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Fed didn't save the economy

By Thomas Oliver
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As consensus builds that the recession is over, some are crediting Federal Reserve chairman Ben Bernanke's stewardship and all but re-nominating him by acclamation.

But others worry that declaring the recession over is a tad premature.

"I would be hesitant to declare the recession over while unemployment remains so dire," said George Selgin, professor of economics at the Terry College of Business at UGA and a senior fellow at the Cato Institute, a libertarian think tank.

Even if the recession were ending, Selgin thinks it would be a mistake to credit the Fed with the recovery. (It's not a religious notion to believe that an economy might recover without government direction.)

Selgin says the bailouts of investment banks, insurance firms and troubled TARP banks, plus the unprecedented lending to non-financial companies have been counterproductive and delayed the recovery. He is not alone in suggesting the major impact of the bank bailout money has been to allow those institutions to postpone dealing with their bad loans.

The Fed decided, after Wa-Mu and Lehman Brothers went under, that no other big financial institution would be allowed to fail, codifying the notion of too big to fail. But in order to function properly, the marketplace must be allowed to reward the successful while letting the failures fall by the wayside.

Critics of capitalism point to this recession and the Panic of 2008 as proof the marketplace isn't efficient, that it must be propped up and regulated even more. The counter-argument is that the marketplace wasn't allowed to work. Government intervened.

Selgin believes the Fed, after helping fuel the housing bubble, has morphed from central banker into central planning agency with a corporate welfare department.

In choosing which firms to save and which to leave to the vagaries of the marketplace, the Fed has gone where no orthodox central bank has gone before in picking winners and losers.

And as sure as day follows night, crises bring on cries for reforms.

More regulation of the financial industry is premised on the charge that this recent crisis was brought about by deregulation that defanged regulators of the power needed to rein in those greedy you-know-whats.

"Those who believe this crisis happened because regulators didn't have enough power are lacking an historical perspective on financial regulation," Slegin says. "We've been mucking about with regulations of financial institutions since before the Constitution was ratified."

The history of financial regulation in this country has been a long one, mostly more regulation with a smattering of deregulation every now and then. Almost without fail, regulation has led to new problems, the professor states.

Selgin sees some of the most egregious actors in the most recent financial meltdown as creations of the reforms following the Great Depression. The Glass-Steagall Act, for example, separated commercial and investment banking and gave birth to the world of such freestanding investment banks as Merrill Lynch, Bear Stearns and Lehman Brothers.

We all know where that led.

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