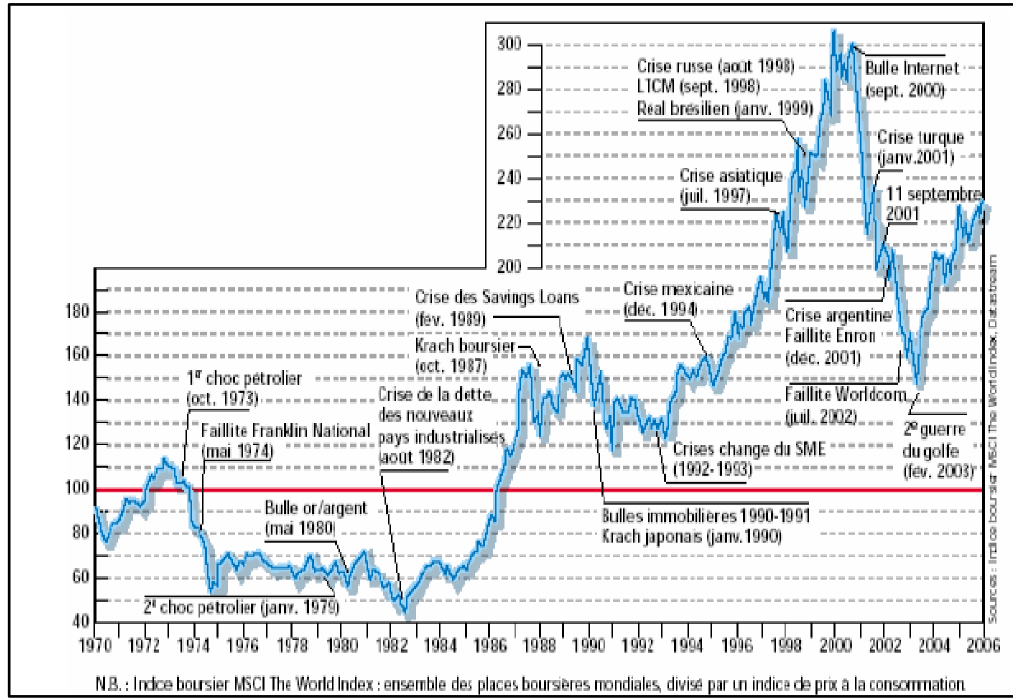
«Es un aumento de la inflación muy peligroso», declaró Charles Schultze, consejero económico en la Casa Blanca. Los estrategas económicos del presidente Carter no se muestran partidarios de un control estricto de los precios. Aconsejan, sin embargo, a unas 5.000 compañías comerciales en EEUU que «vigilen» atentamente la evolución de los precios en sus productos. Dos grandes cadenas de «supermercados» anuncian respetar las limitaciones de precios y proponen «congelar» por seis meses los precios en toda una serie de productos alimenticios. Sector, el alimenticio, que paradójicamente, frente a la tendencia general, conoce una reducción de precios en Estados Unidos. Por el contrario, otras grandes sociedades, entre ellas la Ford, en el sector del automóvil, no parecen inclinadas a cumplir las orientaciones oficiales v rompen las limitaciones aconsejadas para el incremento salarial, a fin de evitar problemas sociales que podrían ser nefastos para el sector.

El «precio» de una política antiinflacíonista podría suponer un incremento importante del índice de desempleo, que rozaría el 7,5% a finales de 1980. Por el momento, el nivel de paro en EEUU se cifra en el 6%, con ligera reducción comparado a enero último. El índice de valores industriales Dow Jones cerró el viernes, en Wall Street, con una pérdida semanal de 42,58 puntos, fijando un índice de 820,56 puntos, baja considerable si se compara al índice de 903,64 puntos que tenía el pasado 13 de febrero.

Naturalmente, todos estos indicativos económicos provocan una serie de críticas contra el presidente Jimmy Carter, sobre todo por parte del conjunto de candidatos a la Casa Blanca. Edward Kennedy, principal adversario de Carter dentro del Partido Demócrata, repitió ayer en Chicago que sólo una política económica de control de precios, salarios y beneficios, acompañada de un aumento del precio de la gasolina, podrán devolver la calma a la turbulenta situación socio-económica de EEUU. Es evidente que la economía, incluso por encima de la problemática de política anterior (rehenes en Teherán, invasión soviética en Afganistán, boicot de EEUU a los Juegos Olímpicos de Moscú), se convierte en el elemento capital en la campaña electoral hacia la presidencia de Estados Unidos. De ahí que las propuestas antiinflación de Carter tendrán un doble objetivo, político y económico. Faltará, en última instancia, que las acepte el Congreso, cada vez más dividido entre demócratas y republicanos como lógica consecuencia de un año electoral, para que puedan ser operativas.

Annex 6:

Figure 6: Economic cycles and global economic crises of 1970 to 2006.



Source: Stock Index, MSCI The World Index