Part III

Remedies and Repartee

Part III covers opinion makers, particularly in the United States. My selection of opinion makers is perhaps peculiar. I exclude professional journalists as well as actors in the drama. Henry Paulson, Ben Bernanke and others have published books that are apologies explaining their past actions. I exclude these, although I do provide boxes with a summary of the statements of Ben Bernanke and Timothy Geithner below. I have also omitted the legal inquiries into the events surrounding the demise of Bear Stearns and Lehman Brothers.

The pundits and opinion makers whom I do examine fall into three groups. Chapter 4 covers vocal 'saltwater' economists, represented by two Nobel Prize winners considered to be somewhat left leaning in politics and social issues. Chapter 5 includes 'freshwater' economists, represented mostly by two authors somewhat present in the popular press, although less so than their saltwater counterparts, and considered to be more 'right wing', and 'Austrian' economists, who are excluded from the mainstream and are considered to be further to the right than freshwater economists.

The variety of viewpoints raises the issue as to whether there is a scientific basis on which to appraise, accept or reject these opinions or whether it is all a question of ideology. Chapter 6 examines this question and points to areas of convergence and lessons that researchers in each school can learn from others.

The crisis response of the main actors: Ben Bernanke and Timothy Geithner

Boxes 1 and 2 summarize the actions of the Federal Reserve System and the Treasury in responding to the financial and economic crisis, while respecting as much as possible the version of events as told by the head of each under the Obama administration.

According to Ben Bernanke, the Federal reserve system responded to the financial crisis with four categories of action:

1 Interest rate cuts at the following times:
- August 2007
- September 2007 FOMC (Federal Open Market Committee) reduces the target rate by 50 points (1 point = one hundredth of one per cent)
- over the following months to spring 2008, reductions of another 325 points
- October 2008, a further 100 points (50 points co-ordinated with 6 central banks October 8)
- December: the 0–25 basis point range was targeted.

In spite of the cheap access of funds for banks, there was no increase in lending, so the federal reserve moved to provide liquidity to the private sector. Besides the communication of policy communication, it used the following tools:

2 Using of federal Reserve assets to extend credit or purchase securities for bankers and primary securities dealers in the following ways:
- primary securities dealers (broker-dealers that trade in US government securities with the Federal Reserve Bank of New York) becoming eligible to borrow from the Fed
- credit facilities such as reduced spread between fed rate and discount rate, increased term to 90 days, etc
- bilateral currency swap agreements with 14 foreign central banks (impact on the dollar globally)

3 Using Federal Reserve assets to provide liquidity to borrowers and investors in critical nonbank credit markets:
- facilities to purchase commercial paper at three months term
- facilities for loans against AAA-rated asset-backed securities collateralized by student loans, auto loans, credit card loans, and loans guaranteed by the Small Business Administration
- a facility to finance bank purchases of high-quality asset-backed commercial paper from money market mutual funds
- a facility to buy high-quality (A1-P1) commercial paper at a term of three months
- a facility to provide three-year term loans to investors against AAA-rated securities backed by recently originated consumer and small-business loans

4 Purchasing long term securities for the Fed's portfolio

Sources: Bernanke speeches 2008–2010

The Narrative of Geithner and Treasury's Response to the Crisis:

Geithner thought the best plan would align three cannons.

a. Monetary policy: the Federal Reserve would lower borrowing costs to nearly nothing.
b. Fiscal policy, through which massive government outlays – a stimulus – would help fill the gap in private spending.
c. Recapitalization of the financial sector, which meant getting money into banks to help them absorb losses and continue lending

Upping the degree of difficulty was the need to coordinate with other countries, since the crisis was already global. Geithner attacked the problem in two steps:

a. "Stress tests" were designed to persuade panicked investors, amid what amounted to a run on every bank, to buy shares in any of them. This was an alternative to government buying shares, which would be seen as a step towards nationalization.
b. Fix the system: by incremental and technical reform of regulation without dismantling the dominant institutions or restructuring the industry.

Geithner said: "I think it's very important for banks to understand that they lost the basic confidence and trust of the American people. And they have a long way to go to earn that back. And every judgment they make now going forward – in terms of how they pay their employees, how they run their institutions, how they meet the needs of their customers, how much they support this very important effort of reform across the system – is going to be important to rebuilding that basic trust and confidence."

(All things Considered, 2009)