The Constitutional Law of Money

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Fall, 2017

Discussion Questions for Class 18

The Financial Crisis

Readings:

Ricks, Morgan. *The Money Problem: Rethinking Financial Regulation* 93-101 (Chicago: University of Chicago Press, 2016).

Blyth, Mark. *Austerity: The History of a Dangerous Idea* 21-45 (New York: Oxford University Press, 2013).

Gorton, Gary, "Some Reflections on the Recent Financial Crisis," Yale and NBER (Aug. 29, 2102).

Recommended: Eric Rosengren, "Broker-Dealer Finance and Financial Stability," Keynote Remarks at the Conference on the Risks of Wholesale Funding, New York, Aug. 13, 2014, at [URL]

Background:

Since 2008, commentators have increasingly agreed that that the Crisis occurred when a panic began in the shadow banking sector, an industry created by financial institutions that produce short-term modes of funding that allow them to invest in longer-term lending. As Ricks explains, holders of short-term liabilities in the wholesale money market there "ran" on the institutions that had issued those liabilities. Those short-term liabilities had been acting like money; they were (are) "money-claims" in Ricks's vocabulary. Blyth and Gorton agree on that point, as do Rosengren and an increasing number of financial analysts.

The authors vary, however, on a number of other matters. First, they differ on why most economists and financial experts had failed to see the Crisis coming. Read the materials carefully for an answer to that question, keeping in mind that Ricks is a legal scholar, Blyth is a political scientist, and Gorton is an economist. Second, the authors differ on whether financial crises are inevitable. Their takes on that matter are related to their conclusions about why experts did not see the crisis coming.

Finally, we can use these materials to think at the structural level about the system. The question here is whether there are remedies for the instability that plagues the modern system. As the con law of money teaches us, modern liquidity has been engineered in law. Given that institutional character, it falls to us as legal thinkers to consider how we might re-design the system.

Discussion Questions:

1. Ricks and Gorton make financial panics sound like reasonably frequent events. Blyth, on the other hand, arguably accepts the diagnosis of the Crisis as a low-probability, high-impact event. Who's right?

2. According to Blyth, systemic risk is "emergent from within and amplified by the interlinking of individual agents' decisions in a way that is not predictable from knowledge of those individual decisions." (*Austerity* 44). Does Ricks agree?

3. On the foreseeability of the Crisis, how would you compare Gorton and Blyth?
   a. What is Gorton's basic position?

   b. What is the neoclassical approach that Blyth identifies as the root of economists' blindness to the problems of financial instability?

4. Where are each of these authors on the question whether the Crisis of 2008 was inevitable? Who do find most persuasive?

5. Blyth argues that the Crisis was largely a private sector problem. Gorton agrees insofar as he treats banking as a "private money" problem. But if the neoclassical vision and the financial architecture are connected, we need to have an account of the role and responsibility of the state for the Crisis. How would you begin to build an answer to that question?

6. Most commentators agree that Dodd-Frank increased the stability of the current system through a combination of measures including reforming regulatory assignments and consolidating supervision of regulatory efforts in the Financial Stability Oversight Council, increasing capital requirements applied to financial institutions, prohibiting propriety trading by commercial banks (the Volcker Rule), revising the regulation of derivatives and securitization, and creating a resolution procedure for large financial entities. But as a number of commentators note, Dodd-Frank did not fundamentally restructure the system.

   If you were invited to brainstorm at the structural level, what reforms to the monetary design might you recommend?