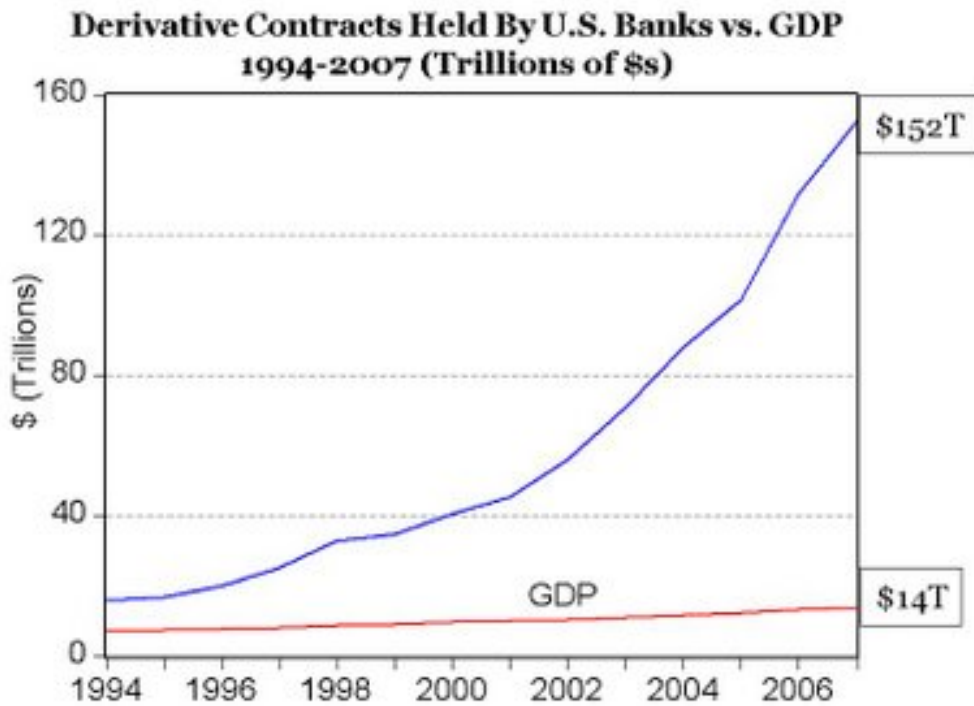
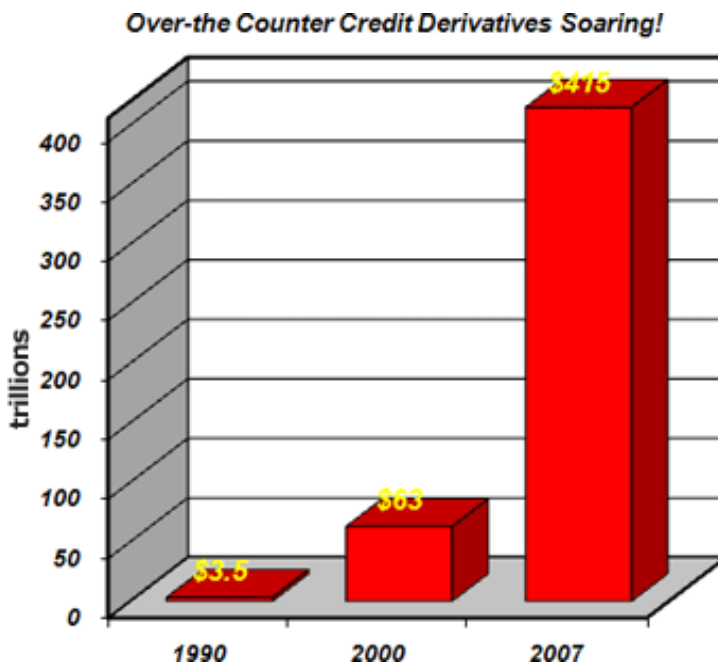


Econ 105: Lecture Nineteen



<http://economistblog.com/wp-content/uploads/2007/11/carpediem41.jpg>



<http://www.marketoracle.co.uk/images/2008/over-the-counter-credit-derivatives-soaring.gif>

Some relevant statistics:

- Financial assets were less than five times larger than US GDP in 1980, but over ten times as large in 2007.
- The notional value of all derivative contracts rose from about three times global GDP in 1999 to over 11 times global GDP in 2007.
- In the US, the share of total corporate profits generated in the financial sector grew from 10% in the early 1980s to 40% in 2006 (*The Economist*, “What went wrong,” March 19, 2008).

Historical context:

- Roosevelt’s New Deal government put in place an extensive system of financial regulations in the United States.
- The single most important initiative was the Glass-Steagall Act of 1933, which divided up the banking industry into two distinct segments, “commercial” and “investment” banking.
- The segregation of commercial banking and capital markets was intended to prevent the use of bank deposits to finance speculative capital market activity, a practice that helped bring on the crisis of the early 1930s.
- In the 1970s and 1980s, two developments undercut the efficacy of the Glass- Steagall system.
 - First, US financial markets were buffeted by rising inflation and the Third World debt and Savings and Loan crises. These events created great strains in the system.
 - Second, financial institutions were increasingly successful in evading regulatory constraints, in large part because political commitment to a strong regulatory system had weakened over the decades.