Confronting The Kindleberger Moment:

Credit, Fiscal and Regulatory Policy to Avoid Economics Disaster

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Abstract

We have reached a “Kindleberger Moment”, where, as Charles Kindleberger described in his *World In Depression, 1929 – 1939*, the initial failure to act forcefully enough with expansionary fiscal policy and restraints on the power of finance in the early stages of the contraction, has lead to such economic deterioration and severe political conflicts that, even when governments know what is needed to resolve the crisis, they no longer have the political power to do so. The current revival of the “austerity buzzards” in the UK, Europe and the United States and the stalling of real financial reform are testament to the unification of capitalists under the umbrella of finance and presage the broader centrifugal social forces that are tearing down the political ability to act in the U.S. and Europe. A possible antidote to this political paralysis and even retrogression is for progressives and reformers to unite around a set of policy principles to restore employment, income and net assets to workers and to restore and re-direct investment toward key transitional projects, especially confronting global climate change. While this is necessary on a global scale, the focus here is mostly on the U.S. and to some extent, Europe. As part of this program, there must be restructuring in the financial sector, including in monetary, financial and regulatory policy. This paper outlines several of the reforms that are needed, including the implementation of a broader effort by the Federal Reserve to stimulate credit for real investment, the deployment of a broader array of credit tools to direct credit to productive and transformational purposes and the support of true public options for financial institutions, in other words, more “finance without financiers”. Using the Federal Reserve to support fiscal expansion and using public financial institutions to fund key investments are likely to be the most effective mechanisms in the current environment since the lack of aggregate demand and the high risks associated with borrowing may limit the effectiveness of using incentives on the credit supply side to promote more investment and employment.
I. Introduction

“Minsky Moment” entered the popular lexicon when, at the height of “phase I” of the financial crisis in mid-2008, some financial journalists and even mainstream economists discovered that there actually existed some sensible economic theory that could help us comprehend the financial disaster that was threatening to bring down the world economy. Since that time, we briefly entered the “Keynes Moment” when politicians and economists in the U.S., Europe, Asia and even in the “temples” of neo-liberalism such as the IMF, re-discovered the absolute necessity of expansionary fiscal policy to stem the massive deflationary forces that had the world economy in a death grip. For a brief period, these governments pursued unprecedented “Keynesian” fiscal policies to try to break the downward economic spiral and, to some extent, they temporarily succeeded.

But now, the orthodox forces in Europe and the U.S. are trying to bury Keynes (and Minsky) once again, and resurrect the liberal – now completely reactionary – policies, theory and lexicon of a bygone age – calling for brutal austerity measures to restore the “confidence” of financial markets, which, they say, will lead the global economic recovery by bringing about lower interest rates, higher investment and greater employment. These politicians and the economists who give them credence now make these pronouncements with a straight face, despite the fact that it was these financial markets and these economic policies which have brought us the greatest global economic calamity since the Great Depression. And, they repeat these mantras despite the fact that there is no empirically defensible economic theory which would predict that in the deflationary economic conditions we now find ourselves, massive global fiscal retrenchment will bring about more economic growth or employment generation. Have they already forgotten that “financial confidence” led primarily to speculative bubbles and fat bonuses for bankers rather than productive and sustainable investment and jobs? And now that serious financial reform regulation is stalled in the US and dying a slow death in Europe, do they think that restoring financial confidence in Europe will produce any different effect?

So what “moment” are we now in? I think we have reached the dangerous and treacherous “Kindleberger Moment”. In his important book, *The World In Depression, 1929 - 1939* the late economic historian Charles Kindleberger argued that the failure to quickly and forcefully pursue adequate expansionary fiscal policy and reverse the deflationary forces of the global economy led to fatal political centrifugal forces, tearing apart political coalitions and institutions capable of bringing about real solutions to the economic crisis. Kindleberger argued that this failure was due not only to lack of understanding of the importance of expansionary fiscal policy, but also to forces of financial speculation and the financial markets more generally, that made expansionary fiscal policies extremely difficult to carry out. This failure of...
understanding and failure of will to press forward with the needed economic policies and to bring under control the forces of reaction (including finance) that were attempting to undermine them, ultimately blocked the ability to end the Great Depression through peaceful means.

We are at a “Kindleberger Moment” in another important and related sense. In his important book, Manias, Panics and Crashes, Kindleberger develops Minskian financial themes to show, among other things, that at a time of crisis, governments and central banks throw out the so-called Bagehot rules of “lender of last resort” (‘lend only to solvent institutions, on good collateral and at a penalty rate of interest’) and typically bail-out the masters of finance, doing whatever it takes to get the job done. As Kindleberger aptly puts it, in these situations, in practice, ‘the only rule is that there are no rules’. So, governments and central banks in the U.S. and in Europe have saved the financiers, claiming, of course, that they are saving the citizens. In a cynical marketing ploy, they call a bail-out of European Banks a bail-out of Greece.

These saved and re-empowered banks and their allies in business, politics and the academy have, for now, successfully blocked the serious financial reform in the US that we need and are well along their way to delaying and probably ultimately killing serious reform in Europe as well. With the blockade against serious financial reform efforts, and now the attempted restoration of fiscal retrenchment and austerity, the same powers that brought on the crisis are simply trying to hit the re-start button in the hope that they can back to minting money for themselves at the expense of virtually everyone else as they have been doing in recent decades.

In the meantime, monetary and credit policy are in a hiatus, with economists and central bankers divided about the feasibility of more expansionary measures at almost zero interest rates, much less the desirability of doing so. And that most independent of Central Bankers, Jean-Claude Trichet of the European Central Bank (ECB) leads the charge for liquidating the workers, while bailing out the banks who lent recklessly to Greece and other governments.

But, given the severity of the crisis, as Kindleberger argued, hitting the re-start button will not work. The crisis is deepening, and instituting more austerity on the one hand and financial bailouts on the other to restore the confidence of finance is not a real solution. It will just hasten the forces of political and economic disintegration as we are witnessing in the U.S. and many European countries. A look at political paralysis in the U.S. and savage austerity in the UK, and other parts of Europe tells the tale.

So what should be done? A first and necessary antidote to this “Kindleberger Moment” is to unify political and intellectual forces that are pushing for real solutions: for Keynesian fiscal reflation and serious financial regulation, for more democratic control over central bank policy, including over the increasingly powerful ECB, for more public control over credit facilities (“finance without financiers”) and for an over-throw of the now discredited mainstream economic doctrines that legitimize and act as cheerleaders for the misguided policies that are now once again becoming dominant in Europe and, increasingly, in the U.S. One of the positive aspects, in fact, coming from this economic crisis has been a flourishing of economic analysis

expansion and fight the forces of finance and speculation that ultimately led to political disintegration to the point that these policies were no longer feasible.
and promising proposals from many “heterodox” economists. But a more concerted and unified effort is still needed to put aside less important doctrinal disputes and come together over the key issues and solutions.

After all, that is what the financiers have done. In the battle for financial reform in the US, for example, small and large banks, financial institutions and non-financial institutions worked out their differences to stand united against serious financial regulation. And they have mostly won, suggesting that the capitalist class is increasingly united under finance. Indeed, this is the ultimate force of “financialization”: the political unification of the capital under the leadership of finance.

What financial and fiscal policies should we unify around? In this paper, I will present a range of proposals that I believe can be helpful in getting us out of this “Kindleberger Moment”. I will focus on the areas of monetary policy and credit policy and will also present some remarks where these issues interact with fiscal policy and financial regulation. Of course, in one paper it is impossible to develop a comprehensive program, even if I knew what that program should be, which I don’t. Indeed, the issues addressed here are so far-ranging as to preclude a detailed analysis. Still, this paper offers the outlines of a range of policies and initiatives in these areas that are designed to help move us away from the abyss. As I just mentioned, many others have developed promising policies as well. Far from suggesting that these ideas should constitute THE PROGRAM my goal here is to make a contribution to what I hope will be a series of intensive discussions over the coming period to hammer out the outlines of a consensus.

The Argument

The financial-monetary mechanism is broken, both politically and economically. I, and many others, have already noted the destructive political dominance of finance, or unification of capital under finance, as I have put it (eg. Crotty and Epstein; Kwack and Johnson; Ferguson and Johnson; Dumenil and Levey).

But the financial-monetary mechanism is also broken in purely economic terms. In the lead up to the crisis, the speculative, bubble inducing aspects of finance were accompanied by at least some financing of real investment and some credit allocation to useful purposes in the U.S. and elsewhere. Today, financial institutions have greatly impaired balance sheets and, instead of lending to the real sector, are hoarding cash while earning enormous profits through speculative trading. Monetary policy had some, though a declining influence over credit markets and the real economy, (though it was dominated by neo-liberal “inflation-targeting” doctrine that has no serious merit). (Prior to the crisis, financial regulation, of course, was virtually non-existent). But today, the ability of monetary policy to revive the private economy through traditional tools is highly impaired because of the broken balance sheets of the banks themselves, and because the traditional interest rate channel, already weak before the crisis, is even less powerful now in the era of extremely low interest rates. Moreover, the failure to enact serious and immediately applicable financial reform and restructuring has meant that a simple application of expansionary credit channel using financial institutions as intermediaries is more likely to result in increased activity among financial institutions and markets, without appreciably affecting credit conditions facing real sector borrowers. Central banking is also broken because of its continued doctrinal
subservience to neo-liberal ideas such as inflation targeting, and its continued political subservience to finance.

In this environment, without substantial financial and monetary policy restructuring, only fiscal policy can create the aggregate demand that could generate significant amounts of employment in the short to medium term. But expansionary fiscal policy runs up against the deficit hysteria noted earlier, especially in an environment in which it is difficult to impose taxes that would raise significant amounts of revenue without significantly reducing aggregate demand, namely financial speculation or banking taxes and taxes on the wealthy.

In short, we need an interconnected restructuring of finance and banking markets so that they can begin to increase credit to and facilitate investment in the real sector while reducing the speculative position taking and investment; we need to facilitate the expansion of fiscal policy to generate employment and aggregate demand; we need a different central bank policy to promote real investment and employment; and we need financial regulation which can increases the likelihood that these initiatives and policies will lead to stable employment growth rather than more instability and financial speculation.

More specifically, we need:

1. **Fiscal Policy**: Significant expansionary fiscal policy directed to employment generating and green transforming public and private investment supported by central bank purchasing of government and quasi-public debt issued to finance these activities.

2. **Central banks** must use an array of tools to support real investment and employment generation including:
   a. Expanding their balance sheets further and help support government efforts to generate employment, prevent foreclosures and make a green transition by buying paper from existing or new financing institutions designed to address these issues.
   b. Use to a greater extent asset based reserve requirements and loan guarantees to support these investments.
   c. We must continue to press for central bank accountability and the abandonment of failed doctrines such as inflation targeting.

3. **Financial Reform**: given the financial reform bill recently passed, as flawed as it is, and the financial reform discussions happening in Europe and in international fora, we must continue to press for a financial reform and restructuring to repair the broken financial system, reduce the systemic bias toward financial instability and reduce the political power and wealth of finance, including serious financial transactions taxes. (For a range of ideas along these lines see SAFER, www.peri.umass.edu/safer; Americans for Financial Reform www.afr.edu; CEPR, www.cepr.org; Demos, www.demos.org; and the Roosevelt Institute http://www.newdeal20.org/

4. **Finance without Financiers**: Finance is too important to leave exclusively, or even primarily, to the private markets. With the financial system broken we need to revive and build public financial institutions in many key areas, in order to provide public options. This will not only
improve credit allocation to needed areas, it will also reduce the “structural blackmail” of finance who can threaten to withdraw, thereby leaving the public vulnerable. With significant public financial sector to step in, the threat is not so credible. Indeed, that is what has happened in the U.S.: the combination of Fannie and Freddie and with the Fed buying so much of the paper, we have created a highly flawed public option in housing finance that has prevented a complete collapse of the housing market. Of course, we would hope to have a more efficient public option in other areas, but the value of this one in a crisis should not be dismissed lightly.

The rest of the paper is structured as follows. Sections II and III discuss central bank policy. Section II discusses the evolution of central bank policy during the crisis and Section III suggest how it needs to be reformed. Section IV emphasizes the importance of creating “public options” in the financial sector, more finance without financiers if we are to revive our economy and make the transitions we need to prevent disaster. Section V briefly discusses Federal Reserve Accountability and Section VI concludes.

II. The Evolution and Failure of Central Bank Policy in the Current Crisis

A brief discussion of the failures of central bank policy in the current crisis will help inform our discussion in the next section about what needs to be changed. Central bank policy managed to temporarily save large parts of the financial sector, but failed to revive the real economy.

Why, did this happen. I believe there are two key reasons for the failure: First, the Federal Reserve (Fed), the Bank of England (BOE), the Financial Services Authority (FSA) and other financial authorities had allowed the financial system to get so complex and so opaque, that the authorities undermined their own ability to implement the lender of last resort function. That is, the financial authorities allowed the financial institutions to become too big too fail, but too complex and opaque to save. Second, central banks abandoned their roles as managers of credit flows and left that entirely to the private financial sector, adopting instead a model of using short term interest rates to manage macroeconomic policy with an orientation almost exclusively to fighting inflation.

These problems did not arise overnight. On the financial regulation side, we reached this point as a result of a forty year dynamic of financial de-regulation, financial expansion, crash and then, government bailout. Following each major crisis and bailout, financial de-regulation was expanded and the cycle began anew but at a higher level of size and complexity. The crash of 2007 – 2009 was simply a continuation of this dynamic. But this time, the system had gotten so large and so complex that the bail-out could not work. (Crotty and Epstein, 2009b)

The focus on inflation fighting connected to several other mistakes. Specifically, with ample support of the economics profession, the financial authorities made four fatal mistakes in dealing with the crisis: commodity inflation obsession; the surrender to fiscal policy straight jackets; ignorance of the functioning of the financial structure including the role of toxic products; a fatal over-commitment to the prerogatives of private finance and financiers along with an associated allergy to increasing the role and power of the state.
First, central bankers – persuaded by years of misleading arguments by much of the macroeconomics profession - were obsessed with maintaining their "inflation fighting" credibility. As a result, throughout the key first year of the crisis, they engaged in LOLR actions to help increase financial liquidity, but these were creatively designed to allow them to continue fighting a perceived threat of inflation; as a result, these early actions were insufficiently expansionary and did not slow the economies' descents into a major recession. Second, and more importantly, the hard-fought Keynesian lesson of the need for counter-cyclical fiscal policy even at the expense of running large fiscal deficits, had been virtually lost in macroeconomic thought, and in Europe, buried in the structure of economic institutions of the European Union and Euro area. This led, in the early stages of the crisis, policy makers in the U.S. and Europe to attempt purely monetary solutions to the crisis. But by this time it was too late because the financial crisis had destroyed many financial institutions and markets and had also become a "real" crisis, rendering standard monetary policy ineffective. Third, the central bankers did not understand the key role of the housing and property bubble and bust in bringing down the banks, because they did not fully understand the complex financial instruments that linked the banks to each other and financial markets generally. Nor did they understand how to deal with financial asset bubbles because of their obsession with commodity prices (i.e., inflation targeting). Neither they nor the fiscal authorities developed a strategy for dealing with the crash in housing and property values. Fourth, the central bankers and treasury officials went to excessive lengths to preserve the prerogatives of the bankers as the financial crisis deepened; this greatly limited their willingness to seize the banks, re-organize them, and intervene in their operations to make sure they helped the real economies to recover.

A few data charts will illustrate some of these key points.

**Slowness to Respond**

Figure 1 shows the responses of the Federal Reserve in the early stages of the crisis superimposed on the so called TED spread, the 3 month Libor minus the 3 month U.S. Treasury Bill rate. Though serious signs of financial problems were visible as early as the spring of 2007, the Fed did not respond with interest rate reductions till the late summer of 2007 or with substantially new efforts until late fall of 2007.

**Figure 1**

**Federal Reserve Actions**

**January, 2007 – October, 2008**
By the early winter of 2008, though the Fed was implementing aggressive declines of its federal funds rate, engaging in bigger and more innovative policies of broadening access to the discount window and implementing international swap arrangements, a key focus was still on maintaining its inflation fighting credibility by limiting increases in its overall balance sheet.

Inflation Obsession
Figures 2 and 3 which show the Fed's balance sheet over this period, illustrate this point.

Figure 2
Federal Reserve Balance Sheet
As figure 2 shows, from the beginning of January 2007 until the crisis of September, 2008, the Fed kept total credit relatively constant, presumably because of its over-riding concern about inflation. Only after the Lehman Bankruptcy and the AIG bail-out in September, 2008, did the balance sheet expand, and then, of course, it exploded in size. Note the importance of the Currency Swaps, the key initial component of the international lender of last resort role played by the Federal Reserve. It later came to light that the AIG bail-out which began at this time also gave billions of dollars to fill the holes of foreign bank balance sheets.

Figure 3 gives more detail on the Fed's balance sheet, indicating the growth of a variety of innovative programs designed to increasingly substitute Federal Reserve and Treasury financial actions for those of the private financial sector. These reflect the extreme breadth and innovation of the Fed's actions following the Lehman collapse. Still, the absence of any major credit expansion prior to the collapse is striking.

**Figure 3**

**Total Factors Supplying Reserve Funds: Breakdown**

Source: Federal Reserve.
Source: Federal Reserve

Figure 4
Federal Reserve Security Holdings
During the spring and summer of 2008 as commodity and oil prices increased, the Fed (along with the other key central banks) was gripped by inflation fears, and were lulled by declines in some spreads (Figure 1), even as the pace of decline in the real economy was accelerating at truly alarming rates. It is noteworthy that, there is now considerable evidence that a significant part of these commodity prices spikes were exacerbated by financial speculation conducted by Goldman Sachs and other financial firms. During this period, the Fed and the Treasury department lost precious time to dramatically confront the accelerating crisis. "Indymac" failed in July, the second largest bank failure in U.S. history up to that time, a sign that things were not getting better. But the Fed and the Treasury did not truly spring into action until the debacles of September, 2008. (Figures 1, 2, and 3). By way of international comparisons, we can briefly note that one finds similar responses by the BOE and even more desultory actions by the ECB. (See Crotty and Epstein, 2009b for more details.)

In the responding to the Greek crisis in May/June 2010, the ECB has finally responded in a significant way to buy sovereign debt, but its orientation is primarily to prevent financial stability rather than to promote employment and investment.

Recent Central Bank Policy

Since the start, of the crisis, according to Chairman Bernanke, compared with the period just before the financial crisis, the Federal Reserve System’s portfolio of domestic securities has increased from about $800 billion to $2 trillion and has shifted from consisting of 100 percent Treasury securities to having almost two-thirds of its investments in agency-related securities. In addition, the average maturity of the Treasury portfolio nearly doubled, from three and one-half years to almost seven years. (Bernanke, testimony to Senate Banking Committee, July 21, 2010). This suggests that after the initial stabilization of the financial system through massive interventions, the Federal Reserve policy has been focused on three main goals (see figure 4):

1) Supporting the housing market by its massive operations to buy mortgage debt and utilizing Fannie Mae and Freddie Mac as intermediaries.

2) To try to improve the profitability of the major financial institutions by keeping interest rates near zero, and allowing them to engage in speculation, proprietary trading and virtually any activity that will increase their profitability.

3) To keep interest rates low to keep the cost of financing the Federal deficit relatively low to prevent an explosive increase in the federal deficit and debt ratios.

The actions that the Fed has taken to achieve these goals are extraordinary in historical terms, outside of the Second World War, but they fall far short of what is needed to confront the Kindleberger moment. Home foreclosures are accelerating; employment is stagnant; real investment is tepid. Even using quite conventional analysis, as indicated by a simply so-called “Taylor Rule”. Fed policy should be setting short term interest rates somewhere between -3.0% and -5.0% to achieve normal inflation and employment targets. Obviously, the Fed is not doing
anything like that. (see figure 5 which reproduces an analysis by the Federal Reserve Bank of San Francisco).

**Figure 5**
Target Fed Funds Rate from “Taylor Rule” Model

![Figure 5](image)


In Europe, the ECB is even less committed supporting economic growth, instead focusing on keeping inflation low and doing whatever it can to bail-out banks and fight necessary expansionary fiscal policy. In the United Kingdom, the Bank of England is not contemplating massive further expansionary policies to counteract the draconian fiscal austerity about to be implemented by the Conservative/Lib-Dem coalition.

**Monetary Policy at the Zero Bound**

While the Federal Reserve clearly realizes that more significant expansionary policy may be needed, they are trying to project a desire to implement an exit strategy from the crisis policies. For example, the focus of Bernanke’s recent testimony was the development of plans to shrink the Federal Reserve’s balance sheet to restore it to more “normal levels in the long-run”.
(Cairman Bernanke Testimony to The Senate Banking Committee, July 21, 2010 http://www.federalreserve.gov/newsevents/testimony/bernanke20100721a.htm). Only in answer to questions did Bernanke suggest that the Federal Reserve might not to take more aggressive expansionary policies if the economic situation worsens, as there are many reasons to believe it will. More will very likely be needed and there is significant evidence that large central bank asset purchases can affect interest rates (eg. Bernanke, et. al. 2004). The Fed has been purchasing significant amount of agencies and there is evidence that this has kept their prices up. This could be expanded to a broader array of assets.

But to be truly effective, these purchases should be tailored to specific targeted purposes, rather than operating through the financial markets generally. In line with the discussion below of “finance without financiers”, a massive purchase to establish a Reconstruction Finance Corporation, Home Owners Loan Corporation, a Cooperative Bank and or a Green Investment Bank would be likely to be much more effective in generating jobs and socially productive investment rather than broad purchases of financial assets.

The point is that in order for financial policies to be effective, a broader array of tools will need to be deployed. But if the financial system is inherently broken, these might not be sufficient and the creation of alternative financial structures, supported by the government, including the Federal Reserve, is likely to be required.

III. Fixing the Broken Financial System I: More Tools for Credit Allocation

The financial intermediation mechanism is broken. Figure 6 shows the level of excess reserves as of 2009. The situation has not improved over the last year. Excess reserves in the banking system have increased from $1.7 billion in June 2007 to $1 trillion in June 2010. (Federal Reserve Board, Statistical Release, H.3). Meanwhile, total bank credit has fallen in 2009 at a rate of -6.4 % and at about the same rate throughout the first half of 2010 (Federal Reserve Board of Governors, Statistical Release, H.8). Commercial and Industrial Loans fell at an average annual rate of over (-) 18% in 2009 and at about the same rate in the first half of 2010. Meanwhile, the terms on industrial and commercial loans remain high relative to the federal funds rate. (See Figure 7)

**Figure 6**

Required and Excess Reserves in US Banks
January, 2007 – May, 2009
($ Billions)
In principle, there are three broad ways to fix the financial intermediation process in the US. 1) Utilizing incentive based policy tools such as loan guarantees and asset based reserve requirements to enhance credit allocation 2) changing the banking structure, for example by breaking up the large banks or implementing “new” Glass-Steagall type restrictions to improve financial performance and 3) enhancing public options in finance, creating, more “finance without financiers”. In the next few sections I treat points 1) and 3). Point 2) is important but the recent U.S. financial reform failed to address it, despite enormous efforts on the part of reform groups and legislators.
First, I present some brief historical context which shows that more direct interventions into the financial system ((1) above) and more public options in finance ((3) above) have been widely and successfully used, especially in times of great transition and crisis.

**Western Central Bank Policies after the Second World War: Credit Allocation for Social Goals**

Following the disasters of the Great Depression and the second World War, governments in the UK, Europe, Japan and even the US asserted much greater control over central banks and the banking industries. (Capie, et. al.). Central banks became, once again, important institutions for financing and managing government debts accumulated during the war; and after the war, central banks also became important tools for rebuilding and restructuring national economies and providing for social needs, often under government’s direction. Central banks utilized a variety of credit allocation techniques to accomplish these goals, and in most cases, these techniques were supported by capital and exchange controls on international capital movements. (see, for example, Epstein and Schor, 1992).

The types of controls central banks used, the goals they were directed to and their degree of success varied from country to country and time to time. No matter how successful, virtually all of these central banks had ended or severely limited their use of these controls by the mid 1980’s. Under the neo-liberal play book, these controls, despite their long histories and many successes, were thrown in the dust bin of history. Many of these had to be revived on an emergency basis in the recent crisis.

The U.S. government had a myriad of financial institutions, moreover, that supported national goals, notably housing. (Dymski, 1993; Wolfson, 1993). The Savings and Loan banks, along with other government supported financial institutions, for example, supported housing. During this period, the Federal Reserve policy was quite sensitive to the needs of the housing market concerns and even tailored its monetary policy to avoid significantly harming it. (Maisel, 1973).

In Europe and England, central banks that had been independent before the War found themselves subject to state control after 1945 (Capie, et. al., 1999, p 72). During the War, monetary policy was often implemented through direct controls while interest rates were held low and constant. Direct controls continued in the aftermath of the war with various credit allocation techniques. (Capie, et. al., 1999, p. 25.)

**Credit Allocation Techniques**

Credit controls are commonly defined as measures by which the authorities seek to modify the pattern and incidence of cost and availability of credit from what markets would generate on their own (Hodgman, 1972, p. 137). Credit controls seek to influence credit allocation and interest rate structures. (ibid.). In Europe credit controls have served a number of purposes: (1) to finance government debt at lower interest rates (2) to reduce the flow of credit to the private sector without raising domestic interest rates (3) to influence the allocation of real resources to priority uses and (4) to block channels of financial intermediation and thus to assist
restrictive general monetary policy and (5) to strengthen popular acceptance of wage-price controls by holding down interest income. (Hodgman, ibid.).

European experiences with credit controls varied from country to country. In Germany, controls were used only briefly after the Second World War. In the Netherlands and the United Kingdom, extensive use was made of them, but they were always seen as temporary and short-run expedients. In the Netherlands, credit controls were used to support macroeconomic policy, rather than credit allocation. In the United Kingdom, the principle aim of controls was to facilitate low cost government debt. The government was concerned about the impacts of high interest rates on the bond market, on income distribution and on the balance of payments. A more limited aim of the quantitative ceilings was to guarantee a flow of short term credit at favorable interest rates to high priority activities such as ship building and the finance of exports and productive investment in manufacturing. Credit ceilings were put into place, and exemptions were sometimes made for priority sectors (Hodgman, 1972, p. 144). Moreover, the Bank of England identified sectors for which credit should be limited, such as consumption and the financing of imports. In England, as elsewhere, these credit controls were accompanied by exchange and capital controls.

In France, Italy and Belgium were a different story. There, the principle of controlling credit flows and interest rates to serve national interests was widely accepted. France had, perhaps, among the most extensive and successful sets of controls, that were part of the government’s overall approach to industrial policy. The Bank of France was nationalized in 1945, and placed under the National Credit Council, the institution in charge of implementing the financial aspects of the government plan. (Hodgman, p. 147; Zysman, 1987). The broad aim of credit policy in France was to contribute to the modernization of the French economy and its ability to compete in international markets. To influence the volume and allocation of credit, the Bank of France used various methods (see Hodgman, 1972, p. 148 and Zysman, 1987, for descriptions).

Variable “asset based reserve requirements” were widely used. These require banks have to observe minimum reserve requirements based on the assets they hold, but the central bank varies these to promote lending to desired sectors. They do this by allowing lower required reserve rates on privileged assets. A second technique – ceilings on credit extension – have been used as well. The ceilings were used to reduce credit expansion without raising interest rates, and also to allocate credit: priority sectors were exempted from the ceilings. These included short-term export credits, medium-term loans for construction, and others. These ceilings applied to a large range of financial institutions, and were accompanied, as well, by capital and exchange controls as an important concomitant. (Hodgman, 1972. pp. 148-149; Zysman, 1987). A third tool was the scrutiny of individual credits made by banks. This allowed the Bank of France, for example, to approve loans for privileged purposes. Another approach to affecting the allocation of credit involved the use of rediscounting of bills at lower interest rates for priority purposes (ibid., p. 151).4

4 Analysis by Lester Thurow and the U.S. House Banking Committee in the early 1970’s identified three main techniques for protecting or promoting priority sectors: (1) asset based reserve requirements4 (2) government borrowing in the capital market and re-lending to preferred
Zysman (1987) has emphasized the role of these credit allocation techniques in helping to revive the French economy and help it adjust to structural challenges in the post war period. Italy and Belgium also used similar policies. In the case of Italy, a major goal was to help develop the Southern part of the country. (U.S. House of Representatives, 1972, p. 11).

Oddly enough, there has not been a comprehensive statistical analysis of the effectiveness of these controls over a range of industrial countries. The studies that have been done report that the controls were effective (ibid; p. 145). More broadly, the general consensus of analyses of these experiences is that they are most successful when the controls apply to a broad swath of the financial sector, to avoid arbitrage and avoidance, when they are accompanied by capital and exchange controls, to avoid capital flight, and when they are part of a coherent plan of economic promotion and development (Zysman, 1987; Hodgman, 1972; U.S. Senate, 1972; U.S. House of Representatives, 1981). These same lessons apply to developing countries as well, though they were not always applied.

Applying Credit Allocation Tools to Revive the US Economy

These credit allocation tools can be effectively applied in the United States to help revive the U.S. economy. Indeed, they have been applied since the start of the crisis by the Federal Reserve and the Treasury. The Federal Reserve used a host of massive financial guarantees in 2008 and 2009 to try to prevent a total financial meltdown. Appendix I shows the array of special programs that were in place as of July, 2009. Some of these have been eliminated by summer, 2010. These include guarantees for money market accounts, guarantees to loans and brokers, massive loans to AIG and several other institutions that allowed major banks and investment banks to unload devalued assets at full price, and massive purchases by the Federal Reserve of mortgages underwritten by Fannie Mae and Freddie Mac.

In other words, these credit allocation tools were used to allocate massive amounts of credit to the financial sector itself. The key and important exception to this is the housing industry, which received significant amounts of credit from the Federal Reserve. In addition, the Federal Government has been using loan guarantees as part of the “stimulus package” including guarantees for nuclear power plants and for auto companies.

Extending Credit Allocation tools to Provide Employment Generation

Tom Palley and Robert Pollin have proposed significantly extending credit allocaton tools such as loan guarantees and asset based reserve requirements. In a recent Nation article, “18 Million Jobs by 2012” Pollin detailed a plan to mobilize bank reserves through a combination of loan sectors and (3) competition by government financial institutions for primary saving flows and lending captured flows to preferred sectors (for example, through the government postal savings system). In the case of Sweden, asset based reserve requirements were used to aid the housing market. (ibid.) In Japan, government savings institutions were used to capture personal savings flows and these were channeled by the finance ministry (of which the Bank of Japan is a part) to industries that were perceived to most preserve economic growth. (ibid., p. 13).

5 Of course, GM and Chrysler received funds as well, but that was not from the Federal Reserve.
guarantees and variable asset based reserve requirements that would penalize “high stakes gambling” by banks. In combination with other policies, mobilizing $800 billion in loans could generate “18 million jobs by 2012”.


While these approaches are promising, there are two significant obstacles to their success, apart from political opposition. First, the U.S. economy may be too depressed to generate the aggregate demand that would lead borrowers to want to borrow significant amounts of finance to expand employment and production. Second, with the very limited scope of the financial reform legislation, and the very long phase in periods of those aspects of it that might significantly reduce speculation, the profitability of speculation, propriety trading and other forms of financial investing (rather than investing in employment creating assets), loan guarantees and asset based reserve requirements might not be sufficient to generate much investment.

In this environment, more direct public intervention to create job creating finance and investment is likely to be required. In the next section, I briefly describe some historical experiences with this “finance without financiers” and suggest some policies to pursue in the current period.

IV. Fixing the Broken Financial System II: Finance Without Financiers

At this “Kindleberger Moment”, I would argue that we need now a much stronger role once again for "finance without financiers". The lack of aggregate demand in the system and the intense dysfunction of the existing financial system means that alternative public financial structures are likely to be needed to emerge from the crisis.

In short, we need publicly oriented financial owners and managers to operate a larger share of the financial system in the U.S. (and arguably, in other rich countries). For starters, the U.S. and other governments should develop programs to utilize the ownership stakes they have in financial institutions and to develop publicly oriented banks to better serve the needs of the real economy. These publicly oriented financial institutions can take many forms: fully nationalized large banks that engage in the full range of banking activities; nationalized banks that serve specific purposes, such as making green investments or supporting cooperatively owned business or credit for small business owners; or public support for smaller local banks or a network of smaller local banks.

To prevent these banks from engaging in the same destructive behavior that private financial institutions pursued, it will be crucial to develop social governance structures to prevent "finance without financiers" from becoming "finance FOR financiers". These social governance structures will need to have several components, including democratic governance

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by those effected by the financial institutions' actions, strong financial regulation over-all to prevent massive gaps in practices between publicly oriented financial firms and the market, and compensation and/or tax schemes which reduce the benefits in the system for destructive financial practices. Where possible, these social governance structures should build on existing local practices and institutional structures, where possible, rather than being invented whole cloth or imported wholesale from abroad.

We have historical and current precedents to build on to develop public options in finance to help galvanize the economy.

**The Current State of Finance Without Financiers in the United States**

The first place where this issue will emerge is with respect to the role and transformation of the GSEs. The Republicans have made the GSEs the whipping boys of the financial crisis and have called for their reprivatization. But democrats and even many capitalists have indicated that the role of the Fed supported GSE remains crucial to avoiding a further deepening of the crisis. But so as not to leave the impression that the GSE's are the only candidates in the U.S. for "finance without financiers", in this section I will briefly survey a somewhat broader field of potential institutions and programs.

First it is important to recognize the significant public stakes in other, massive financial institutions. The U.S. government now owns a majority stake in AIG, the insurance giant. It also owns substantial shares of Bank of America and Citibank, as well as a handful of other institutions, including GMAC, the financing arm of GM. These are institutions which the government could, in principle, be exerting much more significant control over than they are to promote social goals such as financing green investments, infrastructure schemes, cooperative firms for employment generation, and so forth.

Second, are Community Development Financial Institutions (CDFI), that David Gordon identified. CDFIs may be banks, credit unions, nondepository loan funds, or venture funds that strive provide affordable and appropriate financial services to people and communities who traditionally lack access to such services. (Bernanke, 2009, pp. 2 -3) Depending on the institutions and local needs, they may offer financing for homeownership, rental housing, commercial real estate, health care, small businesses, microenterprises, charter schools and child care facilities among other purposes. They often work with traditional lenders to attract private capital. The Shore Bank in Chicago is one of the better known examples of a CDFI. In 1994, the Congress created the CDFI Fund housed with the Treasury Department. The Treasury estimates that it attracts $15 in non-federal funding for every $1 it invests in a CDFI. Today, there are more than 1000 certified CDFIs with a collective $25 billion in assets. This is a very small number. Moreover, the financial crisis has created major problems for the CDFIs, as it has for all financial institutions. Grant funding for CDFIs is falling, and repayment problems are on the increase. While the net charge off rate in 2007 was .55, but 2008 it had grown to 1.7. A survey in 2009 found that two-thirds of the foundation were planning to cut funding to CDFIs (Bernanke, p. 4).

Obviously, much more could be done, as David Gordon has suggested (*Fat and Mean*). the Treasury department could invest much more money into CDFIs devoted to job creation,
green transition, cooperatives creation, and other social goods. And while there appears to be some discussion of steps to improve the CDFI situation, there seems to be very little discussion of such major steps. Advocates for expanding and protecting CDFIs propose: 1) making more Federal funds available (liquidity, capital and project finance) 2) getting money to CDFIs fast in the current crisis to protect them and their stakeholders and 3) establishing and enforcing obligations on the part of all financial institutions to support community finance. (Seidman, 2009, p. 6) This includes expanding loan guarantees, subsidies and investments by the GSE's, tax credits for housing, and small businesses by SBA, and other programs. Yet, there is no plan afoot to do this at the level that is required to make a substantial difference.

Third, there is a large pool of investments going into so called "socially responsible" investments. According to the 2007 Report on Socially Responsible Investing Trends in the United States (the latest one which is available), before the crisis hit, there were $2.7 trillion in assets invested in "socially responsible" investments. This represented roughly 11 percent of assets under professional management in the U.S. Of this, however, only $25.8 billion were invested in community investment. (Social Investment Forum, 2007) Again, these are operating on the margins of the financial markets.

Finally, there are massive amounts invested in worker pension funds. Much has been written on how to use these for socially desirable goals, but relatively little has been done.

But the most important candidates for more finance without financiers is the development of a Homeowners Loan Corporation to buy up mortgages and reissue them so that homeowners can stay in their homes and increases their net wealth; (see Robert Kuttner, Presidency in Peril, for a recent discussion) and for a Green Jobs Bank, a public investment bank (or set of banks) to fund green investments (Pollin, et. al., Green Recovery: A Program to Create Good Jobs and Start Building a Low-Carbon Economy, http://www.peri.umass.edu/green_recovery/; eg., Dean Baker and Pollin, 2009, Public Investment, Industrial Policy and U.S. Economic Renewal http://www.cepr.net/index.php/publications/reports/public-investment-industrial-policy-and-us-economic-renewal) Capital investment by the Treasury, partially subscribed by the Federal Reserve, could form the capital for these institutions (as could guarantees for private investment).

Approaches to Finance without Financiers

This is not the only mechanism for creating more public options in finance. Here we briefly discuss four approaches to longer term social ownership and control: 1) Full public ownership and control of the bank 2) Part public and part private ownership of general purpose bank 3) Separate off one or more special purpose banks from the nationalized bank 4) re-privatizing the bank but run it as a public utility in which its activities are highly restricted, but it, in turn will have a moderate but fairly stable rate of return.

Model 1: Nationalized/Public Banks

Role of Public Banks in Achieving Public Goals

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Public banks can play a very important role in this context. They can be large and multi-purpose, they can be smaller and more decentralized, or they can be small and networked to achieve economies of scale in terms of support, insurance, and risk pooling.

Role of a Large Public Bank in the Current Period

In the current context, there are both short term and long-term goals that could be well served by socially oriented banks. In the short term, such banks could provide lending to businesses and provincial (or state and local governments) that are trying to maintain employment and services and expand production. Nationalized bank will be more oriented to provide these kinds of loans rather than sitting on excessive reserves or paying out dividends to stockholders trying to keep the private capital cushion high enough to prevent nationalization, or paying excessive salaries and bonuses to top executives and "rain makers" who will not be needed in the national banks because these kinds of high stake trading activities are very unlikely to occur.

In this longer term, these same priorities would be more central to the operations of the "nationalized bank" than a typical privately owned institution. That is, the nationalized bank would place more evidence on lending to businesses, governments and households engaging in real investment and employment generation, rather than investing in proprietary trading, speculation and mergers and acquisitions.

In the medium to long term, the bank could develop expertise in those areas of great need for the European and US economies. All of these economies have major longer-term structural needs, including making a transition to climate-safe economies.

The nationalized banks can:

1. Specialize in funding for "green initiatives", both small and large. These can include, lending to 1) Business with new technology ideas, serving some of the role of venture capitalists but not requiring such a massively high rate of return and hurdle rate as they do 2) smaller business loans directed at projects such as home and building refurbishing, that can help green the economy (Pollin, et. al, 2009; ) 3) Underwriting government bonds issued for important social goals such as green technology, education funding, mass transportation. Having a large player in the public bond arena that can compete with and try to keep more "honest" the other players in this market would be of great use to municipal, state and provincial governments 4) In the US (and some European countries?) student loans can be underwritten—as economies must retool for the green future and other future challenges. In the US, for example, playing a role in education loan business to once reduce the corrupt and monopoly practices could help reduce excessive fees and loan costs. 5) Public banks, if they have enough market power, can help enforce standards in the financial market place in those areas where demanders of bank services will prefer these higher quality services. In other words, a large bank that enters the marketplace enforcing higher standards can help promote a dynamic of a "race to the top" in the provision of high quality banking services.
There are activities that the public banks will be prohibited from engaging in. The rampant deal making in toxic assets; proprietary trading and exotic financial engineering unrelated to public purposes.

Where will the bank get the assets to engage in these actions: they will get it from depositors and other capital providers. The public bank will be seen as extremely safe, with a government guaranty provided to depositors and other providers of long term credit, but the rates of return paid will not be as high as possibly available in other financial markets and institutions. This can be sustainable, however, only if there is strong monitoring of the investment portfolio of the bank to make sure that they investments are relatively low risk or achieve important social goals for which there are high social rates or return. In the latter case, the direct subsidy cost of the government on the activity has to be accounted for and appropriated by congress and the fiscal authorities. This way, the bank may be able to take some significant risks to achieve social objectives, but these have to be transparent and paid for transparently by the congress and fiscal authority. Budgets for such activities must be appropriately considered through the normal appropriations process.

Thus, these public banks can advertise to depositors that by investing in these banks, they are truly investing in America and that their investments are safe. Combined with the broad deposit network this should provide a large amount of credit funds available to invest in the real economy.

**Model 2: Smaller more Specialized Public Banks**

A second approach would be to carve out a smaller bank with one or more specialized goals. For example, the government could create the "Green Bank of America" or that would specialize in lending to private businesses and governments for green activities. Other examples would be the "European Education Bank", and/or "The European Infrastructure Bank" which would focus on underwriting (possibly in public private partnerships) the creation of more infrastructure, particularly those meeting social goals such as green transportation. In this case, the government would then divide the "good bank" into two or more parts and and retain those that would specialize in these actions and sell off those that would be privatized .The public bank would want to retain the depositor base in order to fund these more specialized, activities.

Another example would be the "Co-op Bank of The United States", where the bank would fund worker's, or farmer's or community cooperatives or other cooperative businesses, including co-operative banks. To be sure, a larger bank could have these different specializations as separate departments within them.

**Model 3. Public Utility Model**

Another model is to turn the nationalized banks into a public utilities, perhaps with joint public/private ownership. This is an approach similar to that that was common in the United States in the early Post-World War II period. This would be a return to what Paul Krugman has called "boring banking". Banks would fund basic investments as they did in the 1950's -1980's in the areas of basic corporate loans, housing, business, state and local governments. They would
have to hold a high level of capital and have a significant liquidity cushion. In exchange, they would have strong government guarantees on deposits and other long-term borrowing which would enable them to attract deposits and credit at competitive rates. Thus, public utility banks would have relatively stable earnings and modest rates of returns. They could attract capital from pension funds and other investors wanting this risk and return profile. (Kotlikoff, 2010).

The major differences between the public utility model and the nationalized model is that:

1. The bank would not be subject to close day to day management of their operations in which they were expected to satisfy specialized public goals. Of course, the broad restrictions imposed on these banks would force to act broadly in a consistent manner with public goals.
2. Their profits would only accrue to the public as a portion of the government's share of the capital of the bank.

As a model, the public utility model might be more acceptable in the U.S. than a fully nationalized bank would be. And avoiding issues of social versus private rates of return might make this bank somewhat easier to operate, as it would then just have to subject itself to a market test. Its major disadvantage is that it would not be as useful as a tool for achieving specialized social goals as would a public bank as described above.

**Governance, Financial Regulation and Policy Space**

**Social Governance: Oversight, Incentives and Management**

One lesson we can draw from our case studies is that there is crucial need for strong "social governance" if publicly owned financial institutions are to remain effective agents of the public. In other words, just because institutions are publicly owned, does not mean they will be publicly oriented.

We define “social governance” as the institutional arrangements which structure the management of public banks under social control. The key to effective social governance is to have democratic management systems that effectuate not just transparency, but accountability to a broad array of stakeholders. This is in contrast to the "shareholder value" notion that requires the firm to be accountable to shareholders only. Social governance requires that the firm be accountable to stakeholders including workers connected with the firm, community members that are effected by the firm's actions, and where relevant, other institutions, like state and local governments, which may be strongly impacted by the firm's actions. Of course, if the bank is publicly owned, then the public owners must also be appropriately represented.

Social governance may take various forms in different countries since the past history and the institutional framework is different from one country to the other (path dependency). But the most effective approaches are likely to involve "checks and balances" to ensure that a wide range of important stakeholders have voice.

To implement such social governance, it not only makes sense to pay careful attention to local institutions and customs, but it may be sensible to build on currently existing institutions. For
instance, in Germany the co-determination system which involves both managers and labor
unions in the decision process, could provide a useful point of departure for the building of social
governance. In France, the “Comité d’entreprise” which brings together managers and unions for
decisions on social matters, can be used to become the major institution of social governance.

In the U.S. public banks should have a board of directors which are "hands-on" directors,
consisting of government officials from Treasury and other relevant government institutions. for
If, for example, the bank's charter is to serve as a "green bank", then, perhaps, the Energy
Department as well as stakeholder representatives, such as labor, small business, state and local
government, as well as specialists with expertise in green transformation would have
management oversight.

Compensation Policies

Pay scales both inside the public financial institution, as well as for other financial firms,
will have an important impact on the success of "finance without financiers". The pay of bank
staff and executives must be high enough to attract excellent talent, (so cannot be on the normal
governmental scale, presumably) but at the same time would be no where as high as has been
made by Wall Street rainmakers and CEO's in the roaring 90's and 00's. The goal, presumably,
would be to attract excellent, experienced and skilled people who nonetheless have a strong
public orientation. There may need to be limits on financial pay in private sector firms –perhaps
through taxation policy - in order to prevent the gap between the public employees and private
ones from becoming so large that they undermine the public orientation of the managers of
public firms.

The Importance of Strong Financial Regulation7

For any of these schemes to work, there has to be strong financial regulation overall.
Unfortunately, the recent financial reform legislation is unlikely to bring about the needed reform
because it sets up a set of regulatory reform contests over the next several years (for example,
more than 250 rule makings) that bank lobbyists will have the resources to shape while financial
reform groups, such as the Americans for Financial Reform (AFR) are being disbanded for lack
of funds. The likely failure of financial regulation will have serious implications for the ability to
mobilize the domestic financial system for economic recovery.

First of all, without appropriate financial regulation, our financial systems would inevitably lead
to more booms, crashes, and overall instability. All financial institutions – these public ones
included – have difficulties operating in such an environment. This boom and bust cycle could
place enormous strains on the incomes and even solvency of the public banks.

Second, without strict and successful regulations, the attraction of very high short run rates of
return and extremely high salaries and bonuses in the private financial sector could pervert the
public purposes of public banks, by eroding the efficacy of monitoring and regulation, by pulling
away expertise and management skill, by making it more difficult to attract capital during

7 See SAFER (www.peri.umass/safer), the Americans for Financial Reform, the Roosevelt Institute, DEMOS and
CEPR for extensive analysis and proposals for financial reform.
financial bubbles and by eroding the confidence of regulators in the necessity and usefulness of the public banks.

Third, strict financial regulations would help the public banks make the transition from insolvent private banks to successful public ones. The public bank would be able to attract good talent because, among other reasons, these bankers would realize that they cannot do enormously better in the private sector; the kinds of investment skills learned in the public bank will also be useful in the private banks and vice versa, making it easier to find skilled bankers who are more willing to adopt to the culture of public banking. Over time and more generally, there would be more likely to be self-reinforcing dynamics between as the divergence between returns and actions of public and private banks would be less than would occur in the absence of strict regulation and the return of "wildcat" finance.

**Creating Policy Space for Socially Productive Finance: A Financial Speculation Tax**

In the absence of serious financial regulation, perhaps the most powerful tool for creating policy space for productive finance is Financial Speculation Tax or finance tax, for example, along the lines promoted by Dean Baker and Robert Pollin, and now endorsed by the AFL-CIO, Adair Turner and others (see Baker, Pollin, et. al, “Revenue Generation from a Financial Transactions Tax” and a list of other papers and endorsers http://www.cepr.net/index.php/issues/fst/)

**V. Financial Reform and Federal Reserve Accountability: A Necessary Part of Financial Reform**

The recently passed U.S. Financial Reform Legislation paradoxically handed much more power and responsibility to the Federal Reserve System, despite the widespread perception that the Fed had failed miserably to prevent the financial crisis. In addition, there is very little in the reform bill that enhances the accountability and democratic governance over the Federal Reserve. (For an official summary of the law, see (http://banking.senate.gov/public/_files/070110_Dodd_Frank_Wall_Street_Reform_comprehensive_summary_Final.pdf), The not insignificant but modest increase in transparency resulted from hard fought efforts by reformers to subject the Federal Reserve to regular audits. A watered down version of this legislation passed, but more systematic and comprehensive audits were lost due to the strong lobbying by the Fed and the and support of the Treasury. (Dean Baker, http://www.commondreams.org/headline/2010/07/15-5)

In previous versions of the bill there were more comprehensive audits, the elimination of Fed membership by small banks, a source of enormous Fed political power, Presidential rather than Banker appointment of the President of the New York Fed, and the restriction of banker voting on boards of the Regional Federal Reserve Banks. Most of these were watered down or eliminated hence the audit language is all that remained.

The main reason for the lack of major Fed reform was the power of the Fed to mobilize banks and the Treasury/Obama administration to support it. But an additional factor was the fact that progressives did not have a coherent reform agenda for the Fed. This is surprising, since many of us have been discussing and writing about Fed reform for thirty years or more. There
has never been a consensus on the left of what type of reform to pursue and as a result, we did not have a strong voice on this issue. That should be corrected as we move forward.

The need for more Fed accountability important in the coming period. This is because: 1) The Federal Reserve (and other central banks) will continue to be extensively involved with bank restructuring operations, placing at risk billions of tax payer dollars, and significantly intervening in/management the operations of financial institutions. 2) The Federal Reserve's monetary policy, as it operates around the zero bound and is engaged in credit easing (CE) operations will be making multiple credit decisions affecting particular securities, particular institutions, and particular markets. 3) The Federal Reserve's CE operations are designed to support a number of government goals in reviving the economy, including supporting fiscal policy by, among other policies, conducting open market operations in long dated treasuries. In such circumstances, close cooperation and coordination between the Federal Reserve and the Treasury is not only desirable but also necessary. 4) A number of the large, unorthodox operations undertaken by the Fed involve credit risks for the Fed, and therefore to the public. The Fed has received lines of credit from and guarantees from the Treasury for some of these credit risks (see Bernanke, 2009). In these circumstances, the Fed must be held accountable to tax payers for these operations. 5) Last but not least, the Fed has been given more powers to regulate “Systemically Important” bank and non-bank financial firms.

V. Conclusion: Our Problems are Far Bigger than Even This

We are in a Kindleberger moment where we have to move forward quickly to restore employment, incomes and hope to massive numbers of people before the disintegrating political and social forces fully take over and create truly horrific results. But as if this were not a big enough problem, in fact our difficulties are even greater than this. The reason is that we cannot simply go back to our Keynesian, Minskian or even Marxian tool box. Why? Because of the specter of global warming and massive climate change. So while we must find a short term solution to economic hardship and political disintegration, we must also develop the economic theory, policy tools and political commitments to tackle this over-riding problem of climate change in the medium to long-term.

Stimulating aggregate demand and creating full employment in the medium term in a way that only expands the carbon footprint, is no longer viable. (See Juliet Schor, “Beyond Business As Usual” The Nation Magazine, http://www.thenation.com/article/beyond-business-usual and her new book Plenitude, 2010). The equivalent of digging holes and filling them back up is no longer sufficient as a polemical device to argue for more employment generating policies if, in digging those holes, we spew carbon into the atmosphere.

So while we can be confident (even smug perhaps) that we were and are right and the mainstream was wrong about the financial and economic dangers of conventional policies, we can no longer be so smug that we really have the correct solutions unless and until we integrate the profound global problem of climate change that we, our children and grand children face.

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8 See Bernanke, 2009, for a discussion of CE operations, and his concern NOT to engage in credit allocation operations. However, these will be virtually inevitable given the nature and scale of the credit easing programs.
In that light, the kind of employment we create is important; the kind of fiscal spending we design is key; creating means to share work and generate incomes that do not add to the carbon footprint – these are all crucial considerations that we can no longer afford to mostly avoid.

I trust that we will rise to the challenge. But let’s not wait too much longer.
Appendix

Forms of Federal Reserve Lending

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<tr>
<th>Forms of Federal Reserve Lending</th>
<th>Discount Window</th>
<th>Secured Discount Window</th>
<th>Secured Lending</th>
<th>Term Auction Facility</th>
<th>Term Securities Lending Facility</th>
<th>Term Auction Facility</th>
<th>Term Securities Lending Facility</th>
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<tbody>
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<td><strong>Whom can participate?</strong></td>
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<td>Reserve banks</td>
<td>Reserve banks</td>
<td>Banks, primary dealers, and other financial institutions</td>
<td>Banks, primary dealers, and other financial institutions</td>
<td>Banks, primary dealers, and other financial institutions</td>
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<td><strong>Maturity</strong></td>
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*Discount Window* includes primary, secondary and overnight window loans.

1. The *Fed*’s FFYY: PMT and TSLF will operate through February 2, 2023 as announced on December 13, 2022.
2. The *Fed*’s FFYY: PMT, TSLF and TSLF will operate through February 2, 2023 as announced on December 13, 2022.
3. The *Fed*’s FFYY: PMT will operate through February 2, 2023 as announced on December 13, 2022.
4. The *Fed*’s FFYY: PMT will operate through February 2, 2023 as announced on December 13, 2022.
5. The *Fed*’s FFYY: PMT will operate through February 2, 2023 as announced on December 13, 2022.
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8. The *Fed*’s FFYY: PMT will operate through February 2, 2023 as announced on December 13, 2022.
9. The *Fed*’s FFYY: PMT will operate through February 2, 2023 as announced on December 13, 2022.
10. The *Fed*’s FFYY: PMT will operate through February 2, 2023 as announced on December 13, 2022.

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