

## ECO 209 Macroeconomic Theory and Policy

### Case Study No. 7

Case Study No. 7 on ***The Failure of Free-Market Lending*** will be discussed in class during the week of February 26. The required short-readings have been posted on the course website. Read these articles and come to class ready for the discussion. The following questions will help you in your preparation:

- 1) What does Kemal Derviş mean when he says that not all public (government) debt is created equal? What is important regarding the so-called public-debt burden? Is a perpetual bond with a zero coupon actually debt?
- 2) What does he mean by “long-term balance-sheet implications of how borrowed money is used”? What is needed for a long-term balance-sheet approach to be adopted by policymakers?
- 3) For Adair Turner, what was the fundamental cause of the financial crisis that resulted in the Great Recession? Why couldn't mainstream economists foresee the crisis? Despite its growth, why private debt wasn't considered a major threat to economic stability?
- 4) Why does private debt have important implications for economic stability? What are the risks involved in private debt? What happens during the “good” times, pre-crisis upswing? And during the post-crisis downswing?
- 5) Should fiscal policy be used to ameliorate the post-crisis downswing? In what sense can debt be seen both as a cause and as a consequence of the crisis?
- 6) According to Adair Turner, how could the private sector's leverage be constrained in the future? And according to Guttenberg and Werner? Is it a borrowing (i.e., demand) problem or a lending (i.e., supply) problem?
- 7) Are banks just financial intermediaries? Do banks borrow in order to lend (as *The Economist's* article seem to suggest)? Does someone need to save for someone else to be able to borrow? Is savings a prerequisite for investment?