Financial Crisis Inquiry Commission Report: Classic Misdirection

The report of the panel of 10 (six Democrats and four Republicans) was delayed by a month as the final report became more of a partisan attack on Wall Street and a push for more regulation of the financial markets. The Republicans ultimately decided not to endorse the report, but instead issued their own report on the cause of the financial crisis.

According to the official report issued today by the FCIC, blame for the financial meltdown beginning in 2007 can be placed on

- Widespread failures in financial regulation
- Breakdowns in corporate governance
- Excessive borrowing
- Policymakers caught by surprise
- Systemic breaches in accountability and ethics

Wrote commission chair Phil Angelides (jointly appointed to the committee by Nancy Pelosi and Harry Reid),

> Despite the expressed view of many on Wall Street and in Washington that the crisis could not have been foreseen or avoided, there were warning signs. The greatest tragedy would be to accept the refrain that no one could have seen this coming and thus nothing could have been done. It we accept this notion, it will happen again.

On the other hand, the minority report issued by the four Republican commissioners wasn't much better, blaming a large part of the crisis on the government-sponsored entities (GSEs) Fannie Mae and Freddie Mac and the Community Reinvestment Act (CRA), which was used to entice banks and mortgage lenders to make loans to borrowers of sub-standard credit quality. The closest this report came to explaining the cause of the Great Recession was this:

> Through the GSEs, FHA loans, VA loans, the Federal Home Loan Banks, and the Community Reinvestment Act, among other programs, the government subsidized and, in some cases, mandated the extension of credit to high-risk borrowers, propagating risks for financial firms, the mortgage market, taxpayers, and ultimately the financial system.

In a distracting non sequitur, the Republicans concluded their report with a warning: "We caution our nation's leaders to learn the appropriate lessons from history and take seriously the need to reduce our federal deficit."

Little was said about the "moral hazard" implied by backing risky decisions with government guarantees, and nothing at all was said about the role of the Federal Reserve. In fact, in a prescient article written in February 2010, a month before the FCIC was even created, Professor Thomas Woods, (author of the *New York Times* bestseller *Meltdown*) said that the blame for the crisis by those present at the debacle's creation would predictably be placed on capitalism and deregulation. He added,

> It is not enough to call this a distortion of the truth. It is a grotesque distortion, worthy of the Soviet politburo. The crisis is in fact the altogether predictable fruit of massive government and *central-bank distortions of the economy*. [Emphasis added.] That may be why the free-market economists of the Austrian School were practically the only ones to have seen it coming.

Woods reviewed some of the more popular culprits, including the GSEs and the CRA, but then refused to place the blame primarily on them. He asked instead: “Where did all the money come from to buy all those houses and drive up their prices so high so quickly?”

The Federal Reserve System, in its attempt to stimulate the economy with easy money and low interest rates following the dot.com implosion in the early 2000s, built in the bias, which then slowly and then more and more rapidly built up the housing market. Fitting in nicely with the Bush/Clinton/Barney Frank/Chris Dodd ideology to “make housing more affordable for everyone,” the CRA was used as a hammer to force reluctant banks to go along. The promise of government guarantees for any loans that might default continued to encourage the momentum. Wall Street, it is helpful to remember, came late to the party. As noted by Anthony Wile of *The Daily Bell:*

> “Wall Street — at root — is merely a transactional mart that creates liquidity for securities. In the 20th century, and now the 21st, Wall Street has served as an adjunct to central banking credit expansion and [has] even facilitated it. Wall Street is in the money-service business. It makes financial widgets and markets them. It is central banking that caused the 2008 meltdown.”

It is the Federal Reserve that is the engine of inflation, that creates currency out of the ether, that encourages financial decisions based upon false signals. Couple that magic with government guarantees and one can start a conflagration like the housing bubble. Guido Hulsmann, author of *The Ethics of Money Production* explains:

> Because a paper-money producer can bail out virtually anybody, the citizens become reckless in their speculations; they count on him to bail them out, especially when many other people do the same thing. To fight such behavior effectively, one must abolish paper money.

The reports emanating today from the majority and minority commissioners at the FCIC are distractions from the real culprit: the Federal Reserve System. As Woods concludes:

> Since 2007 the typical pattern has unfolded before our eyes: a financial crisis whose ultimate cause is the government’s own central bank is [instead] blamed on anyone and everyone else, while the central bank itself is portrayed as our savior rather than the culprit.

By hiding the machinations of the Federal Reserve System behind millions of documents, thousands of hours of investigation, and hundreds of interviews, and concluding that the real cause of the Great Recession lay elsewhere, these efforts not only misdirect attention away from the one true cause, but continue to build the case for more regulation and government interference in order, allegedly, as Angelides said, to keep another Great Recession from “happening again.”