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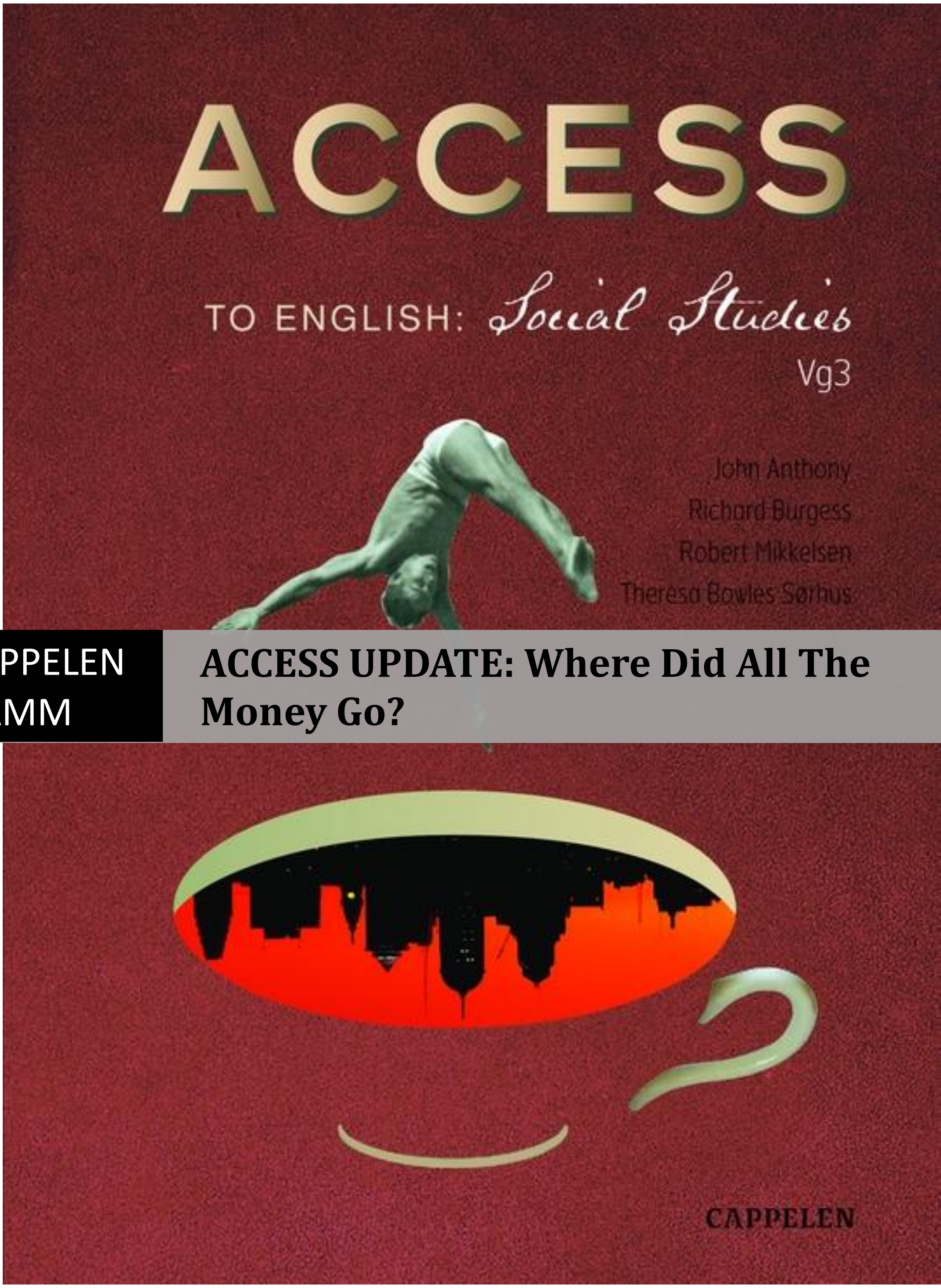
ACCESS UPDATE: Where Did All The Money Go?



What do you understand when the media talk about the financial crisis? What do you think it is? Is it something particularly American? When did it start? What do you think are the causes of it and what does it mean for you personally? Discuss this before reading the article below.
Jot down some key words that reflect your opinions on the financial crisis.

In Chapter Four of *Access to English: Social Studies* an article entitled "The Anglo-American World: Riches and Rags" (pp. 219-227) examines the impact of the economies of the United Kingdom and the United States on the world. It concludes with the following sentence; "It remains to be seen if the United Kingdom and the United States will continue to be models of economic development in the future as they have been in the past." The following article addresses that question in light of the recent, dramatic events in the global economy.

Where Did All The Money Go?

(By Robert Mikkelsen. Article published August 31, 2009)

Going down

You are probably aware that the global, free market consumer economy that was pioneered by the United States and the United Kingdom has been in deep trouble recently. Many years of economic growth have been replaced by the sharpest economic downturn since the Second World War. Production has decreased. Trade has decreased. Investment has decreased.

This has, in turn, increased unemployment, which means that there are fewer active workers to pay the taxes that governments need to cover increasing welfare costs.

Poverty has increased. Consumers are nervous. They sit on their savings and buy fewer of the goods that business make, which leads to even *less* production, *less* trade, *less* investment … and so on, in a long, downward spiral. Some people speak of the beginning of a new Great Depression like the one that dominated the world between 1929 and 1940.

Yet only three years ago the global, free market consumer economy was booming. Most countries in the world took active part in it. Today many are running for shelter, trying to protect their domestic economies. What went wrong?

The origins of the crisis

With the wisdom of hindsight, many today are pointing the finger of blame back to the 1980s, to the years of Prime Minister Margaret Thatcher and President Ronald Reagan (see "The Anglo-American World: Riches and Rags," pp. 219-220). They were both firm believers in the free market. In their view, many of the government regulations that had been put in place during the Great Depression and after the Second World War were standing in the way of economic growth and progress.

They started an era of *deregulation*, removing what they viewed as bloated and expensive government programs and regulations standing in the way of private initiative. Yes, this would lead some people to become very rich and some to fail, but that was the heart of a free market. Successful and rich people invested their money (or "capital") into new businesses that made new jobs, income and consumers. Unsuccessful people did not deserve to be kept afloat by government regulations or tax payers' money in the form of state subsidies or welfare checks.

This "back to basics" approach worked (see pp. 221-222). The ailing economies of the US and the UK took off and began a long period of expansion that made them models in the global economy.

Stock market speculation

But by removing regulations on finance and business interests, Thatcher, Reagan and those who followed also opened up for the kind of speculation and unequal distribution of income that had once led to the Great Depression. Let's take speculation first. Before deregulation, banks in the US were required to have a certain percentage of what they lent out in assets. For example, if they lent out $100 they had to have about $10 (or 10%) of that in assets. The government guaranteed this. It also guaranteed customers' savings deposits in a bank if it should go bankrupt. This was done because in 1929 some banks had speculated in the stock market, investing many times the value of their assets and then lost them all when the stock market crashed, plunging them into bankruptcy and debt. This had led to a "run" on all banks, good and bad, because customers feared their money would disappear before they could withdraw it. The financial system ground to a halt. Production and sales fell. Banks would not lend to one another or to other businesses – who knew which one would be the next to fail?

More: Boom and bust

Leveraging

Skip forward to the beginning of the 21st century. Regulation of the commercial banks has been relaxed. More importantly, a whole new set of financial institutions has entered the arena – financial investment houses on Wall Street with names like Bear Stearns and Lehman Brothers. They do not make money by loaning out money and charging interest on it. Rather they make their profit by buying and selling stocks, bonds and other "investment

objects." They are not subject to the same kind of regulation as commercial banks. In practice, a financial house does not need to have a certain percentage of assets corresponding to its investments. The sky is the limit. For example, if it has $100, it can use that as a basis to loan 30 times that amount – that is, $3000 – to invest. Now, if the investment shows a 10% increase in value – that is, $300 – the house has made a $200 profit! It can now take its $300 and loan 30 times that amount again – that is, $9000 – and begin the cycle again for even greater profits.

This is known as "leveraging" your assets – using them to borrow money to make a big profit. Notice, however, that it assumes two things: 1) that the investment will go on increasing in value and 2) that someone is willing to loan you the money.

Derivatives and the subprime mortgage market

At the start of the 21st century banks across the United States and throughout the world global economy invested vast sums of money in financial investment houses and the money market, which continued to show amazing profits. One reason for these profits was a new kind of investment invented by the financial houses known as a "derivative." Basically a derivative is a kind of investment object that has been "bundled" together with others of its kind to reduce the risk of losing money if one of them should fail. An investor buys some portion of this "bundled" derivative. It is a way of spreading the risk of an investment throughout the financial community.

One of the most popular derivatives was made up of "bundled" sub-prime mortgages. A mortgage is a loan from a bank for the purchase of a house based on the value of the house and the income of the persons taking the loan. A "sub-prime" mortgage is a loan which is potentially greater than the value of the house and the income of the persons living there – in plain language, more than they can afford to pay back and more than the bank can get back even if it sells the house.

So why in the world would a bank loan out money to someone who can't pay it back, for a house that may not be as valuable as the loan it is offering? Simple answer – profits. The bank is betting that the incomes of the loan takers and the value of the house will increase over time as the economy grows, making up the difference. Meanwhile, thanks to derivatives, it has "sold" this sub-prime mortgage for a profit to one of the financial investment houses or another bank or perhaps a hedge-fund or one of many financial actors all over the world eager to make a profit from an endlessly expanding economy.

The bubble bursts

By 2007 financial actors all over the world had invested hundreds of billions – perhaps *trillions* – of dollars in American mortgages, many of them sub-prime. Everyone was betting on better times. But it is in the nature of the free market that there comes a point when the demand for a product is completely filled. Another way of saying this is that there is "overproduction" of a product. This does not mean that people no longer *want* the product. It means they can no longer *pay for it*. In 2007 the housing market came to that point. Every possible line of credit to buy houses had been used up and abruptly there was a greater supply of houses than there was a demand for them. Then the price of houses in the United States *began to fall*.

Suddenly the investors' profits turned to losses – huge losses. Leverage came back to bite them with a vengeance. They were threatened with losing not only the $100 dollars they originally had. They could lose the entire $3000 they had loaned and invested in sub-prime derivatives. And they did not have the money! Everything but $100 was invested. So they frantically tried to sell their $3000 in sub-prime market derivatives. But nobody wanted them! Nobody knew what they were worth. They had become "toxic assets"; that is, poisonous investments dragging whoever held them into bankruptcy.

This forced investors – especially the financial houses – to try to borrow money to cover their losses. But no one would lend them money! Who knew if they could pay it back? Lehman Brothers went bankrupt. The panic spread. The financial system ground to a halt. Production and sales fell. Banks would not lend to one another or to other businesses – who knew which one would be the next to fail?

More: Timeline: Credit crunch to downturn

The heart of the matter

The crisis that began in the United States swept through the global free market consumer economy it had pioneered. Since 2008 governments around the world have tried to get their economies up and running again by pumping tax money into the free market system. This is known as "stimulating" the economy. One of its major aims is to give banks and other financial institutions enough cash to cover their losses and to begin loaning money to each other and other business again. At the same time, there is talk of increased government regulation of the financial community so this kind of thing will not happen again; that is, a *re*-regulation to correct the mistakes of *de*-regulation.

As of writing this, the hundreds of billions of dollars in government stimulus packages appear to be having a positive effect. However, it is far too soon to say if any these measures will be successful in the long run.

More: Living with less: The human side of the global recession

Moreover, underlying all of this there is a deeper problem – what the economists would call a “structural problem”. It can be summed up in a simple question: How could it happen that a large part of the population of the United States – the richest country in the world – did not have enough income to be able to pay for a mortgage on a house? The simple answer is that there has been an increasingly unequal distribution of income in America. For more than thirty years the rich have been getting richer and the poor have been getting (relatively) poorer. Middle-class families have seen their incomes stagnate or fall. Similar developments have been detected in the United Kingdom. This is not the result of any conscious policy. It has been going on both before and after Thatcher and Reagan. Though their de-regulating policies no doubt speeded up the process, it seems to be a built-in characteristic of the free market consumer economy (see pp. 225-226).

So here’s a question for you. How can a free market consumer economy remain stable and productive if it can’t provide enough income for its consumers to buy all the goods it produces – for example, houses? If you can solve this problem, let the governments of the world know. They would love to have the answer.

More: The layman's finance crisis glossary

ACTIVITIES

1 DISCUSSION

Now that you have read the article, go back to your key words from the pre-reading exercise. Have your opinions changed at all now that you have read more background information? Discuss the ways in which they have the changed. Do you feel more confident or worried about the future?

2 UNDERSTANDING THE TEXT

Form groups of four. Close your books and take turns asking your group the following questions.

a) What has happened to the consumer economy in recent years?

b) What is deregulation?

c) Why did Margaret Thatcher and Ronald Reagan want deregulation?

d) What immediate effect did deregulation have?

e) How do financial investment houses make money?

f) What does it mean to “leverage” your assets?

g) What is a “sub-prime mortgage”?

h) Why did banks offer sub-prime mortgages?

i) Why did the price of houses in the United States begin to fall?

j) What effect did the fall in price have on investors?

k) What have governments done to get their economies up and running again?

l) What underlying structural problem has contributed to this economic crisis?

3 DISCUSSION

Discuss in small groups:

a) Do you know of ways that Norway has been affected by the economic crisis? Has it had an impact on industries in your region? On people you know? On plans for the future? Do you think this will be a long downturn or do you expect the world economy to improve within in a short time?

b) One of the theories of the free market economy is that it allows consumers and investors to make clear, reasoned decisions about how to use their money. Looking around you, do you think this is the case? What do you think makes people spend money in today’s world? What do you spend your money on? Why?

c) Is there something wrong with being rich? Why shouldn’t people who are successful in business have the right to keep all profits of their labor? Why tax the rich more?

d) *Silver lining?* Some people think the financial crisis might be a blessing in disguise. Perhaps people will consume less. Perhaps they will drive less and industry will pollute less. What other possible advantages might come from this crisis? How might the world be improved by it?

4 STYLE AND TONE

Re-read the last two paragraphs from the text and answer the questions.

a) Find an example where the author uses an ironic tone in the last two paragraphs. Explain why you think it is ironic.

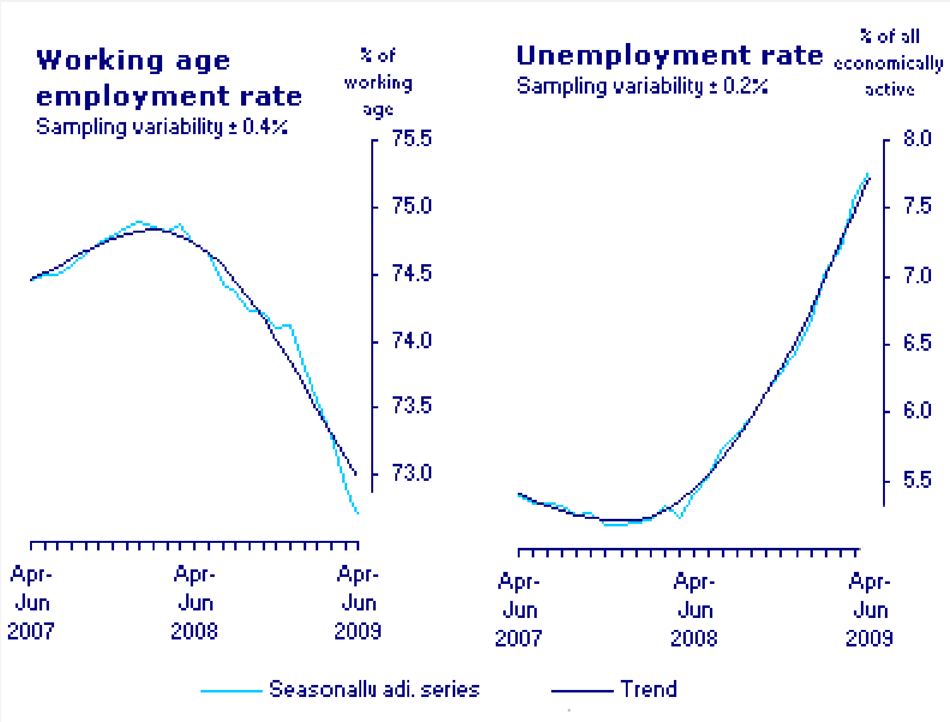
b) Find an alternative word for *unequal* ("unequal distribution") that you think gives a better description, and explain why you think it is better.

c) What is the effect of the author adding the descriptive phrase "the richest country in the world" to his sentence on paying mortgages?

e) Read the last 3–4 sentences of the paragraphs **Stock market speculation** and **The bubble bursts.** What phrases does the author repeat in these two paragraphs? What are the effects of this repetition?

5 WORKING WITH STATISTICS

Employment/Unemployment Rate in the UK



Source: http://www.statistics.gov.uk

"Working age" here means the labor force, people of working age, which is normally between 18 and 67.

a) What is happening to the number of active people of working age?

b) What direction is employment moving in?

c) What is the difference in the employment rate from April-June 2007 to June 2009?

d) What is the unemployment rate for the three months to June 2009?

e) What is the increase compared to the previous quarter?

These are percentages, and what these percentages mean in a head count is that the number of unemployed people increased by 220,000 over the quarter and by 750,000 over the year, to reach 2.43 million.

f) Having read the article on the financial crisis, state briefly what problems the UK might expect if this trend continues.

6 QUICK RESEARCH

Choose one of these tasks and write a brief summary of your findings.

a) How high is the present rate of unemployment in the United States and the United Kingdom? Is this larger or smaller that the rate in Norway? What can you conclude about the economies of the three countries by comparing their rates of unemployment?

US unemployment

UK unemployment

Norwegian unemployment

b) What impact has the economic crisis had on charities in the United States and the United Kingdom? Choose one country and prepare a short report on it for the class.

The United Kingdom:

Big Issue; Charities and the Economic Crisis

Economic Crisis Hits Small Charities Hard

Charities in Crisis as Fundraising Fails

The United States:

Charities in US Feeling Stress Amid Economic Crisis

Assessing Impact of Financial Crisis on Nonprofits

For U.S. Jewish charities, economic crisis is 'first, second and third priority'

c) Look into the "Terra Scandal" in Norway. What are the latest developments? Make short report on it to the class. What lessons might be learned from this case?

Terra Securities Scandal

Terra Securities, Norway Towns Sue Citigroup for Subprime Loss

Citigroup Structured Notes Bring Gloom to Norway

Bickering over Terra scandal

7 WRITING

a) You are the public relations officer of a local bank. Unfortunately, most of the funds you have invested for your customers have been lost because of the sub-prime mortgage crisis. Their money is gone. Write a press release to your customers explaining what has happened in a way that puts the bank in the best possible light (i.e. not at fault, but just caught in the storm). What is the tone of your letter? What kind of language will you use? (You may wish to compare press releases with a classmate when you are done. Who has the most successful language and why?)

b) Write a letter from a bank customer whose money has been lost because the bank invested it in sub-prime mortgage derivatives, which are now worth nothing. Address the letter to the director of the bank. What is the tone of your letter? What kind of language will you use? What are your demands? What kind of pressure could you mention you might bring to bear to have them met?

c) You are the head of a small charity called "Feed the Folks." You write an appeal in the local newspaper asking people for donations. You are aware that the economic crisis has made people reluctant to give money, but try to convince them that this is the very time such donations are needed. What is the tone of your letter? What kind of language will you use? How will you frame your arguments? What will you appeal to in people?

d) Write a letter to the editor where you argue why banks are important institutions in a well-functioning society.

e) Write a newspaper editorial about the possibility of positive changes in society due to the financial crisis. Give your editorial the title: *Brave New World*.

8 LANGUAGE – EUPHEMISMS

A *euphemism* is a polite word or phrase used to describe a controversial or indiscreet activity, or we can call it a substitute word which is often more politically correct.

For example, instead of saying “He died”, we try to soften the news by saying “He passed away”, or “He’s gone to meet his maker”. These then would be euphemisms.

The financial crisis has given us many new clever euphemisms, a few of which the author of “Where Did All the Money Go” also uses.

a) In the table below the euphemisms in column 1 are correctly described in column 2. The text in column 3 states what the euphemisms suggest and the text in column 4 states what they often mean, in other words the meaning behind the euphemism. Unfortunately, the editor was having an off day and got the text in columns 3 and 4 all mixed up. Match the four columns.

Term	**What it refers to**	**What it suggests**	**What it might often mean**
Leveraging	Positional advantage; power to act effectively	Cheery breakfast cereal	Poor
Derivative	An investment that derives its value from another more fundamental investment	Suggests that there is growth when in fact there is not	Irresponsible banking

Subprime	Mortgages with an increased risk of default and thus incurring a greater rate of interest	Giving oneself an advantage	Loss
Credit crunch	Times when money is not readily available	A cut of quality beef?	The "place" where business is done, more of an abstract concept
The market	The abstract notion of the place where business transactions take place	Sounds mathematical and positive	Loss
Downgrowth	Biology: a bodily structure that grows downwards	Still seems to suggest that there is some gain	Great risk that loan recipient will not be able to pay the loan back – risky debt
Underbanked	Consumers who can't rely on banks to help them	Suggests someone has not used financial institutions enough	Bundling bad debts
Negative profit	Nothing left over when costs have been covered	An old-fashioned town square	Big financial crisis

Some fun euphemisms:

He does not have a beer gut – he has developed a liquid grain storage facility.

He is not a bad dancer – he is overly Caucasian.

She does not get lost all the time – she investigates alternative destinations.

He is not balding – he is in follicle regression. Or: he's becoming an organic skinhead.

He does not get falling-down drunk – he becomes accidentally horizontal.

He is not a male chauvinist pig – he has swine empathy.

She is not afraid of commitment – she is monogamously challenged.

b) Now you try your hand at creating some euphemisms. For example:

He is not always late in delivering his homework – he is …

9 LANGUAGE – IDIOMS

Here are some common idioms based on money. Can you understand them all? Write a definition of each idiom as if you were a teacher trying to teach new language learners what they mean. Then use the expressions in a sentence to show their usage.

- Put your money where your mouth is
- Money is the root of all evil
- Money burns a hole in his pocket
- Not for love or money
- Pin money
- Throw good money after bad
- Get your money's worth
- Money talks
- Not worth a plugged nickel
- Let's see the color of your money
- You pay your money and take your choice
- Pay the piper

Some interesting quotes about finance and the banking world:

"A banker is a fellow who lends you his umbrella when the sun is shining and wants it back the minute it begins to rain." - Mark Twain

"I hate banks. They do nothing positive for anybody except take care of themselves. They're first in with their fees and first out when there's trouble." - Earl Warren

"Finance is the art of passing currency from hand to hand until it finally disappears." - Robert W. Sarnoff

"There is no conspiracy of bankers in America; they don't need to conspire, they all think alike." - Gore Vidal

"If you put the federal government in charge of the Sahara Desert, in five years there'd be a shortage of sand." - Milton Friedman

"The natural effort of every individual to better his own condition is so powerful that it is alone, and without any assistance, not only capable of carrying on the society to wealth and prosperity, but of surmounting a hundred impertinent obstructions with which the folly of human laws too often encumbers its operations." - Adam Smith

"Don't knock the rich. When did a poor person ever give you a job?" - Dr. Laurence J. Peter