The Financial Panic of 2008 and Its Aftermath: a brief addendum to "Non-State Actors and the International Institutional Order: Central Bank Capture and the Globalization of Monetary Amnesia," American Society of International Law (ASIL), Proceedings of the 101st Annual Meeting (2007).

Since publication of this essay by ASIL in 2007, the United States has experienced a full-blown financial panic, a multi-trillion dollar bailout of the financial sector, and the so-called Great Recession, one of the steepest declines in economic activity since the Great Depression of the 1930s. The financial crisis has had global implications, slowing economies and increasing unemployment throughout the U.S. and overseas while undermining public sector budgets for states and localities across the country. Even now, a year after the panic, the reported U.S. unemployment rate is 9.6 percent and still rising; unreported unemployment is much higher, including discouraged workers who have given up on looking for work and those who have had to settle for part-time work. Residential foreclosures are still peaking and the commercial real estate market is in serious decline.

The 2007 ASIL essay discussed the influence of "non-state actors" in distorting the U.S. and global economies by channeling financial resources away from public sectors. The Federal Reserve and other foreign central banks were seen as the primary mechanisms for allocating credit away from public sectors and into private speculative investments. The consequences have become more apparent since the financial crisis hit a year ago: budget cuts for public education and infrastructure investment alongside booms and busts in housing, stocks, and other securities markets.

The ASIL essay goes on to explain why the Federal Reserve and many other central banks are considered to be "non-state actors." It is true that members of the Federal Reserve's Board of Governors are appointed by the President of the United States and subject to Senate confirmation. But the Fed's most important policy-making decisions are made by its Federal Open Market Committee which includes the presidents of the twelve privately-owned regional Federal Reserve Banks. This arrangement, which insulates central bank policymaking from any genuine accountability, has been defended as necessary to keep inflation low. While it's true that the privatized Federal Reserve has been vigilant in keeping (some) consumer prices stable, it has been an abject failure in maintaining price stability for health care costs and of course for asset prices. The privatized Federal Reserve has presided over what was perhaps the largest inflation and the greatest collapse of asset prices in history.

Throughout the past two decades, the Federal Reserve has pursued an agenda in the interests of its private banking constituents – a cartel that makes a mockery of principles of free-market capitalism. While Alan Greenspan served as its chairman, the Federal Reserve Board deregulated lending standards and looked the other way as banks loaded up on risky mortgages

and mortgage-backed securities. Ben Bernanke, Greenspan's successor as chairman, has pursued a bailout strategy that rewards the biggest and most powerful Wall Street banks – J.P. Morgan, Goldman Sachs, Morgan Stanley, Bank of America, and Citigroup. These banks, which fueled the bubble economy with their reckless lending practices, are now heavily subsidized at taxpayer expense. Yet, they are still paying their executives enormous bonuses while most of the country is still mired in austerity.

The ASIL essay also seeks to resurrect the 1941-1951 history of the U.S. economy, a period when the money changers had been chased from the temple of finance. During this time, the Federal Reserve was directed by the politically accountable branches of government, and it accordingly pursued a program that channeled cheap credit to the Treasury. Also during this time, the Federal Reserve used its regulatory authority to prevent speculative bubbles by imposing minimum down payment and margin requirements on borrowing for stocks, housing, and consumer spending. The result was a period of financial stability that permitted the federal government to finance the most important national projects of the century – victory in World War Two, the rebuilding of war-torn Europe and Japan through the Marshall Plan foreign aid program, and the conversion of the U.S. economy to a peace-time powerhouse through the G.I. Bill of Rights that provided public education, health care, and jobs for nearly a third of American families.

Now more than ever we should consider this alternative paradigm of a politically accountable central bank reflecting a much wider diversity of interests and perspectives. For instance, Representative Ron Paul, a conservative Republican, recently introduced legislation that would subject the Federal Reserve to regular audits so that Congress and taxpayers will know where and how the Federal Reserve has spent more than a trillion dollars of taxpayer money. That legislation was supported by over 240 members of the U.S. House of Representatives, including such liberal Democrats as Representative Dennis Kucinich. But the Wall Street interests have lobbied against this legislation which is now bottled up in the House. Likewise, New York City Mayor Michael Bloomberg recently brought suit in federal court against the Federal Reserve under the Freedom of Information Act to force disclosure of the identities of the financial institutions that have received more than a trillion dollars in loans and other support from the Federal Reserve. Bloomberg prevailed in the trial court but the Federal Reserve is now appealing to the U.S. Court of Appeals for the Second Circuit.

It has been said that the cure for the ills of democracy is more democracy. Today that means more democracy in our central bank and more democracy in our financial system.

Timothy A. Canova
Chapman University, Orange, California
September 2009