What the 2008 Federal Reserve transcripts reveal

Andre Damon
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On February 21, the US Federal Reserve Board released over 1,500 pages of transcripts covering the 2008 meetings of the Fed's policymaking Federal Open Market Committee (FOMC). The transcripts reflect the deliberations of Fed officials concerning the greatest financial crisis since the Great Depression of the 1930s.

The release of the transcripts comes nearly five-and-a-half years after the collapse of Lehman Brothers on September 15, 2008, the largest corporate bankruptcy in US history. The bankruptcy filing by the Wall Street investment bank set the stage for the passage, less than three weeks later, of the $700 billion Troubled Asset Relief Program (TARP)—the taxpayer bailout of major banks that was followed by additional bailouts and subsidies running into the trillions of dollars.

The media has, by and large, paid only the most superficial attention to the documents. The press accounts have largely echoed the official narrative given out by then-Fed Chairman Ben Bernanke, who has repeatedly said the crisis largely took him unawares.

There is much in the transcripts, however, that indicates there was growing concern within the Fed that what was emerging throughout 2008 was a very serious financial crisis. This is clear from the first set of transcripts, dated January 9, in which Bernanke notes that "there are a lot of indications that we may soon be in a recession." He continues: "I think a garden-variety recession is an acceptable risk, but I am also concerned that such a downturn might morph into something more serious."

Later that month, at a January 21 emergency meeting in which the Federal Reserve cut interest rates by 0.75 percent, Janet Yellen, who was then Federal Reserve vice chairman and this year succeeded Bernanke as chairman, noted: "The risk of a severe recession and credit crisis is unacceptably high, and it is being clearly priced now into not only domestic, but also global markets."

In April, following the Federal Reserve-mediated intervention to avert the failure of Wall Street investment bank Bear Stearns, government regulators made these concerns public in testimony before the Senate Banking Committee. At the hearing, Bernanke justified the use of public funds to finance the buyout of Bear Stearns by JPMorgan Chase, warning of the risk of a generalized financial crisis.

The prospect of a collapse of Bear Stearns, he said, raised issues that "extended well beyond the fate of one company." He then outlined its likely impact: "The sudden failure of Bear Stearns likely would have led to a chaotic unwinding of positions in those markets and could have severely shaken confidence. The company's failure could also have cast doubt on the financial positions of some of Bear Stearns' thousands of counterparties and perhaps of companies with similar businesses."

In other words, had the government allowed Bear Stearns to collapse, all of the other big Wall Street banks would have been threatened.

The transcripts include instances where Federal Reserve officials, suspecting the magnitude of the events that were unfolding, nevertheless sought to keep the extent of the crisis under wraps. On March 18, two days after the collapse of Bear Stearns, Fed Governor Frederick Mishkin noted, "We are in a financial crisis, and it is worse than we have experienced in any other episode of financial 'disruption,' which is the word I use. I will not use 'financial crisis' in public. 'Financial disruption' is still a good phrase to use in public, but I really do think that this is a financial crisis."

Timothy Geithner, then president of the New York Federal Reserve (and subsequently treasury secretary in the Obama administration), argued behind closed doors against any public statements that might reveal the depth of the crisis. At the FOMC meeting cited above, Geithner said, "There is nothing more dangerous in what we're facing now than for people who are knowledgeable about this stuff to feed these broad concerns about our credibility and about the basic core strength of the financial system."

As Geithner was making these statements, the biggest Wall Street banks were exacerbating the unfolding subprime mortgage collapse, and pocketing billions in profits, by issuing and betting against toxic mortgage-backed securities.

The claim repeated after the fact by Federal Reserve officials that they had not foreseen the crisis, while embarrassing, is self-serving. It serves to obscure and minimize their own responsibility for the policies that led to the financial disaster.

After all, it was the Federal Reserve that encouraged the stock market bubble of the 1990s and the housing bubble of the early 2000s—and the orgy of speculation and outright criminality that they involved—by keeping interest rates extremely low and gutting what remained of financial regulation.

To cite one example, Ben Bernanke's predecessor, Alan Greenspan, together with Clinton administration Treasury Secretaries Robert Rubin and Lawrence Summers, fought tooth and nail in the late 1990s to prevent the regulation of derivatives, including the credit default swaps and synthetic mortgage-backed securities that helped trigger the financial crash. Greenspan and his colleagues forced the resignation in 1999 of Brooksley Born, then head of the Commodity Futures Trading Commission, after she put forward a plan to regulate derivatives. Born later recounted that Greenspan told her there was no need for the government to prevent financial fraud. "You feel that there need to be rules against it, and I feel that the market will sort it out," he told her.

Even during the 2008 discussions, the Federal Reserve was covering up for the banks' criminal activities. For instance, the transcripts show that the Federal Reserve had significant evidence in 2008 that the London Interbank Offered Rate (Libor), the benchmark global interest rate for some $350 trillion in financial assets, was being systematically rigged. "There is considerable evidence that the official Libor fixing understates the rates paid by many banks for funding," said Fed economist William Dudley in a report on April 30, 2008. Despite this, regulators did not launch any investigation into Libor-rigging until 2011.

The fact that major international banks were underreporting to the Libor board the interest rates they were paying for loans from other major banks was itself an expression of the deepening financial crisis, as Fed officials well knew. Interbank interest rates were rising because market confidence in the creditworthiness of some of the biggest financial institutions was eroding. Had banks reported what they were actually paying to secure loans from their peers, the rising rates would have been seen as evidence of financial difficulties, leading to a fall in their share values, withdrawal of credit and possible bank runs. So the banks simply lied.

The transcripts likewise belie the official claims that the Federal Reserve and the government could do nothing to stop the collapse of Lehman Brothers, despite their having bailed out Bear Stearns in March and the mortgage finance giants Fannie Mae and Freddie Mac earlier in September.

There are good reasons to believe that the Bush administration and the Fed made a calculated decision to allow Lehman to collapse because they recognized that the entire financial system was insolvent. It was necessary to throw Lehman to the wolves in order to create a crisis atmosphere sufficient to ram through legislation authorizing the use of taxpayer money to rescue the financial oligarchy.

A comparison between the cases of Bear Stearns and Lehman Brothers shows that there was no substantial difference between the crises affecting the two firms. Fed officials justified the $30 billion bailout of Bear Stearns on the grounds that the institution was adequately capitalized but unable to borrow and therefore required extraordinary assistance. At a March 18 meeting of the FOMC, board member William Dudley said: "In my view, an old-fashioned bank run is what really led to Bear Stearns's demise. But in this case, it wasn't depositors lining up to make withdrawals, it was customers moving their business elsewhere and investors' unwillingness to roll over their collateralized loans to Bear." Dudley had for two decades worked as the chief economist at Goldman Sachs.

The bailout of Bear Stearns, however, was orchestrated as if exactly the opposite were the case: instead of providing the bank with credit, the US government effectively filled a massive capital hole in the institution by purchasing $30 billion in mortgage-backed securities from the firm as part of its sale to JPMorgan.

In the face of similar circumstances at Lehman Brothers, however, Federal Reserve officials said it was impossible to take any action to rescue the bank. "In the case of Lehman Brothers, there was just a huge hole. I mean, they were insolvent and they had a 30- to 40-billion-dollar hole in their capital structure," Bernanke would testify in 2009 to the Financial Crisis Inquiry Commission (FCIC). He echoed these comments in 2012, saying, "We were helpless because it was essentially an insolvent firm."

Bernanke failed to provide any substantive evidence to back up this assertion to the Financial Crisis Inquiry Commission. "Although Fed officials discussed and dismissed many ideas in the chaotic days leading up to the bankruptcy, the Fed did not furnish to the FCIC any written analysis to illustrate that Lehman lacked sufficient collateral to secure a loan," the commission's report noted.

Bernanke told the FCIC in 2009 that the Federal Reserve felt the Lehman Brothers collapse would have had immense implications, but was powerless to prevent it. He said: "It was going to have huge impacts on funding markets. It would create a huge loss of confidence in other financial firms... So there was never any doubt in our minds that it would be a calamity, catastrophe, and that, you know, we should do everything we could to save it."

This testimony, however, contradicted his public statements in the days following the Lehman bankruptcy, in which he said that the Federal Reserve had believed the fallout from letting the firm fail would be manageable. On September 23, 2008, he told Congress that "the troubles at Lehman had been well known for some time, and investors clearly recognized...that the failure of the firm was a significant possibility. Thus, we judged that investors and counterparties had had time to take precautionary measures."

Testifying on September 2, 2010, Bernanke said the decision not to rescue Lehman Brothers was based on the fact that the Federal Reserve simply did not have the legal authority to intervene. "We are not allowed to lend without a reasonable expectation of repayment. The loan has to be secured to the satisfaction of the Reserve Bank. Remember, this was before TARP. We had no ability to inject capital or to make guarantees," he said.

These statements were contradicted by Merrill Lynch CEO John Thain, who told the Financial Crisis Inquiry Commission, "There was never a discussion about the legal ability of the Fed" to bail out Lehman Brothers at the time. "There was never discussion to the best of my recollection that they couldn't… It was only that they wouldn't."

The collapse of Lehman Brothers set off an immediate panic, with stocks plunging and interbank lending rates hitting record high levels. This helped create the conditions for the $85 billion bailout of the much larger credit insurer American International Group (AIG) and its counterparties the next day. It also served as the justification for Congress to authorize TARP on October 3, as well as virtually unlimited cheap credit to the banks from the Federal Reserve, which would ultimately quadruple its balance sheet to some $4 trillion.

In the aftermath of the Lehman Brothers collapse, Federal Reserve officials adopted the attitude that the political and economic conditions were such that they could justify putting essentially unlimited financial resources at the disposal of the banks. "Given the seriousness of the situation, I believe that we should put as much stimulus into the system as we can as soon as we can," said Janet Yellen in a meeting on October 28.

The officials whose comments are recorded in the transcripts have devoted their entire adult lives to serving the interests of Wall Street, in many cases receiving enormous amounts of money in return, some before, some after, their stints at the Federal Reserve.

The 2008 Federal Reserve Board included such figures as Timothy Geithner, president of the Federal Reserve Bank of New York through January 2009, then treasury secretary under Obama, and now president of Wall Street private equity firm Warburg Pincus.

Federal Reserve board member Randall Kroszner now serves as a senior advisor for Patomak Partners, a company that helps hedge funds and investment banks dodge regulations.

The vast majority of the Federal Reserve Board members spent their careers defending the deregulation of financial markets and facilitating the housing bubble that exploded in 2007, all the while attempting to keep from public view the subprime mortgage racket that collapsed in 2008.

The "blindness" of the Federal Reserve officials was largely willful—intended to allow the speculative bubble to continue as long as possible and create the best conditions to bail out the Wall Street mafia.

In all of the 1,500 pages of Fed transcripts from the fatal year 2008, there is not the slightest suggestion that the banks should be seized, broken up or taken over, and that those responsible for the financial disaster should be held accountable and made to pay for their crimes. The Federal Reserve, far from being an impartial arbiter, above the fray of social interests, is delegated by the capitalist state with particular responsibility for securing the interests of the banks and financial interests, covering up their illegal activities, providing them with the most favorable conditions to speculate, and bailing them out with public funds when their bets go bad.