Book Review: The Courage to Act: A Memoir of a Crisis and its Aftermath by Ben S. Bernanke

In his book, **The Courage To Act: A Memoir of a Crisis and its Aftermath**, *former United States Federal Reserve Chairman* **Ben S. Bernanke** *offers readers a private account of the negotiations and discussions he and his team carried out in formulating the unconventional monetary policy that would be the backdrop to navigating the US economy through its most trying period since the Great Depression.* **Alex Verkhivker** *welcomes the memoir as a thoughtful reflection on Bernanke's time at the helm of the Federal Reserve.*

***The Courage To Act: A Memoir of a Crisis and its Aftermath.* Ben S. Bernanke. W. W. Norton and Company. 2015.**

In 1913, the United States Congress established the Federal Reserve System through the Federal Reserve Act, which was signed into law by then President Woodrow Wilson. The Act purported to provide a means of responding to different stress points in the banking sector by creating a central banking system that would pursue the interests of US citizens by seeking to ensure maximum employment and price stability for the US economy.

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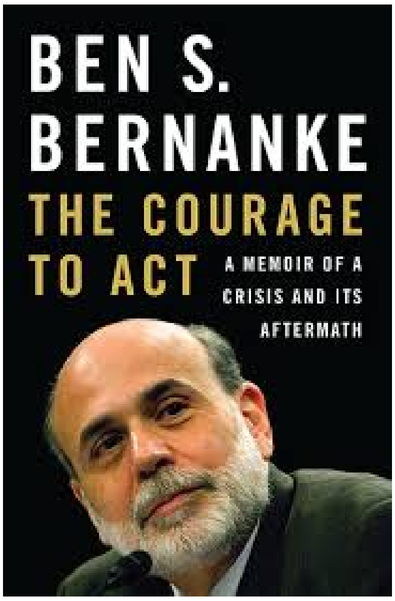
The Federal Reserve Board was created to oversee the set of twelve chartered Reserve Banks that were scattered across various regions of the United States. The Board was to be made up of political appointees and situated in Washington. With the formulation of the Banking Act of 1935, Congress established seven members to serve on the Board of Governors, who would be appointed by the President of the United States and confirmed by the Senate. In October 2005, Ben S. Bernanke was nominated by President Bush to replace Alan Greenspan as chairman of the Federal Reserve. He was confirmed by the US Senate and began his chairmanship on 1 February 2006.



In his memoir, *The Courage To Act: A Memoir of a Crisis and its Aftermath*, Bernanke does a superb job of channelling the emotions and duties he experienced during his rookie season as Fed Chief. The traditional model of mortgage lending had become much more complex by the start of his term and housing finance was on everyone's agenda in 2006. The new model of lending, sometimes referred to as the *originate-to-distribute* model, centred on lenders making loans to brokers, who would try to connect a throng of borrowers with as many mortgage originators as possible. As the traditional model of lending became more complicated, the mortgage originators were not the traditional commercial banks or savings and loan institutions they once were. The originators could now be nonbank subsidiaries of Wall Street firms who were funded on a short-term basis and whose funding could dissolve at any point.

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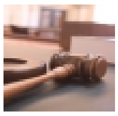
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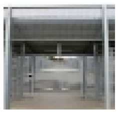
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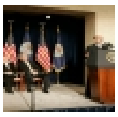
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Image Credit: Ben Bernanke Sworn into the Federal Reserve Post (Wikipedia Public Domain)

'The Subprime Spark', as Bernanke coins it, was rising rapidly, and by 2005, the originations of all mortgages that were subprime had soared to 20 percent. In his own words, Bernanke concedes that the Fed was too slow and too cautious in responding to the risky lending and poor underwriting standards taking place, but hastens to remind his readers that the individual Reserve Banks housed bank examiners responsible for overseeing the operations at local bank branches. When the Board in Washington attempted to make the supervision of banks more centralised, Bernanke notes, Reserve Bank staff would assert that they were better informed about local district conditions.

Another conceit of Bernanke's is how fragmented the financial regulatory system really was prior to the financial crisis. Both the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission regulate financial markets. National banks are regulated by the Office of the Comptroller of the Currency and savings institutions are under the eye of the Office of Thrift Supervision (OTS). The problem, as Bernanke points out, was that financial institutions would switch their charters in order to change the entities that regulated them. The biggest subprime lender, Countrywide Financial, had switched the charter of one of its subsidiaries and, as a result, the Fed was replaced by the OTS as the regulating supervisor.

Coupled with this fragmented regulation was the development of the shadow banking system: a network of nonbank subsidiaries that included mortgage companies and providers of credit

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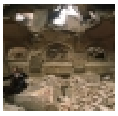

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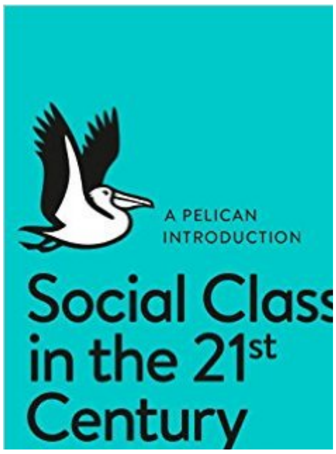
insurance that would carry out traditional banking functions, but would do so with funding that was short-term and with deposits that were not government-insured. All this posed tremendous concern for US consumers who used financial services and needed protection against the banks.

Bernanke does not excuse his critics in the memoir, who argued that he and the Fed had often been 'asleep at the switch' during Congressional hearings. Such critics often referred to the Home Ownership and Equity Protection Act (HOEPA), which allotted the Federal Reserve the power to outlaw risky mortgage lending. Why was more not done by the Fed to protect against equity stripping, loan flipping or lenders who gave out loans to borrowers that borrowers did not intend to buy?

In part, the reluctance of Bernanke and his other governing members was historical. Lenders had largely denied low-income and minority borrowers access to credit, and subprime lending was seen as the remedy for this discriminatory practice. The former Fed Chair does an admirable job in relaying the thinking of the Federal Reserve for its inaction in using some of its enforcement authority and readers are left sympathetic to issues that are multi-faceted and require the guidance of a legion of staff that can often maintain opposing views.

There is much economics to learn from after reading Bernanke's memoir and even more to take away from the communications strategy Bernanke pursued. His thinking on formal policy communication diverged from that of his predecessor, Greenspan, and could very well be the tool that Bernanke is best remembered for in helping the Fed navigate its way out of financial collapse. Bernanke championed formal inflation targeting, and his utmost responsibility was in maintaining the independence of the Federal Reserve from political pressure and in promulgating the transparency of Federal Reserve proceedings.

Bernanke's goal was to properly align the actions of the Fed with the expectations of participants in financial markets. Bernanke appears honest and sincere throughout his memoir, admitting his



faults and thoughtful when considering the criticisms of his sharpest critics. Bernanke's mastery of monetary policy and banking regulation intermingles with quotes from colleagues, friends and family, which lend the memoir a much needed reprieve from the heated issues it elsewhere discusses. In navigating America's central bank through two presidencies over two terms as chairman, Bernanke elicits admiration for his efforts and sympathy for his shortcomings in this memoir, reminding readers that, ultimately, his mission and wishes at the helm of the Federal Reserve were to best serve the American people.

Alex Verkhivker is a contributor to *Capital Ideas* at The University of Chicago Booth School of Business. He has previously worked as an economic researcher with the Federal Trade Commission in Washington and as an Associate Economist at the Federal Reserve Bank of Chicago. He has written for the Becker Friedman Institute For Research In Economics at The University of Chicago, The United Kingdom Centre for Policy Studies CapX, *Forbes*, *Huffington Post*, *Washington Examiner*, *The Times of Northwest Indiana* and *Economics 21* – the economics portal of the Manhattan Institute for Policy Research. Alex holds degrees in economics and management from The University of Chicago and UCLA, respectively. You can follow him on twitter @averkh. Read more reviews by Alex.

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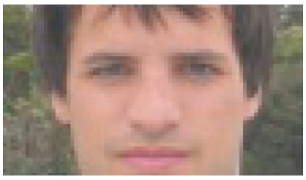

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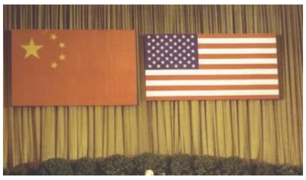

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