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So-Called Financial Reform:
More Power to the Systemic Risk Generator

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Earlier this month the White House unveiled a complex new scheme of interventionism, purportedly to prevent future financial crises.[1] The scheme would materially multiply and intensify the vast array of subsidies and regulations *already* in place to politically manipulate the financial sector (and cause moral hazard). The scheme, which would also make the Fed a "systemic risk regulator," was unveiled soon after White House chief economist Larry Summers claimed that the Obama Administration was somehow committed to free markets.[2]

We live in an age when most people – especially from Harvard and Yale – seem wholly ignorant of the actual *meaning* of a "free market." Obama's more intensely-interventionist scheme can only cause more trouble (and crises) down the road, because the Fed, in fact, is the systemic risk *generator*.

The tragic facts before us today are no different from those that *preceded* the recent crisis. The Fed *already* has a systemic monopoly on currency issuance – *already* exerts a systemic influence on bank reserves – is *already* the system-wide lender of last resort to deadbeats – and *already* universally alters short-term interest rates and thus the all-important shape of the Treasury yield curve. Moreover, it was precisely the Fed's mismanagement of its *existing systemic powers* that contributed so much to the latest financial debacle – just as previous Fed powers contributed to the stock-price crash of 1929 (*also* preceded by a deliberate inversion of the yield curve) and Great Depression of the 1930s. A financial crisis prevention system that gives more power to the Fed is like a fire prevention system that gives arsonists even bigger supplies of matches and gasoline.

The Obama administration says it's committed to the "free market," even as it multiplies Washington's subsidies and regulations in finance. It's interventionist scheme will further empower the Fed and make it a so-called "systemic risk regulator," which will only make matters worse in the long term, since the Fed, in fact, is the systemic risk generator.

Yes, the current labyrinth of subsidization and regulation of the financial sector in the U.S. is haphazard, Byzantine, and arbitrary. It's also true that good and bad financial firms alike must obey the contradictory edicts of the Fed, FDIC, OCC, CFTC, Treasury, GSEs, SEC and IRS (plus the array of state-level regulators and Congress-backed pressure groups, like ACORN). But that doesn't mean the solution lies in giving still more power to any one of these subsidizers-regulators, including the Fed. On the contrary, it warrants a massive *scaling back* – and eventual *abolition* – of these morally and economically hazardous subsidies, regulations and agencies.

What the financial sector really needs is the Rule of Law, not the Rule of Politicians – and regulations are *not* objective laws but rather politically manipulable edicts which arise from subsidies; public subsidies always come with strings – and often *nooses* – attached. The Treasury plan proposes not the elimination of the alphabet soup

[1] See Binyamin Appelbaum and David Cho, "Obama Blueprint Deepens Federal Role in Markets," *The Washington Post*, June 17, 2009; Henry J. Pulizzi and Damian Paletta, "Obama: Regulatory Plan Seeks 'Careful Balance,'" *The Wall Street Journal*, June 17, 2009; Maya Jackson Randall and Michael R. Crittendon, "Plan for More Fed Power Could Become a Lightning Rod," *The Wall Street Journal*, June 17, 2009.
[2] Henry Pulizzi, "Summers Affirms Administration Commitment to Free Markets," *The Wall Street Journal*, June 12, 2009. See also Timothy Geithner and Lawrence Summers, "A New Financial Foundation," *The Washington Post*, Monday, June 15, 2009.
[3] Neil Irwin and Binyamin Appelbaum, "Lawmakers Balk as Administration Tries to Redefine Central Bank's Role," *The Washington Post*, June 19, 2009.
[4] See Phil Izzo, "Economists React: Regulatory Overhaul, Sensible or Burdensome?" *The Wall Street Journal*, June 17, 2009 and Jamie Dimon [CEO of J. P. Morgan], "A Unified Bank Regulator Is a Good Start," *The Wall Street Journal*, June 29, 2009, p. A15.

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of regulators that currently exits but instead their congregation into yet another board populated with buck-passing bureaucrats – this one titled the "Financial Services Oversight Council." Only a few Congressmen have balked at the Treasury's new scheme,[3] while most top economists and leading bankers have supported it.[4]

According to the Treasury, its plan[5] will "promote robust supervision and regulation," "establish comprehensive regulation," and "provide the government with the tools it needs to manage financial crises." Thus Treasury believes the problem of recent years has been *not* a lack of regulation but a lack of "robust" and more "comprehensive" regulation, even as it also argues that *despite* its newly-proposed interventions, financial crises *will occur again,* and yet will somehow be "managed" by the government – perhaps as it "managed" the latest one? We agree that there *will* be future financial crises, but precisely *because* intervention is now being *intensified.*

Plugging holes of freedom. According to the Treasury, "gaps and weaknesses in the supervision and regulation of financial firms presented challenges to our government's ability to monitor, prevent, or address risks as they built up in the system." Of course, one man's "gap" is another man's *freedom of action*. The Treasury plan seeks to close "regulatory gaps" – which means it seeks to eliminate remaining pockets of freedom of action that may exist in the financial sector. At root, the Treasury plan presumes that free markets "fail" and government intervention provides a "fix" of the failures, even though, as we've argued, the latest debacle represents yet another historically classic case of *government failure*.[6]

According to Treasury, precisely to the extent any freedom or any degree of management discretion still remains in the U.S. financial system – say, in bank lending, securitization, derivatives, commodity speculation, or hedge funds – the more we'll all suffer from financial crises. This false premise fails to recognize that government intervention causes systemic crises; by its nature government policy is ubiquitous and systemic; no specific firm or sector can possibly exert an equivalent kind of systemic influence. While Treasury admits that today's financial system is a mixture of market freedoms and government controls, it insists, against all logic and experience – including the world's extensive experience with socialist schemes and systems – that the *free* part of today's mixture is the problem, and so it wants remaining freedoms to be squelched, and the system moved further in the direction of *total* (totalitarian) control. The Treasury plan conforms to our assessment that the U.S. is moving inexorably to a system of socialist finance.[7]

The best way to assess the likely impact of Treasury's scheme, which will likely be enacted in law (and without much alteration) later this year, is from the perspective of what, in fact, actually *caused* the latest financial crisis:

1. The Fed and the yield curve. As was true in every U.S. recession and credit crunch since 1966, the latest ones were triggered by a deliberate inversion of the Treasury yield curve by the Fed.[8] This *systemic interest-rate structure* has systemic effects. Nothing in the Treasury's proposed "overhaul" would preclude the Fed from inverting the yield curve yet again. Instead, Treasury proposes "new authority for the Federal Reserve to supervise *all firms* [even non-financial] that could pose a threat to financial stability, even those that do not own banks."

2. "Too-Big-to-Fail." This government policy induces banks to obtain federal protection by boosting their asset size, with little regard for asset quality, liquidity or capital adequacy. The policy, which purports to contain systemic risk, in fact encourages it, in part by giving easy and cheap access to the Fed's discount window, which further subsidizes bank mismanagement and systemic risk. A policy of "too big to fail" (TBTF) renders responsible banks – and the banking system – too burdened to succeed, while fostering favoritism and cronyism. TBTF should be abolished, and failed banks should go bankruptcy court, as they now do not.[9] Yet nothing

[5] For the actual plan – which is 88 pages long, and titled *Financial Regulatory Reform: A New Foundation; Rebuilding Financial Supervision and Regulation*, U.S. Treasury Department, Washington, D.C., June 2009 – see http://www.financialstability.gov/docs/regs/FinalReport_web.pdf.

[6] See our reports, "Roots of the Latest Banking Crisis," *The Capitalist Advisor*, July 11, 2008; "About Those Crazy Aunts and Uncles [Fannie Mae and Freddie Mac] Still Living in the Basement," *Investor Alert*, August 22, 2008; "This is the Scapegoat Phase," *Investor Alert*, October 27, 2008; "Why They Won't Leave Bad Enough Alone," *The Capitalist Advisor*, February 13, 2009; "Banking Without the 'Too-Big-to-Fail' Doctrine," *The Capitalist Advisor*, March 31, 2009.

[7] See our five-part series, "Socialist Finance in America," *The Capitalist Advisor* – Part I (October 15, 2008); Part II (November 21, 2008); Part III (November 30, 2008); Part IV (December 24, 2008) and Part V (April 20, 2009).

[8] See our reports: "The Fed Wants a Recession," *Investor Alert*, January 6, 2006; "Global Yield Curves and Economic Growth," *The Capitalist Advisor*, February 24, 2006; "Global Yield Curves and Equity Performance," *Investment Focus*, February 17, 2006; "The Policy Mix Index: Yield-Curve Inversion Signals Trouble Ahead," *The Capitalist Advisor*, September 25, 2006; "The Recession of 2007," *Investor Alert*, December 7, 2006; "Inverted Yield Curves as Bull Market Killers – and Bear Market Predictors," *Investment Focus*, February 7, 2007; "When 'Corrections' Degenerate Into 'Bear Markets,'" *Investment Focus*, September 18, 2007; "The U.S. Yield Curve as a Predictor of the Business Cycle," *Investment Focus*, December 15, 2008.

[9] See our reports: "Banking Without the 'Too-Big-to-Fail' Doctrine," *The Capitalist Advisor*, March 31, 2009; "Bankruptcies are Bullish, Bailouts are Bearish," *Investor Alert*, September 22, 2008; and "Politicized Bankruptcy and the Mistreatment of Bondholders," *The Capitalist Advisor*, June 9, 2009.

in the Treasury's "overhaul" scales back on the policy.

3. Government deposit insurance (FDIC). This program allegedly stabilizes the banking system but in fact it *taxes sound banks* while *subsidizing bad ones*, thereby systematically weakening the system. In the process, the FDIC encourages banks to finance their assets disproportionately with deposits, relative to longer-term debt or equity; this induces risky practices, such as illiquidity and over-leveraging. There results a gradual *displacement of private capital with government financing*. Safe and sound banking requires that government deposit insurance be phased out and (eventually) abolished.[10] Yet nothing in the proposed Treasury plan even hints at scaling back the FDIC. In fact, the plan endorses the recent, reckless extension of the FDIC's statutory account coverage (up from $100,000 to $250,000) plus the agency's unprecedented guarantees of new debt issuances by banks.[11]

4. Fannie and Freddie. These "government sponsored enterprises" (GSEs) went bust last September (which further contributed to the crisis), with nearly $6 trillion in assets (and even more in liabilities), after having securitized or purchased a slew of shoddy residential mortgages in a deliberate (and politicized) scheme to promote home ownership for the un-creditworthy and undeserving. By last fall the GSEs had grown to the point of controlling *two-thirds* of the residential mortgage market, nearly *twice* the share it controlled just a decade earlier; by any definition, this is a *systemic* (and destabilizing) influence.[12] Yet since failing, the GSEs have received roughly $400 billion in *additional* funding and/or guarantees from the Treasury and the Fed. Nothing in the proposed Treasury scheme reigns in the power or funding of the GSEs, or at all curbs their irresponsible policies.

5. CRA and other inducements to unsound lending. The Community Reinvestment Act (CRA) and related laws *force* banks to lend to the un-creditworthy, and this also contributed materially to the latest housing-credit-financial crisis. Nothing in the Treasury plan abates these harmful laws or related agencies (like HUD). If anything, the plan expands them, primarily through a new "Consumer Financial Protection Agency" (CFPC), which would likely exert additional pressure on financial institutions to provide less-profitable, unprofitable and/or overly-risky products and services. The case for a "CFPC" rests on the false premise that the latest crisis was caused by "predatory lending." In fact, the problem was *predatory borrowing*. Banks and investors (in MBS) were victimized by irresponsible deadbeats (see, for example, "liar loans") – encouraged by government policy.

Regarding the five main areas summarized above – the five main factors that *caused* the latest housing-credit-financial crisis – Treasury's published plan is either *silent*, or worse, *expands* and *intensifies* the powers and funding of the five main culprits. The plan adds insult to injury by also imposing regulations on those less-subsidized, less-regulated areas of the U.S. financial sector – *derivatives and hedge funds* – which actually worked *quite well* in the past two years in *dispersing risks* and *minimizing losses*.

The Fed welcomes its new powers. It's no surprise that Fed head Ben Bernanke would tell a Congressional committee this week (June 25) that he *endorses* the Treasury's plan, as it would grant *him* still more power; but it's revealing what Bernanke *admitted* about those powers:

> To avoid such situations in the future, it is critical that the Administration, the Congress and the regulatory agencies work together to develop a new framework that strengthens and expands supervisory oversight and includes a broader range of tools to promote financial stability. . . . In terms of additional Fed powers, especially the Treasury proposal to make the Fed the consolidated supervisor of systemically critical firms, that's not a major difference in terms of powers from what we currently have – which is being umbrella supervisor of all financial holding companies. Rather, it would be a change in approach, where we would take a system-wide approach in how we would regulate those firms, rather than looking at them bank by bank or firm by firm. So it's not a massive increase in our powers; it's really a change in the strategy behind those powers.

We see above Bernanke telling Congress that the new Fed powers proposed by Treasury *are not really much different from those it already wields* – even *prior* to the onset of last fall's financial crisis, the same powers which were obviously *inadequate* to the task of preventing the crisis in the *first* place or to the task of containing it once it began. What then is the *point* of the Treasury plan, other than to satisfy the power lust of those who presume

[10] See Richard M. Salsman, *The Collapse of Deposit Insurance – and the Case for Abolition* (Great Barrington, MA: American Institute for Economic Research, 1993).

[11] See Margaret Chadbourn, "FDIC May Extend Guarantee for Deposits Over $250,000," *Bloomberg*, June 23, 2009. What was originally named the "Temporary Liquidity Guarantee Program" (initiated in 2008) will now likely become *permanent*. The FDIC is now guaranteeing about $700 billion of debt for about 7,100 financial institutions – *above and beyond* its 2.5X increase in deposit insurance coverage (which now covers $13.5 trillion of deposits at 8,250 institutions, a sum which is half again as large as the entire U.S. national debt).

[12] "Those Crazy Aunts and Uncles [Fannie Mae and Freddie Mac] Still Living in the Basement," *Investor Alert*, InterMarket Forecasting, Inc., August 22, 2008.

"market failure" and government "fixes" of same? It should be no wonder that Chapter IV of the Treasury's plan is titled "Provide the Government With the Tools It Needs to Manage Financial Crises,"[13] for this implies that the newly empowered Fed will *not* be able to prevent future financial crises; instead it will "manage" them – perhaps by yet again nearly tripling its balance sheet, monetizing low-grade securities, bailing out mismanaged financial institutions, gyrating interest rates, debasing the dollar, and strong-arming banks into taking TARP money and absorbing insolvent, toxic competitors, just as it has done over the past year.[14] The Treasury scheme means that in the future the Fed will be able to do such things not *only* to banks but *also* to an array of large and risky *non-financial firms* located economy-wide.

Mr. Bernanke also admitted to Congress on June 25 that the policy of "too-big-to-fail" (TBTF) was destabilizing one, yet he also refused to foreswear its further use:

> Under current circumstances, and the system we have, the failure of one of those firms [the top ten U.S. banks, with 50% of the deposit base] would be very dangerous for the American economy, and that's why I believe the centerpiece of financial regulatory reform should be steps to get rid of the "Too-Big-to-Fail" policy, to find measures that allow a large firm to fail when it is appropriate, but to do so in a way that doesn't bring everything else down with it. We need greater oversight, capital and supervision of those companies and a resolution regime in the case of failure.

Bernanke also refused to foreswear further nationalizations of banks, which means the Fed, armed with new powers, could easily lend to and then nationalize non-financial firms in the future. In an exchange with Rep. Michael Turner (R-OH), who opposed the TARP last fall and recently proposed a bill (HR 57), titled "Preserving Capitalism in America Amendment" to the U.S. Constitution (102 co-sponsors); the amendment would forbid state ownership of firms. Turner asked if the latest crisis could have been resolved had this amendment been in place; Bernanke answered thus:

> I agree with you that limited government ownership and limited government intervention in the private sector is frequently a good policy, and in that respect, you know, I think that's a very good approach. However, in order to make that a viable policy in our financial sector, we need to have a set of rules and regulations that can allow financial firms to fail, but in a way that doesn't bring down the entire system. I believe in failure. As someone once said, capitalism without failure is like religion without sin. We need to have failure, but we also need regulations that allow the orderly wind-down of large financial firms. In order to avoid ever having government ownership again in the financial sector, you need to figure out a way to avoid having the crisis in the first place and I think that should be the first priority.

But the Fed itself, along with its TBTF policy and the FDIC, ensures that we *cannot* "avoid having the crisis in the first place." These institutions cause the financial crises in the *first* place, then *intensify* them, then receive *additional* funding and *wider* powers after having done so.

The Fed, the yield curve and systemic risk. As we've noted, the Treasury scheme will give the Fed still greater power, and with no assurance that it will not, yet again, invert the Treasury yield curve and thus instigate further recessions, credit crunches and financial crises. Some reformers claim that Bernanke and his Fed cohorts can be trusted with its new powers, because they've learned so much from the latest debacle. In truth, nothing material has been learned, for if it had been, *someone would now be restraining the Fed's systemic power to invert the yield curve*.

Bernanke himself learned nothing prior to the latest crisis, because he deliberately inverted the yield curve even while *knowing* the harm it would do. While doing so, he repeatedly lied to Congress about what would happen.

In a speech given in April 2004, Bernanke explained the nearly-unerring forecasting power of the yield curve:

> Asset prices provide information, particularly about market expectations, that is difficult to obtain elsewhere. . . . Financial markets serve to aggregate private-sector information . . . Asset prices and yields are inherently forward looking and thus may contain information about future economic conditions not evident in other series. Moreover, asset prices, unlike many data series, are available on a timely and continuous basis and are not revised . . . Various yield spreads have been found to be informative about the future course of the economy . . . Of

[13] *Financial Regulatory Reform: A New Foundation; Rebuilding Financial Supervision and Regulation*, U.S. Treasury Department, Washington, D.C., June 2009 – at http://www.financialstability.gov/docs/regs/FinalReport_web.pdf.
[14] "The Force Fed," *The Capitalist Advisor*, InterMarket Forecasting, Inc., June 26, 2009.
[15] Ben Bernanke, "What Policymakers Can Learn from Asset Prices," remarks before The Investment Analysts Society of Chicago, Chicago, Illinois, April 15, 2004 (http://www.federalreserve.gov/boarddocs/speeches/2004/20040415/default.htm).

> these variables the term spread (also known as the slope of the yield curve) had been recognized for some time as a useful indicator of cyclical conditions. . . . It is interesting that the slope of the Treasury yield curve has turned negative), at least briefly, at between two and six quarters before every U.S. recession since 1964. . . .
>
> The slope of the yield curve is potentially informative for several reasons. To some extent, it captures the stance of monetary policy. For example, when the yield curve is sharply upward sloping, as is the case today, one can usually conclude that monetary policy is in an expansionary mode (because the short-term policy rate lies below the average of expected future short-term rates). Either an expected pickup in economic growth or higher expected future inflation would also tend to raise long-term rates relative to short rates, steepening the yield curve.
>
> Evidence for the predictive power of the slope of the yield curve has been found for other industrialized countries as well as for the United States. . . . [Fed researchers have] studied the predictive value of the term premium using data from France, Germany, Italy, the United Kingdom, and the United States [and] found that the slope of the yield curve is useful for predicting growth at about a six-quarter horizon, with the link being somewhat stronger in the United States than in Europe. Although the evident information content of the term spread and other yields and spreads is intriguing, these variables hardly provide a foolproof forecasting tool.[15]

Bernanke and his Fed colleagues <u>knew</u> the long history of inverted yield curves preceding recessions, knew they could invert the curve, and then did so, <u>deliberately</u>. While doing all of this, Bernanke <u>purposely misled</u> the public, the financial community, the media, and Congress about the likely effects of inversion. Finally, after the resulting damage, he blamed <u>other</u> factors and sought <u>more</u> power.

Bernanke was obviously *well aware that an inverted yield curve would cause a recession*, and he also knew the Fed, which controls short-term rates, can always determine whether they are above or below long-term rates, which means he knows the Fed can invert the yield curve and cause a recession at anytime. That's *exactly* what it in causing the recession of 2007-2009. It's laughable that Bernanke would conclude (above) by claiming the yield curve was "hardly a foolproof forecasting tool." It is, in fact, quite fool proof, but *nothing* can be *damn-fool* proof. Bernanke is a damn fool, but much worse, a knave: he *knew what he was doing* and he *knew it would destroy wealth*.

In March 2006, just prior to the deliberate inversion, Bernanke gave a speech titled "Reflections on the Yield Curve" to the Economic Club of New York; there he insisted the result of inversion would be *different this time*:

> If investors expect [economic] weakness to require policy easing in the medium term, they will mark down their projected path of future spot interest rates, lowering far-forward rates and *causing the yield curve to flatten or even to invert. Indeed, historically, the slope of the yield curve has tended to decline significantly in advance of recessions* . . . What is the relevance of this scenario for today? Although macroeconomic forecasting is fraught with hazards, *I would not interpret the currently very flat yield curve as indicating a significant economic slowdown to come* . . . In previous episodes when an inverted yield curve was followed by recession, the level of interest rates was quite high, consistent with considerable financial restraint. This time, both short- and long-term interest rates – in nominal and real terms – are relatively low by historical standards . . . Ultimately, a robust approach to policymaking requires the use of multiple sources of information and multiple methods of analysis, combined with frequent reality checks. By not tying policy to a small set of forecast indicators, we may sacrifice some degree of simplicity, but we are less likely to be misled.[16]

By *denying* that an inverted yield curve would do damage *this time*, a policy he was *then preparing to impose*, Bernanke tried to divert attention from his knavery; by his eclectic approach, he insisted, "we are less likely to be misled." Really? He deliberately misled his listeners. He lied. The U.S. recession arrived right on schedule (as in prior cases, about 12-15 months after the Fed first inverted the yield curve, this time in August 2006). The recession began in December 2007. Ten months earlier, in testimony before the Senate (February 14, 2007) Bernanke also actively misled an astute Senator (Jim Bunning, R-KY) who had asked if the yield curve inversion, by then *eight months old*, would ultimately cause a recession or hurt the banks:

> BUNNING: . . . Yesterday in *The Washington Post*, there was an article about the inversion of the yield curve for eight straight months, and how local banks and banking in general – and since that's the

[16] Ben Bernanke, "Reflections on the Yield Curve," remarks before the Economic Club of New York, March 20, 2006. See http://www.federalreserve.gov/boarddocs/Speeches/2006/20060320/default.htm.

Fed's charge, to make sure our banks are sound and secure – were having difficulty with the inverted yield curve. I've questioned you about this before and you have always said it's not very important in this day and time. I ask you again: How long can we stand to have – and we've had it for eight straight months now – an inverted yield curve where short-term rates are higher than our 30-year bond rate?

BERNANKE: Senator, the usual context of this question is, does an inverted yield curve presage a recession or a slow-down in the economy?

BUNNING: It also hurts our banks very badly.

BERNANKE: I'll address that, sir. Just very quickly, though, on the forecasting power of the yield curve, there's been a good bit of evidence that declines in the term premium and perhaps a great deal of saving, chasing a relatively limited number of investment opportunities around the world, have led to a somewhat permanent flattening, or even inversion, of the yield curve, and that that pattern does not necessarily predict slowing in the economy or a recession. Indeed, if you look at other measures of financial markets, such as corporate bond spreads, you don't see anything that suggests anticipations of future stress. The question you raised is a different one, of course, which is the effects on the banking system, specifically. Banks that do their traditional business of taking deposits and making loans are going to be put under pressure because the short-term deposit rates tend to be higher than the loan rates they can get.

BERNANKE: I recognize that's a problem for some banks. Other banks have been able to deal with it by hedging interest rate risk, by getting fees and doing other ways of doing their business. So, overall, I don't see the banking sector as being under tremendous pressure in terms of its profits and asset quality at the moment. But I recognize that particularly for smaller banks, which have fewer options in terms of funds, raising funds, and in terms of earning fees and income, that the inverted yield curve does produce some pressure. From the Federal Reserve's points of view, we're entirely cognizant of that. We hear about it from bankers. We have to set monetary policy, of course, to try to achieve overall price stability and maximum sustainable employment growth. And we sometimes find that in the context of various industries that that policy could create some pressure on individual industries. But we only have this one tool and we try to use it to achieve overall macroeconomic stability while fully recognizing that it does create some problems for some sectors.

BUNNING: You're telling us today that an inverted yield curve down the road will not affect the economy. Did I misunderstand that, or is that accurate?

BERNANKE: I think the yield curve can be inverted for a considerable period without significant implications for the economy as a whole, yes. Possible for some banks, but not for the economy as a whole.

In November 2007 Bernanke brazenly lied to the Senate, denying that the Fed had assigned any probability to the U.S. suffering a recession. In fact, the New York Fed was then assigning a probability of 40%, triple the probability of a year earlier, <u>based on the inverted yield curve</u>, a policy Bernanke was then imposing, after denying it would once again prove recessionary.

Six months later (November 8, 2007) – and just *one month* before the recession actually began – Bernanke was asked by Senator Chuck Schumer (D-NY) about the probability of the U.S. soon suffering a recession:

SCHUMER: On a scale of 1 to 10, with 10 being the most likely, how likely is a recession?

BERNANKE: Economists are extremely bad at predicting turning points and we don't pretend to be any better. We have not calculated the probability of recession and I wouldn't want to offer that today. Again, our assessment is for slower growth, but positive growth going in the next year.

Bernanke *brazenly lied* when he said "we have not calculated the probability of recession." The Federal Reserve Bank of New York maintains a web-site that uses the long history of the yield curve to assign a probability of recession a year ahead, and at the time Bernanke testified in November 2007, that probability was 40%.[17]

Having deliberately caused a recession and credit crunch, and thus contributing so much to the housing-mortgage-financial crisis, and then having repeatedly lied about what he was doing, it is remarkable to witness the audacity with which Bernanke re-writes the history and

[17] See "The Yield Curve as a Leading Indicator," "The Yield Curve as a Predictor of U.S. Recessions," and "Probability of U.S. Recession Charts," at the Federal Reserve Bank of New York (http://www.newyorkfed.org/research/capital_markets/ycfaq.html).

portrays himself as a virtual savior of the system, as he did before the House Budget Committee, on June 2:

> We need to keep in front of us the fact that without the concerted effort of the Federal Reserve, the Treasury and other agencies like the FDIC, supported by the Congress and the Administration, last fall we very likely would have had a serious and perhaps global financial meltdown with extraordinarily adverse implications for the U.S. and global economies. I think having averted that and the fact that we now have a process of slow and gradual repair, both of the financial system and of the economy, is a major accomplishment, and although many issues remain, we must keep in front of us the fact that we averted a very serious calamity.

Bernanke should not be re-appointed as Fed head when his current term expires next January; indeed, he should be fired immediately and prosecuted for perjury.

What was really an act of *deliberate sabotage* on his part, Bernanke re-classifies as "a major accomplishment." But more amazing, perhaps, than a sleazy bureaucrat justifying himself despite inflicting such widespread harm is how the obsequious sheep populating the media, the financial community and Washington let him get away with it. Indeed, most people today praise Bernanke highly and recommend his re-appointment as Fed chairman for another four years when his current term expires next January. In our view, not only is Bernanke's re-appointment wholly unjustified; he should be *fired immediately* and *prosecuted for committing perjury* in Congress.

Mr. Bernanke likes to remind everyone that he specialized in the Great Depression when he was a professor at Princeton. As we've seen, he denies the Fed had anything to do with the latest debacle; indeed, he claims to have saved the day, and the entire world, from utter ruin. How different he sounded back in 2002, when he wasn't yet under the sway of the Fed's massive PR machine, when he admitted that the Fed caused the Great Depression. He was then summarizing the 1963 classic by Milton Friedman and Anna Schwartz (*A Monetary History of the United States, 1867-1960*), which showed beyond doubt, among other things, that Fed officials (not free markets) were to blame. Then he said: "As an official representative of the Federal Reserve, I would like to say to Milton and Anna, regarding the Great Depression: You're right, we did it. We're very sorry. But thanks to you, we won't do it again."[18]

Perhaps it'll take *another four decades* from now for the then Fed head to admit that the Fed actually caused the latest financial debacle. In the meantime, universal blame is directed at market-makers – and at whatever scintilla of freedom still remains; the Fed will get more power, just as it did in the aftermath of the Great Depression. It will soon take on the new title of "systemic risk regulator," even though the evidence is overwhelming that it is in fact, the *systemic risk generator*.

[18] Remarks by Fed Governor Ben S. Bernanke, "On Milton Friedman's 90th Birthday," November 8, 2002 (http://www.federalreserve.gov/boarddocs/speeches/2002/20021108/default.htm).