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President Obama's reappointment of Ben Bernanke to continue to serve as Chairman of the Federal Reserve is quite interesting and deserves public consideration, especially as the U.S. Senate must now weigh in on this choice. While admitting that the financial crisis has presented the Fed Chairman with inordinate problems and challenges, I would like to respectfully offer a different opinion on his performance during the crisis than the President. I would rate his performance as less than mediocre. He has shown little evidence of true leadership skills in directing the national economy and he has effectively given up the independence of the Federal Reserve by his actions. Moreover, he does not seem to fully understand the new directions the economy is headed.

My first concern with the current Fed Chair begins with the origin of the crisis itself. I am one of those, in the company of economist John Taylor and others, that lays most of the blame on the Fed for its exceedingly "easy monetary policy" especially from 2003 through 2005 and the far too "gradual" increase in short-term rates. Now with this sustained easy money, monetary policy did not result in a surge in inflation, as we saw in the 1970s, but it surely did result in both the housing and credit bubbles that we associate with the financial crisis. While Ben Bernanke was not Chairman of the Fed during the earlier time of this easy policy, he was a member of the Board of Governors for much of this period, and was chief advocate of only gradually reducing the exceedingly easy policies in place. (This matter is not only relevant for a proper historical perspective, but also raises concerns about the future. The Fed has taken even more significant steps in the direction of monetary ease in recent months. Any hesitation in removing this accommodation in a timely fashion, as we saw in 2003-2005, poses great risks to either or both, goods and service inflation, or asset inflation.)

While the housing market started collapsing in the spring of 2007, the Fed, now under Bernanke's leadership, was once again hesitant to move aggressively for fear of spooking financial markets. Bernanke and his colleagues kept the target of the federal funds rate above 5% through August 2007. Then, in January 2008, the Fed decided to aggressively reduce the target rate by 75 basis points following an emergency FOMC meeting called by the Chairman. Ironically, this was the right decision, but interestingly for the wrong reason. Apparently, what spooked the Chairman to call an emergency meeting was a collapse in stock prices in Europe, very early in the morning in the US, even before our stock markets had opened. A couple of days after the Fed's large, surprise rate cut, the world was informed that the collapse in European stock prices early that morning of the emergency FOMC meeting was driven by the French bank Societe Generale unwinding basic derivative positions put in place by a rogue trader that resulted in the bank losing over \$7 billion. So, even when the Fed finally started to recognize the need for some aggressive reduction of the monetary tightness, it would appear to be driven by fear, and an even that was both transitory, and properly irrelevant to US monetary policy decisions.

From this point on it became clear to those watching closely that the Fed Chairman was operating from a base driven by fear. Chairman Bernanke has recently stated publicly that he did not want to be Chairman of the Fed during the second Great Depression. Now, no Chairman in his right mind would want this to happen under his or her watch, but to state this publicly suggests that fear is driving decision making. You can see this in his decision making. Rather than having the firm hands of, say, a Paul Volcker, Chairman Bernanke fled from one crisis to another, never really establishing a road map of where the Fed was headed, or even offering a coherent explanation of his behavior. To his credit he has been inventive and creative in response to ever changing problems. But the downside of this approach is it makes his behavior completely unpredictable, in all areas other than the question of “where is the fed funds rate headed?”

For example, in March 2008, Bear Stearns faced a huge liquidity crisis that brought the investment bank to the brink of bankruptcy. Chairman Bernanke and then-Secretary of the Treasury, Henry Paulson, sensed that this investment bank was “too big to fail,” so they orchestrated a forced takeover of Bear by JP Morgan Chase. Nothing like this had been done before. However, to get JP Morgan Chase to agree to the deal, the Fed had to guarantee some \$30 billion in mortgage-backed assets acquired by the commercial bank. In other words the Fed had to effectively put a floor on the value assets acquired by JP Morgan Chase.. Up until this time, neither the Fed nor the Treasury had really taken such steps to prevent the failure of a large investment bank, nor had Congress or any President stated this as a policy they wanted the Fed to follow. This was a creative response, but one “out of the blue.”

One would think this aggressive move by the Fed established the new precedent that certain investment banks were deemed “too big to fail” and the government, through the Fed, would see that such failures did not occur. However, within six months such a precedent was reversed, with no real explanation, when Lehman Brothers was forced to declare bankruptcy. Chairman Bernanke has stated that Lehman Brothers did not have the collateral that Bear Stearns had which allowed the Fed to take the saving action they had earlier done. But this admission really just suggests that the Fed waited too long before taking any actions in this case. In other words, an implicit rule established six months earlier was now overturned by a lack of timely action on the part of the Fed.

The events that then followed the Lehman Brothers failure did show the meaning of “too big to fail” as the financial world witnessed events never before seen. For example, Reserve Primary, a huge money market mutual fund, that owned some of Lehman Brothers short-term debt was forced to temporarily “break the buck,” as the value of their net assets declined following the bankruptcy filing. This is just one example of many different ways in which it became obvious that when a large financial player like Lehman fails the ripple effects can be significant and far ranging.

Then, the new rule that large non-banks are no longer protected by the central bank was once again reversed. Within a few days of the Lehman Brothers failing, the Fed, with the backing of the Treasury, stepped in to bail out the huge insurance firm, AIG, as it dealt with the many credit default swaps they had written protecting investors from the effects of defaults on various instruments.

Obviously the U.S. financial regulators have been forced to address critical issues, such as where systemic risks lie, and where they don't. The Fed along with the Treasury stepped up to make these decisions. This is to their credit. But, while they were acting, they did it in a very piecemeal, haphazard way, changing the tune to fit their mood at the moment. Under Chairman Bernanke, the Fed never indicated that it understood the importance of letting financial market participants know how they planned to operate, outside the realm of setting short term interest rates, or even what they were looking at in making decisions. Because of this, the financial markets' state of panic just continued to escalate. By the latter part of September 2008, the Fed Chairman and Secretary Paulson saw the panic they promoted first hand by their haphazard policies, and they knew they had a huge problem on their hands. In response to the panic, they came up with the poorly hatched TARP plan over a weekend, as their solution. The initial idea was to have Congress give the U.S. Treasury the authority to buy "toxic mortgage related assets." The idea was so poorly developed that even to date, very little of the plan to acquire toxic, or more politically correct legacy, assets has taken place.

The real problem with this plan was that it was so poorly planned and put together that there was an absence of political support for it, as the House of Representatives first voted down the plan. In response, our financial leadership, including Chairman Bernanke could only resort to the politics of fear: "If this plan is not passed, we will have another Great Depression." Now there are two problems with this argument. The first is that it fails to recognize the causes of the original Great Depression were bad economic policies, which were not in place in 2008. Second, and this was the more significant problem, it explicitly communicated an exaggerated fear on the part of our financial leadership to the public. This fear scared the public needlessly in my view. This is why the economy and financial markets went over the cliff in the fall last year.

With the support of Chairman Bernanke for the TARP program, it became further clear that this Chairman did not see it important to protect the independence of the central bank, but rather he became one of the "team players" in full cooperation with the Treasury. Numerous opportunities presented themselves beginning late last year for the Chairman to offer a refreshing dissenting view on policies the Treasury was pushing. For example, in December it would have been good for someone to be defending corporate governance and shareholder interests, rather than pushing Bank of America not to back out of their proposed acquisition of Merrill Lynch, as done by Secretary Paulson.

With the changing of administrations at the start of the year Chairman Bernanke threw his support behind the huge fiscal stimulus plan, only to now begin warning of the sustainability of fiscal deficits. Then, he climbed on board with Secretary Geithner's "stress test" for the largest banks in the country, although this test suggested that the Fed's Basel capital standards and risk management strategies of these banks were inadequate. In all of this, the country has lost one of its key attributes and that is an independent central bank to object when other parts of the government are implementing detrimental economic policies.

Today the country is in need of a Chairman of the Fed that fully understands that the path the economy was on in 2006-2007 was not sustainable. It was being driven by an asset/credit bubble inflated by Fed actions a few years earlier. Rather than suggesting we need to return to these "good old days", we need

someone to explain that it is not a bad thing that the U.S. consumer is once again saving, and this saving is not going into some dark useless hole, but providing capital for productive uses that lay the foundation for future growth. We need a Chairman of the Fed that understands the need of a coherent well articulated plan for the future, not a haphazard populist solution to one problem after another. We need a Chairman that understands and defends the strengths of our economic system, not someone focused solely on the frailties of such a system. It was bad economic policies that made the economic decline of the Great Depression so severe, not the frailties of our system.

Chairman Bernanke has tried his best, but in my opinion his best has not been good enough. We need a real change in our financial economic leadership in this country.