Economics Assignment Summary

In economics we had to watch the HBO movie Too Big to Fail and answer several questions about how it described the financial and economic crisis due to the housing market in 2008. What I learned in the movie was that Lehman Brothers failed and that AIG almost failed because they were giving out loans to people who couldn’t afford to borrow so much money, so they could buy houses at variable interest rates. Because the interest rates were variable, they were really low for the initial period, but after that time the interest rates jumped and people were no longer able to pay off their mortgages. When so many people defaulted on their mortgages at the same time the banks found themselves struggling to stay afloat, and in many cases needed to be bailed out as people stopped investing and having faith in them. Desperate, Hank Paulson, who was at that time the Secretary of the Treasury, convinced congress to pass a bill that allowed healthy banks to accept cash injections that they could then loan out to the unhealthy banks, making their balance sheets look better so people would maintain their trust in banks and continue to deposit their money and take loans from those banks. However the healthy banks took the money and failed to lend it out, instead giving fewer loans, and causing the economy to spiral downwards.

What I learned that is frightening is that only a few years ago the United States was very close to a credit freeze, a second great depression that would possibly be worse than the last one with the impact it would have on American society. And yet despite how close we came to this happening, the American public was oblivious, and still to a large extent is. Though I was aware of the severity of the economic recession we are currently climbing out of, this was the first I had heard about how close we came to such an extreme depression, and when I talked to my family about it over thanksgiving break they too admitted that they hadn’t realized how precarious the situation had been. Not only would it have ruined the U.S. economy, it would have greatly hurt European economies as well. AIG held assets not only in the U.S. but also in many foreign countries, and held not only American but also international insurance and real estate. At one point in the movie GE calls Paulson and warns him that if AIG fails then GE will no longer be able to function, and if GE can’t pay their employees and produce at their standard rate, their suppliers won’t be able to either. GE is just one of many companies that would have been in similar situations had Paulson allowed AIG to fail. As it was, there was little Paulson could do to fix the problem, and the healthy banks were not helping.

Americans tend to operate by buying things with money they assume they will earn in the future, taking out loans and paying them off slowly. They do this because they trust the banks to safeguard their money, and the banks in turn trust other banks to back them up if they themselves need a loan. In 2008, even with cash injections healthy banks weren’t lending money to the failing banks. U.S. debt is extremely deep, and if foreign countries all wanted to be paid back immediately the U.S. economy would not be able to survive that. Likewise, if all people want to pull their money from banks or can’t pay their debt, it greatly threatens our economy. Watching this movie and finding out how truly fragile the U.S. economy is was a very sobering educational experience.