AUSTRIAN MARSHALL PLAN FOUNDATION

The Global Financial and Economic Crisis

A Comparative Study: Austria and the United States

Monica A. Grimm

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This research paper examines the current global financial crisis and its comparative effects on the governments of the United States and Austria. The proximate cause of the crisis has been attributed to the subprime mortgage crisis of the United States, and has advanced to involve every economy in the world. The crisis has had economic ramifications that have provoked a number of stimulus plans from newly elected governments and has affected a number of important industries including the automobile and the housing industry in these countries. Solutions of the crisis include collaboration between global powers, an independent International Monetary Fund to prevent future crises, and an overhaul of our current financial system. Research was accomplished using a variety of trusted sources online and in periodicals and through personal interviews.

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Introduction

Twenty-four months after the fatality of investment company Bear Stearns in June 2007 and nineteen months after the U.S. recession began that December, the effects of governmental action are just surfacing. Many economic analysts couldn't have imagined that this is how the world would appear at this time. How did this financial crisis start? What have the governments of the United States, Austria, and the European Union done to try and undo the damage, and restore prosperity to the world? And most importantly, how can we make sure that something like this will never happen again? This research paper attempts to answer all of these questions.

Cause

The U.S. subprime mortgage crisis

Most evidence pinpoints the proximate birth of the crisis to the subprime mortgage crisis in the United States. However, the more one looks into the origins of the current disaster, the clearer it becomes that the key wrong turn – the turn that made this crisis inevitable – took place in the early 1980s, during the Reagan years in the United States. Attacks on Reaganomics usually focus on rising inequality and fiscal irresponsibility. Reagan broke with longstanding rules of fiscal prudence. Traditionally, the U.S. government ran significant budget deficits only in times of war or economic emergency. Federal debt as a percentage of GDP fell steadily from the end of World War II until 1980. But indebtedness began rising under Reagan, leaving Americans ill prepared for the emergency now upon them. The increase in public debt was, however, dwarfed by the rise in private debt, made possible by financial deregulation and the utilization of securitization. Reagan-era legislative changes essentially ended New Deal restrictions on mortgage lending – restrictions that, in particular, limited the ability of families to buy homes without putting a significant amount of money down. "Government is

the problem", declared Reagan at his First Inaugural Address, and therefore less of it was better. (Krugman, Reagan Did it, 2009) And so the precautionary rules set in place since the last large financial crisis, the Great Depression, were scrapped. Conclusively, less government and financial deregulation, along with tax cuts for the wealthy and an assertion that military force is the principal projection of American influence overseas are the principals of Reaganomics. (Klein, 2009)

Together with looser lending standards for other kinds of consumer credit, Reaganomics led to a radical change in American behavior. Household debt was up to 119 percent of income, compared to only 60 percent of income when Reagan took office. Americans were piling up debt, and they weren't putting aside any of their income. The way that American homeowners rationalized their actions was that their finances looked healthy once they took into account the rising values of their houses and their stock portfolios.

And then came the largest asset-price and credit bubble in history. Lower interest rates during the 1990s made mortgage payments cheaper, and demands for homes began to rise, sending prices up. As the industry ramped up, the quality of the mortgages went down. It was the explosion of debt over the previous quarter of a century that made the U.S. economy so vulnerable. Overstretched borrowers were bound to start defaulting in large numbers once the housing bubble burst and unemployment began to rise. These defaults in turn wreaked havoc on a financial system that took on too much risk with too little capital. (Krugman, Reagan Did it, 2009) According to a financial adviser at a large investment firm, these homeowners were unable to refinance their mortgages because home values had come down considerably. What they owed on a house was more than what the house is valued at. Therefore, homeowners had little choice other than to go into foreclosure. (Financial Adviser, 2009)

For the past few decades, mortgage lenders no longer had to wait patiently before churning more money into the economy. They were able to sell their debts in bundles to factor banks, and then

focus again on lending out more money to homeowners, thereby coercing growth. These bundles were expected to be repaid by the borrowers. (Kiviat, 2009) According to Transunion, a global leader in credit and information management, only 4.5 percent of people nationwide weren't paying their mortgage payment on time in the fourth quarter of 2008. (Transunion, 2009) However, this rate is rising due to high commodity prices, rising unemployment, and people borrowing more than they could afford. And banks no longer have the capital to lend more out on credit. Hence, consumers are no longer able to spend money to drive the economy.

Investment bankers create mortgage bonds by pooling thousands of home-equity lines of credit, giving them safety through diversity. However, the associated rise in delinquencies on subprime mortgages made even the safe bonds risky. Bankers buy the unwanted, lower-rated pieces of other mortgage bonds to create CDOs. CDO-squareds buy up the riskiest parts of other CDOs. And Jupiter High-Grade Collateralized Debt Obligations (CDO) V buys up those riskiest portions. Jupiter High-Grade V is consequently made up of the riskiest portions of other bonds. When it was issued in March 2007, 93 percent of the Jupiter deal was rated AAA. But when things unwind, any default gets compounded by the chain of linked bonds. Nearly 59 percent of Jupiter's investments, the securities based on subprime mortgages, are now worthless – otherwise known as toxic assets. (Gandel, 2009)

The real estate market boom was financed in part by CDOs. Companies that held CDOs could offset their risk by buying Credit Default Swaps (CDSs) from AIG Financial Products (FP). The AIG FP division wrote more than $2.7 trillion in derivatives contracts. Investors used credit-default swaps to hedge against bonds going bad. Banks bought the swaps, reassured by AIG's AAA debt rating, to manipulate capital requirements. It all worked fine until housing firms overbuilt and consumers overleveraged, causing the housing bubble to burst. In turn, this caused the value of CDOs to plunge, which caused holder of CDSs on such securities to demand payment from AIG. When the bonds AIG

insured against started to tank and the insurer's own rating was cut, it all came crashing down to a $40.4 billion loss. Furthermore, with its high credit rating, AIG FP wasn't required to stockpile reserves, or collateral, as traditional insurers must to cover potential losses. (Saporito, 2009)

In this manner, the rating agencies of the United States also played a major role in the crisis. No agency did their due diligent work to assure that the ratings given to investments were right and proper, such as the ones placed on Jupiter CDOs or AIG. The number of structured finance products carrying the rating agencies' highest ratings in 2007 was 37,000. Thousands have since been downgraded, but only after hundreds of billions of these investments went bad and caused the holders to lose a substantial amount of capital. In October 2008, Congress accordingly publicly criticized the heads of the major rating agencies for their role in the financial meltdown. (A Brief History Of: Ratings Agencies, 2009)

Accordingly, the proximate cause of the crisis was the turn of the housing cycle in the United States and the associated rise in delinquencies on subprime mortgages, which imposed substantial losses on many financial institutions and shook investor confidence in credit markets. However, although the subprime debacle triggered the crisis, the developments in the U.S. mortgage market were only one aspect of a much larger and more encompassing credit boom whose impact transcended the mortgage market to affect many other forms of credit. Aspects of this broader credit boom included widespread declines in underwriting standards, breakdowns in lending oversight by investors and rating agencies, increased reliance on complex and obscure credit apparatuses that proved unstable under stress, and unusually low reparation for risk-taking. (U.S. Federal Reserve, 2009)

Though any one of these events that led up to the crisis isn't very damaging, the cascade and chain reaction of these financial faults was a ticking time bomb. So ultimately, the cause of the financial crisis in the United States and the demise of the securitization market can be attributed to the collective irresponsibility of these four bodies of people: the Reagan administration of the 1980s that changed

securitization as we know it, homeowners who bought more than they could afford, the rating agencies who didn't assess effectively, and financial banks who didn't do diligent work to know what they were buying.

European credit crunch

The U.S. subprime mortgage mess ultimately affected the world. It impacted Europe almost immediately after it erupted in August 2007, causing write-downs and credit losses among some of the largest European banks. Though this was only a trigger of the problem, the underlying raison d'être behind Europe's vulnerability lies in the importance of banks to the entire European economy. In Europe, the close connections between banks and industry effectively assure an expansive and profound spread of the contagion. In contrast, while banks are a significant source of financing in the United States, corporations there rely much more on the stock market for investment. And furthermore, Europe is unable to adequately address the challenge due to the fact that the capitals, not Brussels, must deal with the crisis. While the Eurozone members have agreed to follow general guidelines, any assistance packages must be developed, staffed, funded, and managed by the national authorities, not Brussels or the European Central Bank (ECB). This means that the administrative burden will have to be multiplied 15-fold at least, as every country undertakes and implements its own bailout or liquidity injection package. Europe is descending into a lingering banking crisis. In Europe, various regionalized and interconnected weaknesses are much broader and deeper, pointing to systemic problems in the banking sector itself. (Stratfor, 2008)

In addition to the banks, European companies went on a borrowing spree over the past decade that left them deep in debt. Corporate debt in the Eurozone stands at more than $11 trillion, equaling some 95 percent of the region's annual output. Similar to subprime mortgages in the U.S., risky corporate loans were repackaged and sold to investors. Now hundreds of billions of dollars in payments

are coming due this year as sales slump in the global economic crisis. In healthier times, companies might have gone to their bankers to refinance. Nowadays, bank lending to Eurozone companies plunged 40 percent last fall as credit tensed up. How did Europe get into this muddle? Conservative bank regulations banned most risky mortgage lending, so banks had plenty of money to offer businesses. With interest rates low and the euro strengthening, companies were eager to borrow to finance new investments, and thus plunged into the red. (Matlack, 2009)

The global credit crunch intensifies all inadequacies that in capital-rich situations would be solved without too much exertion. Various European countries had such omissions long before the U.S. subprime problem instigated the global credit crunch. Many of these were caused by the post 9/11 global credit extension in addition with the adoption of the euro. After the September 11th attacks, all monetary authorities flooded money into the system. The European Central Bank (ECB) dropped interest rates to 2 percent. The euro's adoption maintained this low interest rate environment, and many new, poorer E.U. members obtained cheap credit.

In addition to the growing credit problem, Italian, French, Austrian, Greek, and Scandinavian banks fueled money into the growing economies in the Baltic and Balkan countries. Limited as they were by their local domestic markets, they pushed aggressively into their Eastern neighbors. Currently, most Eastern European countries have seen a rapid deterioration of their real economies since last September, when credit flows dried up and their main western trading partners entered into recession. The banking sector is crucial to the current crisis and to the region's recovery. (Mirow, 2009) It is still not known how much money is being lost in the east. Independent estimates provide a barely survivable figure of €20 billion to €30 billion in losses. That is why Austria's finance minister, Josef Pröll, has tried so hard to secure an E.U. aid package for Eastern Europe. Yet he has not found much enthusiasm for such a measure in Brussels.

In the two decades since the Iron Curtain fell, Austria's banks and business enterprises unwaveringly and intrepidly conquered one former Habsburg crown land after another. Only since the onset of the great financial famine has it occurred to Vienna's politicians that the future of Eastern Europe is relevant to all of Europe. Considering the insurance premiums for Austrian government debt, the markets now consider the country's danger of insolvency as severe as that of infamously endangered Italy. This is already costing the government €200 million in additional interest on its debt per year. Erste Bank's shares lost some 80 percent of their value in the last 18 months, and other banks aren't doing much better. In addition to Eastern Europe, €3 billion of Icelandic foreign debt is found on the books of Austrian banks. (Ortner, 2009)

Imbalance of global capital flows

Another major cause is the imbalance of global capital flows. In the late 1990s, many Asian countries faced currency collapses. Since then, countries such as China and India rationalized that they needed to build up gigantic reserves of U.S. dollars to protect their currencies. To build those reserves, they ran big trade surpluses, which were in turn enabled mainly by record trade deficits in the United States, which were in turn enabled by massive borrowing from around the world. It was an exceedingly unstable financial ballet, and it has now collapsed under its own weight. (Fox, New World Order, 2009)

Recession or depression?

Therefore, most analysts believe that the United States is in "the worst financial crisis since the Great Depression" and Europe isn't doing so well also. (Bloomberg, 2008) The way to define a recession is two consecutive quarters of decreasing GDP. America's National Bureau of Economic Research has officially declared a recession based on a more rigorous analysis of a range of economic indicators. A depression warrants a decline in real GDP that exceeds 10 percent, or one that lasts more than three years. But a recent analysis by Saul Eslake, chief economist at ANZ bank, concludes that the cause of the

downturn also can delineate the difference between a recession and a depression. And based on his findings, this recession could effortlessly turn into a national depression. (Economics Focus: Diagnosing depression, 2009)

Europe has also not been spared from the term recession. According to a new European Commission forecast, the E.U. is not sheltered from the “deepest and most widespread recession in the postwar era.” (European Commission, 2009) Europe is suffering its first recession since the introduction of the euro about a decade ago. The International Monetary Fund (IMF) predicts output in the Eurozone countries could fall by 2 percent this year, a bigger decline than the 1.6 percent contraction in the U.S. The former Soviet bloc east is sinking into recession as Western banks choke off credit. Just as in the U.S., the collapse of Lehman Brothers last September helped send Europe into a tumble. Stock markets nosedived, credit markets stiffened, and confidence in business crashed. (Ewing, 2009)

In the Eurozone, the economic performance in the first quarter shrank around 4.8 percent. The actual GDP decline through the middle of May for the Eurozone is around 4.6 percent. The economy of the E.U. countries clearly declined more than that of the United States, which suffered a decline of only approximately 2.5 percent in the first quarter. Yet, both players fared better than their Japanese counterpart, where GDP shrank around 9.1 percent. Ewald Nowotny, the ÖNB governor, considers that Europe will experience “some months with negative inflation rates.” Austria is performing better than most in the E.U. Austria only had a 2.9 percent GDP decline, better than in Germany where their GDP declined by 6.9 percent in the first quarter of 2009. Economic researchers assume that these will be the worst declines in GDP percentage throughout the crisis. The ECB also agrees. (Die Presse, 2009)

Though Austria’s GDP is coping well with the crisis, its amount of debt is discomforting. Austrian finance minister Josef Pröll said that Vienna would likely be chastised by the E.U. on its public deficit this year. Under E.U. rules, member states are not allowed to run up deficits in excess of 3 percent of GDP

or suffer the immense penalties. Pröll refused to rule out a deficit ratio of 4 percent or even more. In its latest forecasts published at the end of March, the WIFO economic think-tank predicted that the Austrian deficit ratio could rise to 3.5 percent this year and 4.0 percent in 2010 from 0.4 percent in 2008. (Austria expects slap from EU over deficit, 2009)

Numbers and figures

In Austria, rates of economic indicators weren't excessively atrocious. According to Austria's central bank, the OeNB, the inflation rate in Austria has grown from -2 oercent in the first half of 2007 to 3.5 percent in December of that year. Similar to other countries, this increase can be mostly attributed to the surge in international energy and agricultural commodity prices. (Fritzer, Gnan, Koehler-Toeglhofer, Rumler, & Stiglbauer, 2008) However, Federal Chancellor Alfred Gusenbauer also stressed in June 2008 that the high inflation was eroding the income of the Austrians and curbing consumption. Most positively, Gusenbauer considered the decrease of the unemployment rate from 5 percent to 4.1 percent and the creation of 90,000 new jobs a huge success. (Chancellor Gusenbauer: Austria's economy is among the winners, 2008)

As for the United States, the unemployment rate hasn't been too positive. After experiencing a normal unemployment rate of 4.6 percent in 2007, it jumped to 5.8 percent in 2008. As of May 2009, the unemployment rate is 9.4 percent. (U.S. Bureau of Labor Statistics, 2009) For the inflation rate, the consumer price index indicated that over the last 12 months, the index has fallen 1.3 percent. However, this is attributed to the 27.3 percent decline in the energy index. (The Bureau of Labor Statistics, 2009)

High commodity prices contributed a bit to the crisis as well. Crude oil nearly quintupled in five years; rice tripled in only five months. After the worldwide economic boom went bust, demand brusquely vanished for many commodities. The most evident turnaround has been in oil. These days,

OPEC has reduced supply in an attempt to support crude prices at around $50 per barrel. Yet oil is some 60 percent more expensive now than in December. The only area of the world economy where the fundamentals are improving is commodities. The reason is that demand is recovering for some raw materials. In the case of oil, supplies have been reduced by OPEC cutbacks. And commodities traders are bidding up market prices in general on expectations that supply shortages will return with just a modest improvement in demand. That's because miners, farmers, and oil drillers, hit by the credit crunch, can't finance investments that would increase their production capacity. (Schuman, 2009)

Politics

United States and the election of Barack Obama

As the crisis continued through 2008, many countries were preparing for a change in government. In the United States, the credit crisis emerged as the dominant issue of the presidential campaign in the last two months before the election. Polls showed that Barack Obama's election on November 4th was partly the fruit of the economic crisis and the belief among many voters that he was more capable of handling the economy than his opponent, John McCain. Therefore, the U.S. ushered in a new era, where a Democrat hadn't held the presidential position for almost a decade. Also, Democrats now hold the majority in the U.S. House and Senate, and with Obama sitting in the Oval Office, legislation would more easily be passed over Republican dissenters.

The Republican Party has most recently taken a hit. According to a Pew Research Poll, self-identifying Republicans, as a percentage of adults, have plunged by 7 percent from 2004 to 2009 (Grunwald, 2009). The reason for this could be explained in the party's dealings with the current crisis at hand. Their beliefs have progressed to unpopular, conservative ideas that are tarred by association with former Presidents Reagan and Bush. (Grunwald, 2009)

Austria and the rise of the Right in Europe

Across the Atlantic Ocean, the infamously euro-skeptic Austrians have regained confidence in the European Union as a result of the global financial crisis, a new survey showed in November 2008. According to the latest poll by the Austrian Society for European Policy, ÖGfE, 78 percent of Austrians are in favor of their country remaining in the E.U., compared with 59 percent in the summer. This is the highest number in six years and the third-highest reading since the poll was launched in 1995. Only 16 percent of the population is in favor of Austria quitting the E.U., compared with 32 percent in the summer. Furthermore, 67 percent of Austrians believe that Austria can overcome the crisis with the E.U.'s help while just 15 percent thought their country could solve the problems on its own. Earlier this year, the euro-bashing tabloid daily Kronen Zeitung, read by one in four Austrians, helped fan popular skepticism towards the E.U. to such an extent that politicians called for a possible referendum on quitting the E.U. The ruling Social Democrat party (SPÖ) even suggested that a referendum be held on any E.U. treaty in future, a position that eventually led to the collapse of the SPÖ's grand coalition with the conservative People's Party (ÖVP). (Austrians' Confidence in EU grows in wake of financial crisis: poll, 2008)

Elections were held two years early due to their constant squabbling. Both parties of the grand coalition faced the worst election results in their history, and have ruled Austria either alone or in coalition since the end of WWII. (Same, 2008)The results were peculiar. Analysts believe that the surge of the far Right reflects the voters' dissatisfaction with the failure of the two mainstream parties to provide a functioning government. The far Right made a grand return in Austria, emerging from elections in September 2008 as the second biggest parliamentary block with a total of 29 percent of the vote. Heinz-Christian Strache and his Freedom Party (FPÖ), who were accused of xenophobia and waging an anti-Muslim campaign, won 18 percent, a rise of 7 percent compared with the last elections. Mr. Strache's former mentor, Jörg Haider, won 11 percent of the vote with his new party, the Alliance

for the Future of Austria (BZÖ). The Social Democrats dropped 7 percent to 29.7 percent, while the conservative People's Party won 26 percent of the vote – a decline of 9 percent compared with 2006. This success of the Right owes much to an apparent punishment of the SPÖ and ÖVP for their inability to govern together, rising anxieties over immigration and the influence of the European Union, and perhaps the lowering of the age limit for voting to 16 years. Speaking at his final election rally in Vienna, Strache attacked both the Islamic faith and practices and the E.U. The Freedom Party demands a halt to immigration, a ministry for repatriating foreigners and the return of powers conceded to the E.U. (Pancevski, 2008)

As for the rest of Europe, they are also following the Right in light of the crisis. Twenty of the European Union's 27 member states have a right-wing government head. Oddly enough, this should be the left's big chance in Europe. Capitalism is in crisis. Growth is collapsing. Unemployment is rising, and the state is back in business. The time is ripe for the left to push a coherent alternative to the right's free-market vision of the world. But the classic 20th century parties of the Left are struggling. Of the big four E.U. nations, only Britain's Gordon Brown hails from the left, and his approval rates are diminishing. Left-wing candidates for the European parliamentary elections in June were united only by a lack of focus. (MacShane, 2009) Election results proved that right-leaning parties will forge ahead with conservative approaches to the crisis that limit stimulus spending and corporate bailouts, as they were hailed the European party victors in early June. (European Elections, 2009) One exception includes Iceland, where leftist coalitions won in April. Iceland Prime Minister Johanna Sigurdardottir said she would pursue E.U. membership to ensure her recession-battered nation's financial stability. (After Election, an E.U Push, 2009)

Counter-crisis endeavors

The abrupt end of the credit boom has had widespread financial and economic ramifications. Financial institutions have seen their capital depleted by losses and writedowns and their balance sheets clogged by complex credit products and other illiquid assets of uncertain value. Rising credit risks and intense risk aversion have pushed credit spreads to unprecedented levels, and markets for securitized assets have shut down. Heightened systemic risks, falling asset values, and tightening credit have in turn taken a heavy toll on business and consumer confidence and precipitated a sharp slowing in global economic activity. The damage, in terms of lost output, lost jobs, and lost wealth, is already substantial. (U.S. Federal Reserve, 2009)

Stimulus packages and other legislation

United States

The Obama administration has been battling the crisis since Obama's first day in office. What Barack Obama pledged to do during the campaign – what he is trying to do now – is to change course on every one of those Reaganite characteristics. He believes that government must be part of the solution in areas like health insurance, education, and energy policy. He plans to eventually restore Clinton-era levels of taxation on the wealthy. He has attempted to reregulate the financial markets. Overseas, he has restored the primacy of diplomacy over the use or threat of military force. (Klein, 2009)

Obama has passed a $787 billion stimulus package this year to reassure the markets and get credit flowing again. Included in the package is a middle-class tax cut proposal and a one-time payment for social security and disability recipients. Obama has pledged to create or save 600,000 jobs this summer with money from this stimulus package also. There is a tax provision to first-time home buyers within certain income limits. Also, the government will subsidize 60 percent of private insurance, under a law known as Cobra, for nine months after the loss of a job. Furthermore, the stimulus has a 'Buy

American' provision to stir growth. Despite this, some economists have warned that the package may be too small, given the grave condition of the economy (Herszenhorn & Hulse, 2009)

Bear Stearns collapsed in June 2007 as a result of huge losses in subprime mortgages. Since then, the Obama administration has been bailing out companies that are deemed "too big to fail." How do some companies become so critical to the national economy that they require a huge federal bailout? AIG is America's largest life and health insurer and began receiving money from the government in 2008. The insurer is a huge provider of insurance to U.S. municipalities, pension funds, and other public and private bodies. The idea is that in a global economy so tightly linked, where problems in the U.S. real estate market can help bring down Icelandic banks and Asian manufacturers, AIG sits at some of the critical switch points. "We have no choice but to stabilize [it] or else risk enormous impact, not just in the financial system but on the whole U.S. economy," said Federal Reserve Chairman Ben Bernanke. A failure of AIG could lead to mass redemptions of insurance policies, which would theoretically destabilize the industry; the withdrawal of $12 billion to $15 billion in U.S. consumer lending in a credit-short universe, and even damage airframe maker Boeing and jet-engine maker GE. AIG has written more than 81 million life insurance policies with a face value of $1.9 trillion. It covers roughly 180,000 entities, which employ approximately 116 million employees in 130 countries. AIG also owns more than 950 airline jets. Therefore, the U.S. government has given out some $170 billion to AIG as of March 2. (Saporito, 2009) Tensions flared as the public discovered that some $165 million of bailout money given to AIG was used to give big bonuses to the executives that had allowed faulty conditions to exist in the first place. Some of the money was returned, and now legislation from the stimulus bill forbids institutions that receive bailout money to present to executives.

In January, President Obama nominated Tim Geithner to become the U.S. Treasury Secretary. On February 10, Secretary Geithner unveiled the newest bailout plan for the banks. Enclosed in the plan are four considerable proposals that involve vast monetary sums, but fuzzy details. The Financial

Stability Trust is a program to increase transparency at the banks, run 'stress tests' of a bank's staying power in a downturn, and provide banks with fresh capital through the purchase of convertible preferred stock by the Treasury. Secondly, the Public-Private Investment Fund will deploy $500 billion to $1 trillion in public and private capital to buy banks' troubled assets, almost essentially a 'bad bank' for holding toxic assets. The Consumer and Business Lending Initiative is where the Treasury and the Federal Reserve will use up to $1 trillion to support lending to the auto, small-business, consumer, student, and commercial-mortgage sectors to help ease tight credit. The Treasury will also develop standards for modifying loans and spend $50 billion to help provide more affordable mortgages for distressed families. It backs proposed legislation that empowers bankruptcy courts to adjust mortgages. (U.S. Treasury Department, February) On March 23, Geithner elaborated his long-awaited plan for buying up toxic mortgage loans and securities through the Public-Private Investment Fund. The Geithner plan calls for the Treasury, the Federal Reserve, and the Federal Deposit Insurance Corporation (FDIC) to finance the bulk of up to $1 trillion in toxic-asset purchases by private investors. The government will take on most of the downside risk while evenly sharing the rewards with hedge funds, money managers, and other buyers. Some analysts say the asset sales could move the government farther down the road toward closing or taking over the most troubled banks. (Fox, How Toxic Are They?, 2009)

In the spring of 2009, bank regulators embarked on 'stress tests' of the 19 largest banks to determine which banks actually stand a chance of returning to health. The banks were judged by liquidation value – what they could get for selling their assets on the open market today. Any bank that fails the assessment would have six months to raise additional capital privately. (Fox, Nationalized Nonsense, 2009) In June, results were published in which U.S. regulators told top banks to raise $74.6 billion to build a capital cushion officials hope will restore faith in financial firms and set a course out of the deepest recession in decades. Though 10 of the 19 banks were found to need additional capital cushions, the bankers fared better in the stress tests than many had expected. Bank of America, which

accounted for almost half of the total capital shortfall with $33.9 billion to be raised, said it planned to sell assets and issue $17 billion in common stock among other steps. The results of bank stress tests effectively drew a line between healthy and weak, and quantified exactly how much capital those institutions struggling under the weight of souring loans must raise. The bank reviews, led by the Federal Reserve, showed ten banks needed additional capital to withstand heavier losses that would likely come if the recession worsened. President Obama's administration hopes the firms can fill the capital holes from private sources, although Federal Reserve chairman Ben Bernanke said the government was prepared to help if needed. The total figure appeared to be small enough to ensure that the White House would not have to approach Congress for more rescue money on top of the $700 billion approved last year – a request that would likely be turned down because of voter outrage over the AIG remuneration packages. The American Bankers Association said that the test results should end "harmful speculation." It is not clear precisely how banks will have to increase equity capital. If a bank raises common equity by converting preferred shares issued under the $700 billion bailout fund, the government could become one of the bank's biggest shareholders. President Obama's fiscal 2010 budget, unveiled Thursday, includes at $250 billion placeholder for additional financial rescue efforts. Geithner hopes to get around a total government takeover by creating a market for troubled mortgage securities. Bernanke described the tests as a fair and comprehensive effort that he hoped would allow markets to have "greater confidence that they know the condition of the banks." (Collaboration between Reuters, AP, and CNBC.com, 2009)

The Federal Reserve of the United States has also responded aggressively to the crisis since its emergence in the summer of 2007. Following a cut in the discount rate in August of that year, the Federal Open Market Committee began to ease monetary policy in unprecedented measures in September 2007. As indications of economic weakness proliferated, the committee continued to respond, bringing down its target for the federal funds rate by the spring of 2008. They aimed both to

cushion the direct effects of the financial turbulence on the economy and to reduce the extremely harmfulness of the undesirable feedback loop, in which economic weakness and financial stress become jointly reinforcing. Unfortunately, the intensification of the financial turbulence in the fall of 2008 led to further deterioration in the economic outlook. The committee continued to reduce its target. The Federal Reserve cut the federal funds rate to nearly zero percent and declared that it would essentially print money to fight the deepening recession and locked credit markets. The Federal Reserve has been actively using a range of policy tools to provide direct support to credit markets and thus to the broader economy. They have provided short-term liquidity to sound financial institutions, have provided liquidity directly to borrowers and investors in key credit markets, and have purchased longer-term securities for the Fed's portfolio. The Federal Reserve's approach to supporting credit markets could be described as credit easing. (U.S. Federal Reserve, 2009)

Moreover, President Obama has proposed cracking down on U.S. corporations that use offshore subsidiaries to lower their tax burdens. While most nations do not tax corporate profits earned abroad, Obama says doing so would put $210 billion in U.S. reserves over the next ten years. Critics say the change would make it harder for corporations to compete globally. (Targeting Tax Havens, 2009) The U.S. loses an estimated $100 billion in tax revenues every year on assets stashed overseas. (Pickert, 2009)

Austria

In October 2008, the Austrian parliament had their own crisis policy when they approved a €100 billion bailout plan to stabilize the country's banking sector, with €15 billion set aside directly for troubled banks. The banks would receive state guarantees, capital injections, and loans in the face of the worst financial crisis in generations. Weeks later, the European Commission approved their plans to support troubled banks. The state aid would be available only on terms that would ensure fair

competition with the rest of the E.U. In particular, Austrian authorities promised public funds would only be made available to banks and insurers in exchange for "adequate remuneration" and that there would be "the necessary incentives for institutions to repay the state capital". (EU Approves Austrian Bank Bailout Package, 2008)

From the bailout plan, Erste Bank received €2.7 billion from the bailout. Raiffeisen International and others will probably soon follow. In proportion to Austria's population of only eight million, the €100 billion is far more than Germany and many other countries have allotted. However this provision is not without reason. Though the exact figure is disputed, Austria's banks have probably invested some €300 billion in post-communist countries. No other Western European country has been nearly as hard-hit by the financial crisis in the east, relative to its size.

As a side effect of the bailout plan, Eastern Europe is getting a boost in their economy. The eastern countries depend heavily on Western European consumers. The corporate and government debt problem has been compounded by plummeting exports and consumer spending. After the fall of communism, Viennese financial organizations snatched state-owned institutions in Eastern Europe, and today Austria's banks hold assets in the region equal to at least two-thirds of their home country's total economic output. In propping its banks, Vienna is in effect sustaining their subsidiaries to the East. (Ewing, 2009)

Unfortunately, in April of 2009, Nobel Memorial Prize winner and New York Times op-ed writer Paul Krugman said that Austrian lending to Eastern Europe is off the charts compared with anyone else's, and that means some serious risk given that emerging Europe is experiencing the mother of all currency crises. He proclaimed that Austria is not as outrageously leveraged as Iceland, or even Ireland. But after those two nations, Austria is probably the advanced country at most risk from the financial crisis. Krugman further said that Austria may need a bank bailout that will seriously strain the country's

resources. (Krugman, Austria, 2009) Austrian bankers were outraged by Krugman's comments, and Josef Pröll said the claims were "absolutely absurd." (Pritchard, 2009) Therese and Thomas Brininger, residents of Vienna, believe that though a number of banks have with daughter companies in the east have done substantial lending, "all European countries cannot all be put in one pot. There is a great diversity [and] varying levels of stability." (Brininger, 2009) Other Austrians believe that it an attempt to blemish the Austrian success story in the east.

Housing

United States

With his dramatic plans to restructure Wall Street and Detroit, overhaul health care, and create a clean-energy economy, Obama is certainly taking political risks. (Grunwald, 2009) Obviously, a major piece of Obama's agenda was to help those facing foreclosures. The administration of President Obama passed the Making Home Affordable housing program in February 2009. The Home Affordable Refinance Program gives up to 4 to 5 million homeowners with loans owned or guaranteed by Fannie Mae or Freddie Mac an opportunity to refinance into more affordable monthly payments, and therefore helps to stabilize the U.S. housing market. (U.S. Government, 2009) Many homeowners complained that this plan did not bestow enough. Therefore in early May, the U.S. Treasury Department agreed to expand the program to help out struggling homeowners even more by cutting interest rates further and providing cash incentives to lenders and borrowers alike (Reuters, 2009). Even with this new legislation and help, economists say the U.S. is entering a troubling new phase of the foreclosure crisis. As unemployment threatens to hit double-digits, job losses are leading more homeowners with prime loans – the lowest-risk category – to default. According to the Treasury Department, prime-loan delinquencies jumped 115% in 2008. Some 1.5 million homes could be affected. (Foreclosure's Next Wave, 2009)

Europe

Europe is also having a subprime crisis of its own, though not to the extent of the United States. Cheap credit earlier in the decade led to a consumer spending boom, leading not only to a real estate expansion, but also to an overall economic boom that, even without the subprime issue and the global credit crunch, was going to burst. The European subprime crisis is particularly critical in countries like Spain and Ireland. Banks pushed for more lending by giving out liberal mortgage terms, creating a pool of mortgages that might soon become as unstable as the U.S. subprime pool.

Automobile industry

General Motors and Chrysler bankruptcies

As for the automobile industry, the first governmental involvement was when President Bush gave a $17.4 billion federal lifeline to General Motors and Chrysler on December 19, 2008. Bush gave them three months to negotiate a viable way forward and restructure, or else the loans will be called in at the end of March, and bankruptcy will follow. (No End to the Nightmare, 2009)

General Motors and Chrysler unveiled restructuring plans to fend off bankruptcy and secure more government funding. General Motors announced it would grant 50% ownership to the U.S. government, lay off some 21,000 U.S. workers, eliminate its historic Pontiac brand, close more than 1000 dealerships, and swap $27 billion in bond debt for company stock. Chrysler alleviated its debt by brokering a deal with their four largest creditors and the Treasury Department. They would also persuade all 46 companies holding its debt to back the Treasury-brokered agreement, which would swap $6.9 billion in debt for $2 billion in cash and form a partnership with Fiat. (Crunch Time, 2009)

Lamentably, the U.S. administration of President Barack Obama forced Chrysler into bankruptcy on April 30. Chrysler was deeply in debt, bleeding money, and saddled with unpopular products. Of the best 20 best-selling vehicles in the U.S. in 2008, only one was made by Chrysler. The government has

since cobbled together an alliance with the Italian automaker Fiat. Analysts expect Chrysler to capitalize on Fiat's strengths by introducing smaller, more economical vehicles in the coming years. (Dregle, June) As for the other ailing car company, Obama decided to dismiss General Motors CEO Rick Wagoner earlier this year. Under the GM restructuring plan released in late April, Washington would own 50% of the carmaker, and the United Auto Workers (UAW) union just under 40%. Regrettably, this wasn't enough. On June 1, GM was forced to file for Chapter 11 bankruptcy protection as part of Obama's plan to shrink the automaker to a sustainable size and give a majority ownership stake to the federal government.

General Motors filed for bankruptcy after reaching a deal to sell off its European operations, including German automaker Opel, and UK-based Vauxhall and Saab. Chapter 11 bankruptcy will aim to help GM emerge with only its more profitable plants, brands, dealerships, and contracts. U.S. president Barack Obama said Monday that General Motors had a solid chance of recovering with the proper combination of taxpayer investments, stakeholder sacrifices, and far-sighted planning. Obama noted that GM will receive $30 billion in additional funding from taxpayers, giving the public a 60% share in the company. The government agreed to become a "reluctant" shareholder because that is the only way GM can survive. The future of thousands of car industry jobs in Europe remained uncertain. The German government, which has led the negotiations, will provide a bridge loan to keep GM Europe operating in the short term. German Foreign Minister Frank-Walter Steinmeier described the deal as a "responsible solution" that would preserve the highest number of jobs. Magna International warned during negotiations that it would have to cut about 10,000 jobs from GM Europe's 55,000-strong workforce. As part of the reorganization, GM is expected to cut 20,000 jobs and close about a dozen plants by the end of 2010. GM will also shed its Pontiac, Saturn, Hummer, and Saab brands and cut loose more than 2000 of its 6000 U.S. dealerships by next year. That could result in more than 100,000 additional job losses if

those dealerships are forced to close. General Motors has reported losses of more than $90 billion since 2005, while its share of the U.S. market has dropped to 19 percent. (CNN.com, 2009)

A deepening global slowdown along with gloomy growth prospects and tumbling consumer confidence starts to take a toll on European automakers, which are faced with the need to sustain high levels of investment to support the market transition to low-emission vehicles without the backing of sufficiently strong consumer demand and political support. The fallout of the financial crisis hits auto manufacturers hard, as the credit crunch makes it more difficult for the sector to finance daily operation and, at the same time, also weakens demand for new cars. Consumers are increasingly hesitant to make large expenditures and find it more difficult to get their purchase financed. Without government support and market incentives, overly tight carbon dioxide regulation risks to upset the fragile economics of an industry already in difficult circumstances. The short-term outlook for the European automotive market in 2009 remains weak with no signs of a swift revival, due to challenging market conditions including severe competitive pressures and unpredictable fuel and raw materials prices. Restructuring efforts remained a priority for European automakers as they struggled with high raw materials costs and a flat European market. The European automotive industry is a major contributor to the E.U. economy, generating turnover of 551 billion euro, which represents around 5% of European GDP. The automotive industry provides direct jobs to 2.3 million people and indirectly supports employment of another 10 million families. In Austria, the industry directly provides 33,000 jobs. (ACEA, 2008)

Scrapping Premium

Austria has introduced a scrapping premium for the purchase of new cars. Every Austrian who scraps an at least 13-year-old passenger car and buys a new car receives €1500. The premium payments resemble the regulations of the German ‘Abwrackprämie’, although the premium is higher in Germany

and the car only needs to be 9 years old. In the United States, the American Congress has decided on a scrapping premium similar to the German model. The program, called ‘Cash for Clunkers’, offers $5,000 to owners of a car at least 8 years old to choose a new, consumption-favorable car. The action should boost automobile sales and help the environment. However, there is a deduction if the car is made by a foreign manufacturer. (Scrapping Premium, 2009)

The Securities and Exchange Commission (SEC)

In the United States, seven agencies oversee banking, securities, and futures, and still failed to notice Bernie Madoff’s Ponzi scheme. (Subject: Wall Street, 2009) Christopher Cox, former chairman of the Securities and Exchange Commission (SEC), ignored evidence of a massive Ponzi scheme set up by investment guru Bernard Madoff and passively supervised giant investment banks that went under on his watch. Partly as a result of this lax supervision, the future of the 75 year old agency is in jeopardy. Cox has admitted that his staff brushed off “credible and specific” reports of fraud committed by Madoff over the past 10 years. (Zagorin & Weisskopf, 2009)

Hence, Barack Obama has named Mary Schapiro, a former SEC commissioner, to replace Cox to handle some of the important duties of the commission. Since taking over on January 27, Schapiro has launched an aggressive campaign to strengthen enforcement and reverse a number of Cox-era practices. She is studying new technology to cope with the estimated 700,000 tips the SEC gets from informants annually, like those it received but ignored in the Madoff case. And she has quickly filled senior SEC jobs, selecting a variety of candidates who have been prominent Cox critics. (Zagorin & Weisskopf, 2009) SEC head Mary Schapiro is now signaling that the ratings system might need to be changed further, particularly who pays for ratings. (A Brief History Of: Ratings Agencies, 2009)

Solutions

Gordon Brown and the G8 Council

In a press conference following the close of the E.U. Council held in mid-October, Gordon Brown summed up the actions of the G8 group of countries to reform the international financial system. This leaders meeting agreed upon the principles and the priority areas for global action. The five principles that they have agreed for the financial system are that there should be transparency, sound banking, responsibility, integrity, and global governance. That also agree that, based on these principles, they should move to early decisions about transparency, global standards of regulation, cross-border supervision of financial institutions, crisis management, the avoidance of conflicts of interest – included in that are executive remuneration packages – and the creation of an early warning system for the world economy.

In the press conference, Brown continued to explain that the reform of the international financial system is not only necessary to prevent a crisis happening again, it is essential to end the current crisis. People need to feel confident that their institutions cannot act irresponsibly. So, governments must ensure that off-balance sheet instruments are brought back on to balance sheets and fully declared, have total transparency in the activities of banks, and remove the conflicts of interest, Executive remuneration packages, like the ones given to AIG executives, mustn't reflect excesses and irresponsibility. The public need to know that institutions are acting responsibly and to make the changes that the G8 countries are proposing is a necessary element of building confidence that they will solve these problems and that all the irresponsibility that has happened in the past is rooted out.

The administrations also agreed that they must reform the International Monetary Fund and the Financial Stability Forum for a more effective early warning system to prevent future crises. As far as the International Monetary Fund is concerned, it is very important that the world has an international

organization that is capable of being an early warning system for the world economy. The new International Monetary Fund would be more like an independent central bank in the way it operates, but also one that is capable of bringing countries together to deal with crises as they arise.

Regarding the upcoming G20 Leaders' Summit the following year, he indicated that the summit will hopefully bring a world trade agreement which will be a signal that protectionism is completely unacceptable. Brown stressed that it is very important that all the different players in the world economy are involved in the making of decisions that affect not just one or two continents, but every continent round the world. (Number 10, 2009)

The London Summit

The G-20 Leaders' Summit on Financial Markets and the World Economy was held in London on April 2, at a time when the world confronts the worst economic crisis since WWII. Heads of government and heads of state from the Group of Twenty, Finance Ministers and Central Banks Governors, plus some regional and international organizations attended. Due to the extended membership, it has been referred to as the London Summit. The Summit aims were to bring together the leaders of the world's major economies to stabilize the world economy and secure recovery and jobs. The leaders agreed on steps to do five things: restore confidence, growth and jobs; strengthen financial supervision and regulation; fund and reform the international financial institutions to overcome this crisis and prevent future ones; promote global trade and investment and reject protectionism, to underpin prosperity; and, build an inclusive, green, and sustainable recovery.

Leaders reaffirmed their commitment to work together to preserve long-term fiscal sustainability by calling on the IMF to assess regularly the actions taken and the global actions required. The leaders also agreed to strengthen the financial system by putting in place a better and more credible system of surveillance and regulation to take account of risk and prevent leveraging, including

regulation and oversight of large hedge funds and credit rating agencies. The leaders agreed to make resources available through international financial institutions like the IMF and World Bank. They also agreed to ensure they have the facilities to meet the needs of emerging markets and developing countries. The leaders committed not to resort to protectionism, direct or indirect, and put in place a transparent monitoring mechanism, and they agreed to take measures to promote trade. The leaders also reaffirmed their commitment to low income countries. The G-20 leaders reached an agreement which, in principle, provides $1.1 trillion to various programs designed to improve international finance, credit, trade, and overall economic stability and recovery. Programs include $500 billion for the IMF to aid struggling economies, $250 billion to boost world trade, $250 billion for a new IMF overdraft facility, and $100 billion to assist international development banks in lending to poor countries. (London Summit, 2009)

Anti-isolationist policies

Despite a pledge to not enact new protectionist policies, which economists say could worsen the global recession, seventeen of the G-20 countries have implemented such measures in recent months, according to the World Bank. Individual nations' attempts to preserve jobs and industries through tariffs or subsidies "can lead to a negative spiral of events," according to the bank's president. In its report, the bank says 47 separate isolationist measures have been put in place since November. In the United States, they have given billions in loans to GM and Chrysler – dubbed a "direct subsidy" by the World Bank. In the European Union, they have reinstated subsidy payments for exports of dairy products like butter and milk powder. (World Bank, 2009) Many countries have announced economic-stimulus packages, but national efforts have rarely been coordinated. According to Gordon Brown, Britain's Prime Minister, "the world has got to work together so that global financial flows are in some way supervised beyond simply national regulators. Every other crisis has been dealt with by countries taking action to

solve their national problems. This crisis can be dealt with only by us acting internationally." (Brown, 2009)

It's not astounding that Democrats in Congress added a 'Buy American' provision to the fiscal stimulus bill earlier this year. It might seem sensible to ensure that taxpayer dollars would be used exclusively to support American jobs. It is sparking conflict with American allies, and the 'Buy American' provision could ultimately cost American jobs. American's trading partners expected more of President Obama, who signed a declaration against protectionism at the London Summit in April. He convinced Congress to add a clause to its 'Buy American' effort promising Washington would meet its international obligations. But cities and some state legislatures have signed on to a 'Buy American' resolution pushed by the United Steelworkers Union. Meanwhile, representatives of American allied countries have been consulting about how to respond to the United States' protectionist drive. Some Canadian cities have passed ordinances against buying American. 'Buy American' could make the global recession worse. (Editorial, 2009)

Individual solutions: Austria and the United States

As for Europe, little can be done on a collective level, other than cooperation of the bailouts for financial institutions of individual countries. Only the European Central Bank has extensive powers over the region's economy, and it has fewer policy tools than the U.S. Federal Reserve. As an individual country in the E.U., Austria's main tactic plan predominantly involves Eastern Europe. As a practical step, there must be close cooperation in addressing both regulatory concerns and providing financial support for parent banks and their subsidiaries in emerging Europe. A worsening crisis in emerging Europe will threaten Europe as a whole.

The United States has a lot to change before it can be considered a "safe" institution again. An overhaul of the financial regulatory system is extensive, though necessary. According to the U.S. Federal

Reserve, the U.S. needs stronger supervisory and regulatory systems under which gaps and unnecessary duplication in coverage are eliminated, lines of supervisory authority and responsibility are clarified, and over sight powers are adequate to curb excessive leverage and risk-taking. Regulatory oversight should be coordinated internationally to the greatest extent possible. The Obama administration must also address the problem of financial institutions that are deemed "too big to fail." Most critics find that it is unacceptable that large firms that the government is now compelled to support to preserve financial stability were among the greatest risk-takers during the boom period. The existence of too-big-to-fail firms also violates the presumption of a level playing field among financial institutions. Also urgently needed in the United States is a new set of procedures for resolving failing nonbank institutions deemed systemically critical. A clear lesson of the recent period is that the world is too interconnected for nations to go it alone in their economic, financial, and regulatory policies. International cooperation is thus essential if we are to address the crisis successfully and provide the basis for a healthy, sustained recovery. (U.S. Federal Reserve, 2009)

Conclusion

American novelist Kurt Andersen described a positive effect of the crisis, saying in Time magazine, "the meltdown has amounted to a spectacular moment of global consciousness – an unforgettable reminder that all 6.7 billion of us are in this together, profoundly and inextricably interdependent." (Andersen, 2009) The word "crisis" has its roots from the Greek word *krisis*. It is defined as a turning point. The big question here is when. Sometimes it is a crisis that forces change, whether good or bad. In a world where nationalism comes effortlessly, it is encouraging to know that no nation is facing this alone. It may take this financial crisis to increase cooperation between countries on issues bigger than finance. And that could be the turning point that changes the world.

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