

# Grading the Crisis Response



Even as the Federal Reserve and the U.S. government contemplate flooding the financial system with still more money, a sobering book by a Stanford University economist demonstrates not only how the feds caused, misdiagnosed and mishandled the financial crisis, but also how their responses continue to make matters worse.

The book, titled *Getting off Track: How Government Actions and Interventions Caused, Prolonged, and Worsened the Financial Crisis*, is by John B. Taylor, a senior fellow at the Hoover Institution who was a Treasury undersecretary in Bush *fil*s' first administration. In the book, Taylor says the U.S. wrongly attributed the way the credit markets seized up in the summer of 2007 and beyond to a lack of liquidity. He then shows how counterparty risk was really the culprit, and how the gov-

## Whimsical

**The government's lack of a predictable framework for rescuing banks may have helped drive the market down, author Taylor says.**

ernment's incorrect assumptions and subsequent lack of a predictable strategy may have contributed to the panic that ensued after Fed Chairman Ben Bernanke and then-Treasury Secretary Henry Paulson appealed to Congress for a \$700 billion emergency rescue plan.

In a study that is way too detailed to describe fully in this space, Taylor shows how the Fed's policy of keeping short-term interest rates too low for too long contributed to the housing bubble, as adjustable-rate loans rose to fully one-third of the mortgage market. As for the seemingly capricious rescue of some entities but not others, Taylor says, "there's been no rationale laid out for why AIG and not Lehman was rescued." Among his prescriptions: Stipulate policy on money-supply targets or ranges, increase transparency on the rationale behind buying assets like student loans, and cut the plan to tax small business.