Cause of the 2008 Financial Catastrophe:

The Experts Deceived the Academy and the Nation by Surreptitiously Rejecting Research on Economically Efficient and Constitutional System of Money and Finance, and on Optimal Holding Company Organization and Capital Structure under Constitutional Governance

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The Academy Needs A Center of Constitutional Capitalism Founded on Rigorous Research

By

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Abstract: The Federal Reserve has said that the financial Catastrophe of 2008 was worse than the Great Depression. The Catastrophe has wiped out about twenty trillion dollars of hard earned wealth. The majority of the Financial Crisis Inquiry Commission (FCIC) has concluded that the Catastrophe was manmade (avoidable) and was due to a failure of the Experts including those at the helm of the Federal Reserve. The minority of FCIC contends that the US Housing Policy unleashed unscrupulous lenders and borrowers to cause the Catastrophe. The minority view is consistent with the majority's conclusion that the Catastrophe was manmade and avoidable. But neither view has explained how the lenders got enormous credits to lend. The FCIC (either minority or majority) has not found the root causes of the Catastrophe: (i) how the credits expanded globally and (ii) how the US regulators allowed banks to take the expanded credits as bank debts without requiring banks to raise capitals.

My research shows: (a) the credits expanded globally due to an economically inefficient and unconstitutional system of money and finance; beneficiaries of expanded credits are thus opposed to my research, (b) regulators permitted banks to transgress the minimum bank capital requirements (laid out in FDICIA-1991) through the multi-leveraged bank holding company structure by ignoring my Fed-mimeographed research and heated arguments with top Fed and bank executives, and (c) the Experts suppressed my research on (a) and (b) from being published in top journals they control to sway the Congress to not heed to rejected research. Like the bankers, the Experts and the journals they control lost credibility for failing to foresee the crisis. Actually, they together deceived the Academy, the Congress and people by rejecting my research. The Congress has adopted major policies emerging from my research (safe central banking and minimum consolidated capital for bank holding companies) after the Catastrophe. Publication of my research in top journals would have swayed the Congress on time to adopt all the policies emerging from my research to avert the crisis, preemptively, and to avoid losing trillions of dollars of hard earned wealth.

The shenanigans feasible under the prevailing unconstitutional and inefficient system, being championed by the failed Experts and their cohorts in Wall Street and elsewhere, can be effectively thwarted only if the Academy institutes a **Center for Constitutional Capitalism** founded on research on economically efficient and constitutional governance.[1]

[1] http://pro-prosperity.com/Research/Center%20for%20Constitutional%20Capitalism%20-%20General.pdf

I. Introduction

My research has discovered an economically efficient and constitutional system of money and finance, and proved that the prevailing system is unconstitutional and inefficient.[2] The ultimate beneficiaries of the prevailing system control, directly and indirectly, the publishers of the journals in the Academy of Finance and Economics and can thus reject with impunity any research that challenges the prevailing system. This is the crux of the moral hazard problem the US economy has faced. I have discovered moral hazard in banking and finance through research on bank foreclosure rule (published in the Journal of Finance in 1989 and enacted by the US Congress in the Federal Deposit Insurance Corporation Improvement Act of 1991) and on efficient resolution of moral hazard mimeographed by the Federal Reserve Board in 1991.

The Financial Crisis Inquiry Commission (FCIC)–an institution set up by the US Congress–has concluded that the financial Catastrophe of 2008 was manmade, which could have been avoided and which was due to a failure of the Experts including those at the helm of the Federal Reserve.[3] The Catastrophe wiped out an estimated twenty trillion dollars of hard earned wealth. The current chairman of the Federal Reserve, Dr. Ben Bernanke, has publicly admitted Fed's failures. But he has also declared his appreciation by recommending research which claims that the Catastrophe was a slap by the invisible hands (god).[4]

In any case, the FCIC has declared by using facts and interviews with experts to establish that the Experts failed to presage the financial Catastrophe of 2008. The failed Experts in the Academy of Finance and

[2] This is contained in my published and unpublished papers: (i) "Optimal Bank Reorganization Policies and Pricing of Federal Deposit Insurance," 1989, Journal of Finance, (ii) "Safe Banking," 2003, Journal of American Academy of Business, http://www.pro-prosperity.com/Research/Safe%20Banking.pdf , (ii) "Safe Banking to Avoid Moral Hazard," 2007, Journal of Risk Management in Financial Systems, http://www.pro-prosperity.com/Research/moralhazard-safebanking.pdf , (iv) "Prosperity: Optimal Governance (Banking, Capital Markets, Global Trade, Exchange Rate)," 2005, Citizens Publishing, http://www.pro-prosperity.com/Citizens%20Publishing/TableOfContents.pdf , (v) "Economically Efficient Constitutional Governance," http://www.pro-prosperity.com/Research/moralhazardliberty.pdf , (vi) "Optimal Holding Company Organization and Capital Structure Under Constitutional Governance," http://www.pro-prosperity.com/Research/OptimalHoldingCompanyOrganizationCapitalStructure.pdf , (vii) Lending Federal Funds and Insured Deposits is Sub-optimal for Taxpayers" 2007, http://www.pro-prosperity.com/Research/Sub-optimality%20of%20Lending%20Taxpayer%20Funds%20to%20Hedge%20Funds.pdf , and (viii) Constitutional System of Money and Finance," http://www.pro-prosperity.com/Research/Constitutional-Monetary-Finance-System.pdf

[3] The FCIC Report released in January 2011 says: "The FCIC interviewed hundreds of financial experts, including senior officials of major banks, bank regulators and investors. It is not clear that any of them—including the redoubtable Warren Buffett—were sufficiently confident about an impending crisis that they put real money behind their judgment." The FCIC has reported testimonies of many finance and economics professors with chairs endowed by banks and financial institutions.

[4] A recent paper "Slapped in the Face by the Invisible Hand: Banking and the Panic of 2007," takes the position that "The 'shadow banking system' at the heart of the current credit crisis is, in fact, a real banking system — and is vulnerable to a banking panic." Gorton's research on the shadow banking system has been recommended by Federal Reserve Chairman Ben Bernanke and is the subject of Gorton's new book *Slapped by the Invisible Hand: The Panic of 2007* (Oxford University Press). Ben Bernanke, chairman of the Federal Reserve, recommended it, during a recent interview with *Washington Post* columnist David Ignatius, suggesting its description of the roots of the economic crisis are much in line with his own understanding. This was reported in Yale University News: http://mba.yale.edu/news_events/CMS/Articles/6888.shtml

Economics are based in universities, regulatory agencies and Wall Street and control academic journals and publishing houses.

The failed Experts have rejected my research, which had not only presaged the true causes of a looming Catastrophe but also obtained equilibrium regulatory policies to avert the crisis preemptively. Equilibrium in a model of the economy is like the stability mandated by constitution. The same equilibrium policies as obtained in my research and proposed to the Congress before the crisis, like safe central banking and minimum consolidated capital for bank holding companies, have been adopted by the US government after the Catastrophe struck and wiped out a massive chunk of accumulated wealth. Had the Experts not rejected my proposed policies and had they not prevailed upon the Congress to dissuade adoption of the same policies, which I had proposed before the crisis, the Catastrophe would not have occurred and twenty trillion dollars of hard-earned wealth would not have been wiped out.

That the bank holding companies (BHCs) did not have sufficient capital on a consolidated basis to meet the minimum required under the Federal Deposit Improvement Corporation Improvement Act of 1991 before the Catastrophe and that the Catastrophe was a direct result of inadequate bank capital was very obvious from the public news channels in early 2008 when the then Treasury Secretary Henry Paulson issued warnings to mega BHCs to either raise their capital ratios or be shut down. Mr. Paulson also incessantly talked then about deleveraging going on at the precariously leveraged mega BHCs. After the Catastrophe, the regulators started talking about not having enough tools/power to shut down the mega BHCs, indicating that the tools were not in place to check if the consolidated capital of a BHC was greater than the minimum needed under FDICIA-1991. These new tools (rules) have now been incorporated in the Dood-Frank Bill passed in 2010.

The minimum consolidated capital for BHCs, formally adopted in 2010 and informally enforced by the US government since early 2008, is indeed based my research on BHCs since in 1994, when I was a financial economist at the Federal Reserve.[5] This research was internally evaluated and mimeographed at the Federal Reserve at that time. I even had heated discussion while arguing with top Citibank bank and Fed executives in 1994 about how the holding company structure transgressed the minimum bank capital requirement rule enacted in FDICIA-1991. Even the FDICIA-1991 minimum bank capital rule stemmed from my research on optimal bank foreclosure rule published with J.F. Dreyfus in the Journal of Finance in 1989.

My BHC paper must have jolted the vested interests to institutionalize their animosity towards my research.[6] If the minimum capital rule obtained in my BHC paper were enforced before the Catastrophe, the BHCs could not transgress the minimum capital rule on a consolidated basis and the Catastrophe would not have occurred.

The Federal Reserve had formed a group of economists to fete journal editors and well-placed academics to promote a dogma that the bankers were capable of self discipline, in the wake of my mimeographed research on efficient resolution of moral hazard and BHCs. The group crunched a series of papers using bank call report data and published them in some of the top journals to prove to the US Congress how banks were capable of self disciplining. They simultaneously suppressed publication of my papers on

[5] http://pro-prosperity.com/Research/OptimalHoldingCompanyOrganizationCapitalStructure.pdf

[6] I vividly recall how a senior VP at Citigroup turned red when I pointed out the truth about transgression of the FDICIA-1991 minimum capital rule. He told me: Dr. Acharya, do you want to throw us out of the window? Other Fed Officials present there told him to not take my comments seriously. That meeting indicated to me that the Fed was in league with the bank holding companies to permit such egregious transgression of the FDICIA-1991 minimum capital rule as to cause a depression in 2008 which the Fed has called worse than the Great Depression.

efficient resolution of moral hazard and BHCs. In fact, they even invited a free-market economist who believed in the first-best (efficient) resolutions, the late Nobel Laureate Merton Miller of University of Chicago, to a conference in the Warton School. The organizers excluded my papers which were precisely on the theme of the conference. Merton Miller, however, spoke his mind publicly in his keynote address, which was published later by the Journal of Banking and Finance, which I state euphemistically: the banking economists should exit their profession to engage in productive businesses for betterment of the economy. Miller was very prophetic: The FCIC has in 2011 blamed the ex-chief banking economist, ex-Chairman of Federal Reserve Alan Greenspan, for the Catastrophe. Despite FCIC's conclusion that the Catastrophe was manmade and avoidable, the current chief banking economist Dr. Ben Bernanke, has endorsed a tome by another banking economist to describe the Catastrophe as a slap by invisible hands (god).

I have developed a general equilibrium model to obtain first-best (efficient) equilibrium policies for the economy. My experience with banking economists, who I believe have rejected my papers, is consistent Miller's remarks on the profession. The banking economists may have "succeeded" in terms of better positions and remunerations for themselves by writing the only kind of research, which is aligned with the goals of bankers: to privatize profits and socialize losses, even by transgressing the Congressional mandates like the FDICIA-1991 minimum capital rule by taking refuge on Chinese firewall of the BHC capital structure.

Banking economists in the Academy have made fortunes and occupied star chairs endowed by banks for writing papers published in top journals based on mumbo-jumbo models to show that Chinese firewalls in the BHC structure work fine. The Chinese firewalls work fine to privatize profits and socialize losses through the BHC structure and make the banking economists star professors. But the BHC structure transfers enormous risk to taxpayers, making the economy vulnerable. For example, a non-BHC bank with 8% minimum required capital (under FDICIA-1991) and 92% debt becomes a BHC to take advantage of the Chinese firewalls by fudging FDICIA-1991. After conversion to the BHC structure, the consolidated capital of the BHC can be just 0.64% with 99.2% debt and be permitted by regulators as having complied with the FDICIA-1991. How? The original non-BHC bank becomes a BHC with one bank subsidiary. The parent company of this BHC transfers its original assets of \$100 (debt \$92 plus equity \$8) to its bank subsidiary. The transferred assets of \$100 now become the capital of \$100 at the subsidiary bank. The subsidiary bank now borrows an extra \$1150 in debt and deposits and yet meets the minimum capital under FDICIA-1991 of 8% or 100/(100+1150)=.08. The regulators permit the BHC to operate with a consolidated capital of 0.64% or 8/(1250-8), which is less than one-twelfth of minimum required capital under FDICIA-1991, thanks to the star banking economists in the Academy and in the Federal Reserve.

The bank regulators and top bankers fumed when my research highlighted in early nineties that such BHC jugglery, as illustrated above, permitted BHCs to operate with barely 0.64% capital on a consolidated basis. They have viscerally opposed publication of my research papers then on to ensure that I am eventually purged from the Academy for not being able to publish in the journals they control. But the Great Recession (perhaps the first leg of the next Great Depression) has exposed the jugglery and failure of the star regulators, bankers and banking economists. Now they are obviously more determined than ever before to suppress the truth that I had written path-breaking research that would have avoided (i) losses running to trillions of dollars hard-earned wealth and (ii) turning the US a second-best economy.

The holding company structure has allows ultra-leveraging of BHCs with little capital, as compared to the mandated FDICIA norm, and thus enormously raises the total risk to taxpayers as vividly shown within my general equilibrium model. By rejecting my papers and simultaneously publishing papers based on mumbo-jumbo analysis to show that banks can discipline themselves through the efficacy of Chinese firewalls, the Experts not only failed but also misled the Academy, Congress and Americans.

The US government was ultimately forced to adopt my policy prescriptions of requiring BHCs to have their consolidated capitals exceed the FDICIA-1991 minimum, but only after the Americans lost trillions of dollars of their hard-earned wealth.

My research proves that the current system of money and finance is unconstitutional and inefficient and obtains an economically efficient constitutional system. Data generated by the prevailing unconstitutional and inefficient system cannot show that the system itself is economically efficient and constitutional. The Experts cannot clutch onto their empirical research based on such data to assert, rationally, that banks and capital markets are self-disciplined enough to not transgress the constitution or to not make the economy inefficient (second-best). But empirical papers and theories explaining the empirical findings stemming from data generated by an unconstitutional system have been rampantly published in top journals of economics and finance. These papers have formed the basis of government policies. This is why the system collapsed to cause a financial Catastrophe. This has exposed the unconstitutionality and inefficiency of the system. The authors of such papers controlling the journals are, therefore, reluctant to even review my papers proving inefficiency and unconstitutionality of the system.[7]

I have, therefore, submitted my findings to the government to avert a looming catastrophe. In late 2007, I had sent several memos to Mr. Henry Paulson, Treasury Secretary, to emphasize how the bank holding companies were indeed transgressing the FDICIA-1991 minimum capital requirements on a consolidated basis and thus imposing enormous total risk on taxpayers. The Treasury Department had sent me a thank you note.

The Federal Reserve has released in December 2010 its ultra secret data on the names of the financial institutions that received trillions of dollars of emergency lending during 2008.[8] The Fed and the Clearing House, LLC (comprising top banks) lost the court case filed by Bloomberg News. Bloomberg went to the court after the Fed refused to release the information under the Right to Information Act. The Clearing House had even decided to appeal before the Supreme Court, though the Fed broke ranks to release the data. The Clearing House ultimately lost its appeal, before in the Supreme Court, for suppressing the confidential Fed lending data. There are two important points in the Bloomberg news article on the Fed data release: (i) The Federal Reserve created *a safe central-government banking* facility for the \$3.3 trillion in money markets in 2008. (ii) The ad hoc Fed decision during the crisis caused serious conflicts of interest that benefited private insiders-advisors due to their advance knowledge of the new safe central-government banking facility.

Actual government actions during and after the Catastrophe show that the U.S. indeed adopted the same policies as those discovered in my general equilibrium model: (i) *safe central-government banking* and (ii) the FDICIA-1991 requirement of minimum capital on a consolidated basis for BHCs. But the government acted only after gargantuan losses of hard-earned wealth and a depression in the economy. Shouldn't the Experts who denied publication of such profoundly valuable research apologize for a failure of their judgment to reject my papers? They have not done so. Instead, they are attempting in full throttle to purge me from the Academy by continuing to reject my papers submitted to the journals they control, even without reviews. In addition, they have authored a tome to describe the Catastrophe as a slap by invisible hands (god) with recommendations for the tome from the chef banking economist, the current Federal Reserve Chairman. By making god responsible for the Catastrophe, the failed Experts and their cohorts are basically discarding the FCIC finding about the Catastrophe being manmade and avoidable.

[7] See, e.g., the attached referee report from the Financial Analyst Journal.
[8] http://www.bloomberg.com/news/2010-12-03/fed-created-conflicts-in-improvising-3-3-trillion-financial-system-rescue.html

They are essentially attempting to bury the truth that the same policies, which I had discovered and which the Experts had rejected before the Catastrophe, were indeed adopted by the U.S. after the Catastrophe. Who is then responsible for the Catastrophe and for the immense loss of wealth? The failed Experts! The failed Experts who continue to deceive the Academy cannot credibly arbiter the value of my research or my position and remuneration. Their opinions have lost credibility.

The purpose of this paper is to establish the following:

1. The root causes (sources) of a looming crisis discovered in my research and communicated to the Congress before the Catastrophe are consistent with the conclusions of the FCIC.

2. Preservation of self interests, not the Academic goal of publishing truths discovered by research, led the Experts (a) to reject profoundly important equilibrium policies obtained in my research and (b) to fail abjectly as a result.

3. The failed Experts have vitiated the Academy's unique goal of discovering and publishing truths through research, especially, those that serve the best interest of people who prop the Academy, the nation and, ironically, even the failed Experts.

4. The failed Experts are still continuing their shenanigans to purge me from the Academy by suppressing the truth that my equilibrium policy discoveries pursued for adoption by the Congress before the crisis could have averted the Catastrophe and could have saved trillions of dollars of wealth. The Experts' shenanigans have transgressed my constitutional right to wealth or property which I could have acquired with higher remunerations and promotions compatible with the immense contribution of my research to society (my remuneration is perhaps about 25% of failed Experts' income, on average).

5. Public universities, states and nations should discard judgments of the failed Experts and their publications in their controlled journals (that have failed to publish research of immense value to society) for my promotion and remuneration to further the interests of the Academy and public.

My research is based on a long-run dynamic model of microeconomics to derive micro and macro results in equilibrium of a game among leveraged firms and households, each pursuing for enhancement of their wealth in a free market economy with no interference from the government except enactment and fair enforcement of constitutional rules of law for all. This model is more general than any other existing in the Academy. The Experts have either refused to review my papers based on this model or rejected my papers by stating that my research is controversial or political.[9]

My research is obviously controversial as well as political, despite my personal proclivity to the contrary. My research obtains, in equilibrium, an economically efficient constitutional system or rules of governance for a nation. It proves that the prevailing system supported by the extant research in the

[9] See, e.g., the attached referee reports and my responses (without any reply back from editors) of (i) The Journal of Economic Theory, (ii) Econometrica, (iii) International Economic Review, (iv) Financial Analyst Journal, and the (v) Review of Financial Studies.

Academy is inefficient, unconstitutional and detrimental to national competitiveness. My research thus debases the wisdom established by the Experts and so it seems to them as controversial and political.

But the Academy is supposed to be a fountain of truth. The Experts have failed because they have denied admitting their fallacy. They have rejected the truths discovered through a very rigorous model of the economy founded on the basic underpinnings of economics and finance. They have found no error in my theorems or proofs or model. Neither have they found my model incompatible with the real world economy. They cannot, because my model is a more realistic microeconomic rendition of the economy than any extant model in the literature. The extant models are narrower/restricted forms of my general equilibrium model. The failed Experts and their rejections of my papers submitted to the journals and publishing houses they control cannot, therefore, be a basis of a fair arbitration of the efficacy or value of my immensely successful research.

My research has not only succeeded in presaging the root causes of the Catastrophe, which is considered by the Federal Reserve to be worse than the Great Depression. It has also obtained general equilibrium policies like (i) safe central banking and (ii) consolidated minimum capital requirement for bank holding companies. These policies could have been adopted by the Congress to preemptively avert the crisis, but for the opposition by the Experts. The irony is that these policies have indeed been adopted by the US government after the crisis, i.e., after the gargantuan loss of wealth. The Experts have failed abysmally and my research has succeeded immensely. Yet, they are ruling the roost to pass adverse judgments about my research, surreptitiously, through their ordained blind review process imposed by them on every profession-centric university department where I could work as a researcher to fulfill the missions of the Academy and public. Their surreptitious rulings are not only unconscionable. They are also incompatible with the US constitution and with my freedom to serve with dignity the Academy and public.

To safeguard their positions as long as possible, the failed Experts will obviously use their controlled blind review process to continue denying publication of the truths discovered in my research in their journals. But public universities, states and the nation need to observe the following:

(i) Cognize that the failed Experts are exploiting their blind reviews to eventually purge me from the Academy through a denial of my promotion and salary raises via the system instituted in their profession-centric departments; they will do so to avert debasing of their own positions by blocking propagation of the truths discovered in my research.

(ii) Abdicate the failed Experts' self-serving views expressed surreptitiously in their controlled blind reviews. Foil their attempts to foist such views on the profession-centric departments while judging my immensely successful research.

(iii) Conduct an open review of my research, if needed, by involving only those Experts who are willing to review my research by fully disclosing their identities and by responding to my responses to their reports (in just two rounds). Any real expert with intellectual leadership should have no hesitation in participating in open reviews.

(iv) Judge my true contribution to my profession, university, state and nation, sans the opinions of prevaricating and prejudiced self-serving Experts who have failed.

(v) Avoid subversion of my constitutional right to property that I could acquire with raised status and remuneration if a concocted system of blind reviews of my research had not been foisted on the Academy and on the profession-centric departments by the Experts. The Experts have done so with a view to rejecting with impunity those research papers (such as mine) which debase their selfish positions, notwithstanding the immense value of the discoveries from such research to the nation and the Academy.

I had been warned early on by a well-known professor who was in my thesis advisory committee to not do research that challenges the modus operandi of the markets, lest I would be unemployed. He told me he too was warned by his thesis advisers when he wanted to test for the rationality of markets. His prophecy came almost true, as I have been severely under-employed, relative to the failed Experts. This is notwithstanding the value of my research to society and towards fulfillment of the primary goal of the Academy to discover and spread the truths through research.

As a member of the Academy, I have remained beholden to the Academy and people and not to the failed Experts. Yet, the failed Experts still call the shots to make me severely under-employed. The people, who have lost twenty trillions of dollars of their hard-earned wealth, will be badly disposed towards an Academy that (a) continues to operate at the behest of the failed Experts to suppress relevant truths discovered in my research and (b) inadvertently abdicates its mission of discovering and spreading truths.

A serious student has written this semester that most of the courses taught in the college of business are useless for the vast majority of students and a complete waste of their time.[10] He does not consider my course as one of those useless ones. In fact, he has profusely appreciated his deep learning in my course like almost all of my students have expressed, despite their difficulty and hardship due to grinding in my courses.[11] This makes one wonder how the failed Experts will continue justifying their research and teaching on a system of money and finance, which they have championed thus far, which has abjectly failed to explain the 2008 Catastrophe and which a fellow researcher has successfully proved as unconstitutional, inefficient and detrimental to national competitiveness. These real self-serving issues may explain why the failed Experts are buying as much time as possible to deny me promotion, salary raises and publicity with a view to extinguishing the truths discovered in my research.

This is why the public universities, states and USA need to help publicize the truths discovered by academic research of a fellow citizen by proactively raising my position and remuneration consistent with my true contribution to society to rectify my under-employment at about 25% of the average income of the prevaricating and prejudiced failed Experts. To do so, the Academy needs to establish a <u>Center for Constitutional Capitalism</u> founded on the discovered truths on constitutional and efficient governance.

The remainder of this paper is organized as follows. Section II offers five major views on the financial Catastrophe of 2008. Section III shows how and why the Experts failed or deceived the Academy and the

[10] See the attachment on this student's feedback.
[11] See, e.g., the latest collated feedback http://www.pro-prosperity.com/UIC/Feedback-Fall2010.pdf

nation. Section IV facilitates determination of the root cause of the Catastrophe. Section V explains the significant normative (prescriptive) policies and results obtained within my general equilibrium model. Section VI summarizes my conclusions and proposed steps for the Academy and the nation.

II. Major Views on the Financial Catastrophe of 2008

Here are five major views on the financial Catastrophe of 2008, which wiped out twenty trillion dollars of hard-earned wealth:

1. ***The catastrophe was manmade, due to the failure of Experts including those at the helm of the Federal Reserve***. This is the majority view of the Financial Crisis Inquiry Commission (FCIC).

2. ***The root cause of the Catastrophe was US government housing policy that encouraged unscrupulous lending and borrowing, according to the minority view of the FCIC***. The minority FCIC view is equivalent to the majority view that the Catastrophe was manmade due to a failure of the Experts among the US Housing Policy body and lenders. The minority FCIC view mainly contends that the majority does not find the root cause of the Catastrophe. In any case, ***the FCIC is unanimous that Experts everywhere failed to see the Catastrophe coming and that the Catastrophe was indeed manmade.***

3. ***No one in the academy, government or Wall Street saw the Catastrophe coming***, according to the Federal Reserve ex-Chairman, Mr. Alan Greenspan.[12]

4. ***The Experts in the Academy of Finance and Economics and the top journals they control have not published research on a looming financial catastrophe.*** In their opinions published in New York Times after the financial meltdown, two winners of Nobel Memorial Prize in Economics have effectively concurred with Mr. Alan Greenspan that no one had forewarned the Catastrophe nor knew anything.[13] The Experts have rather produced a tome under the auspices of the Oxford

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[12] "Fed boss Greenspan says no one saw the crisis coming. Really?" The Telegraph, April 07, 2010, http://www.telegraph.co.uk/finance/financialcrisis/7564598/Fed-boss-Greenspan-says-no-one-saw-the-crisis-coming.-Really.html

[13] Noted New York Times columnist and Nobel Memorial Prize Winner, Paul Krugman, writes: "We weren't supposed to find ourselves in this situation. For many years most economists believed that preventing another Great Depression would be easy. In 2003, [Nobel Laureate] Robert Lucas of the University of Chicago, in his presidential address to the American Economic Association, declared that the "central problem of depression-prevention has been solved, for all practical purposes, and has in fact been solved for many decades." http://www.nytimes.com/2009/01/05/opinion/05krugman.html It was in 2003 when I had warned the Congress about a looming financial catastrophe if my proposals on safe banking and consolidated capital for bank holding companies were not adopted. I had, of course, challenged then that the vested interests would not let the Congress adopt the proposed policies until taxpayers lost trillions of dollars. My 2003 memo to the Congress is available here: http://pro-prosperity.com/Global%20Economy%20Chatterbox/Warning-USCongress-In-2003-On-Home-Mortgage-Debacle.html Nobel Prize Winner Joseph Stiglitz writes in New York Times: "The prospect of high compensation gave managers incentives to be shortsighted and undertake excessive risk, rather than lend money prudently. Banks made all these mistakes without anyone knowing, partly because so much of what they were doing was "off balance sheet" financing. http://www.nytimes.com/2009/04/01/opinion/01stiglitz.html It is not

University Press to ordain that the Catastrophe was a slap by the invisible hands (god).[14] This tome has been recommended by the current Federal Reserve Chairman. The experts have thus openly contradicted the findings of the FCIC that the Catastrophe was manmade (avoidable) due to failure of Experts. The Experts are obviously in denial that they failed.

5. As a researcher on optimal bank regulatory policies, ***I have written to the US Congress in March 2003 a memo on safe banking policies along with a published paper entitled "Safe Banking," in a journal not controlled by the Experts, for preemptive prevention of a financial catastrophe that I saw looming under the veneer of government-hooted economic growth***.[15]

   In fact, my book on the topic entitled "Prosperity: Optimal Governance (Banking, Capital Markets, Global Trade, Exchange Rates" was quite appreciated and considered publishable by the economics editor of the ***Cambridge University Press*** in 2003, but the principal of the press declined to have it in his list of published books. My book was later published in 2005 by ***Citizens Publishing***.[16]

   I sent my research-based policies directly to the U.S. Congress because the Experts had blocked publication of my research on ***safe central banking***, ***efficient resolution of moral hazard*** and ***optimal holding company organization and capital structure*** in the journals they controlled and because equilibrium policies emerging from these papers were vitally necessary to avert the looming Catastrophe I had presaged. I have continued to write several research-based policy memos to the Congress and Presidents in almost every year after my first memo submitted to them in 2003.

   The Congress has obviously valued my research by enacting in the Federal Deposit Insurance Improvement Act of 1991 an unprecedented bank foreclosure rule (minimum required threshold capital ratio for banks to remain open) based on a paper with J.F. Dreyfus published in the Journal of Finance in 1989. Perhaps due to their acknowledgement of my bank regulatory research, the Congress considered my 2003 memo and paper on ***safe banking*** seriously to ask the Federal Reserve to testify on safety and soundness of banks and then hold a conference among Experts later in that year. I too was invited to the conference. But the Experts had then, de facto, proclaimed invincibility of the U.S. banking system.[17] My research, however, differed from the

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true that no one knew, notwithstanding my Fed-mimeographed and widely circulated policy papers and heated discussion with top Fed and bank officials. Banks were doing everything with full knowledge and sanction of the regulators and the Experts to ordain a second-best society with a guaranteed first-best existence for themselves.

[14] See Gary Gorton's new book *Slapped by the Invisible Hand: The Panic of 2007* (Oxford University Press).

[15] http://pro-prosperity.com/Global%20Economy%20Chatterbox/Warning-USCongress-In-2003-On-Home-Mortgage-Debacle.html

[16] My computer was hacked in early 2009 and the hackers included Cambridge University Computer Center who hit my modem with throttle packets (every two seconds) to gain entry. The hackers had set a rule to eliminate my email correspondence with journal editors and publishers from my Outlook email server. I reported the matter to the FBI, Congress and President. The US government passed an anti-PC hacking law.

[17] The Experts' pronouncement was consistent with the prevailing hubris of the profession at that time: As written by Dr. Paul Krugman in New York Times: In 2003, [Nobel Laureate] Robert Lucas of the University of Chicago, in his presidential address to the American Economic Association, declared that the "central problem of depression-

view of the Experts at that time and thereafter. The findings of my research are based on the most general equilibrium model of economics ever scripted in the Academy. The Experts did not have any model to proclaim invincibility of US banks and financial institutions.

The minority FCIC view writes (page 45): "The conventional explanation for the financial crisis is the one given by Fed Chairman Bernanke in the same speech at Morehouse College quoted at the outset of Part II: Saving inflows from abroad can be beneficial if the country that receives those inflows invests them well. Unfortunately, that was not always the case in the United States and some other countries. *Financial institutions reacted to the surplus of available funds by competing aggressively for borrowers, and, in the years leading up to the crisis, credit to both households and businesses became relatively cheap and easy to obtain*. One important consequence was a housing boom in the United States, a boom that was fueled in large part by a rapid expansion of mortgage lending. *Unfortunately, much of this lending was poorly done, involving, for example, little or no down payment by the borrower or insufficient consideration by the lender of the borrower's ability to make the monthly payments*. Lenders may have become careless because they, like many people at the time, expected that house prices would continue to rise—thereby allowing borrowers to build up equity in their homes—and that credit would remain easily available, so that borrowers would be able to refinance if necessary. *Regulators did not do enough to prevent poor lending, in part because many of the worst loans were made by firms subject to little or no federal regulation.* "

The minority FCIC report then goes on to say (page 46): In other words, the liquidity in the world financial market caused U.S. banks to compete for borrowers by lowering their underwriting standards for mortgages and other loans. Lenders became careless. Regulators failed. Unregulated originators made bad loans. One has to ask: is it plausible that banks would compete for borrowers by lowering their mortgage standards? Mortgage originators—whether S&Ls, commercial banks, mortgage banks, or unregulated brokers—have been competing for one hundred years. That competition involved offering the lowest rates and the most benefits to potential borrowers. It did not, however, generally result in or involve the weakening of underwriting standards. Those standards—what made up the traditional U.S. mortgage—were generally fifteen- or thirty year amortizing loans to homebuyers who could provide a down payment of at least 10 to 20 percent and had good credit records, jobs, and steady incomes. Because of its inherent quality, this loan was known as a "prime mortgage."

The Federal Reserve, and the minority and majority of the FCIC have made correct conclusions about the Catastrophe. But they have only narrated the symptoms of the Catastrophe. They have essentially cried over the spilt milk without delving into how excess milk was produced. They have not explained how the credits expanded globally and how the US banks were permitted to take these credits as debt without raising enough capitals according to the FDICIA-1991.

In any case, the claim by the Experts and by the ex-Federal Reserve Chairman that no one saw the Catastrophe coming amounts to pure prevarication.[18] I wrote about it to the FCIC, President and Congressional leaders during the FCIC hearings. A prominent member of the FCIC, Senator Richard Durbin, has invariably responded to my memos. The US President and Treasury too have responded to convey thanks to my ideas and suggestions. The FCIC has kept unpublished about 300 documents and interviews to conclude its findings about the Catastrophe. ***The FCIC (majority and minority) has determined that the Catastrophe was manmade due to a failure of the Experts. This is consistent with my memos written to the FCIC based on my research and discourses with top executives in banks, Federal Reserve and rating agencies before the Catastrophe.***

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prevention has been solved, for all practical purposes, and has in fact been solved for many decades." http://www.nytimes.com/2009/01/05/opinion/05krugman.html

[18]See my memo on "Importance of Media and Truth for Capitalism and Wealth Preservation," May 4, 2010, sent to Congress and President, http://pro-prosperity.com/Media-and-Truth.html

III. Did the Experts Fail or Deceive People?

The Experts not only failed to presage the Catastrophe. They also abjectly shirked in their duties by rejecting papers (that I had submitted to the journals they controlled) which not only presaged a looming crisis but also obtained equilibrium policies to avert it based on a more general model than ever scripted by any other in the Academy:

1. The Experts have found no error in my model or in any of my theorems and proofs.[19]

2. Neither have the Experts claimed that my research findings were not based on a more realistic general equilibrium model of the economy than ever scripted by any other in the Academy.

3. The Experts have not refuted my claim that my model is more general than any other ever scripted in the Academy on a microeconomic foundation for derivation of macroeconomic policies for constitutionally efficient governance of an economy.

4. A general microeconomic model to derive macroeconomic policy is, per se, significant due to the absence of rigorous macroeconomic models in the extant literature. Most macro policies have been based on ad hoc (guesswork) models which have failed. I have demonstrated before the onset of the crisis and have been proved right soon afterwards by the actual actions of the Federal Reserve about how the Fed macroeconomic (econometric) model has blundered in setting interest rates usuriously and illegally in the U.S.[20]

5. Reduced forms of my general equilibrium model yield the extant literature's narrower, myopic and unrealistic models, which the Experts have used to make claims to perpetuate their self interests.

   One such claim stemming from myopic, narrower models in the extant literature is that moral hazard in banking and financial markets can yield only second-best equilibrium outcome. This means that bankers can continue gambles to privatize profits and socialize losses. Socialization of losses means that the vast majority of effective producers of merchandize and service lose in the banking gambles. The producers are forced to bail out the losing banks when gambles turn sour. The failed banks seek new funds that the Fed supplies by printing new money or the Treasury gives through borrowing and new taxes. The producers lose once again due to new taxes or due to inflation caused by the printed new money. The Fed ironically lowers interest rate to recover a depressed economy, which essentially forces savers to lend their funds at no cost to the banks for gambling once again. The cycle repeats until it explodes into a Great Depression or a Great Recession. Policies based on narrow, myopic models have won Nobel Memorial Prize in Economics, instituted by a bank!

[19] See the attached referee reports.
[20] See my memos compiled in a paper, entitled, "Constitutional System of Money and Finance," "http://pro-prosperity.com/Research/Constitutional-Monetary-Finance-System.pdf

My research proves that such claims - stemming from narrower, myopic models - are economically inefficient and unconstitutional within a more general model which represents the real economy more accurately. In a more general model of the economy, my research proves the existence of a first-best solution (efficient resolution) to the moral hazard problem and shows that this solution is constitutional and economically efficient. The referee reports show that the failed Experts cannot digest this profound result stemming from a more general and realistic model, which indeed offers a formal economic paradigm to fulfill the constitutional dream of the founding fathers for a first-best society. Policies based on general equilibrium can only achieve stability mandated by the constitution. By rejecting my research, the failed Experts have thus precipitated instability, unconstitutionally.

6. The failed Experts championing second-best solutions have basically ordained (by influencing the Congress through publications in their controlled "top" journals) a second-class existence for the vast majority of effective producers of globally competitive merchandize and service who prop national competitiveness and currency. These Experts and their cohorts in Wall Street just want to remain entrenched in wealth and power by perpetuating an unconstitutional system of money and finance which is inefficient and detrimental to national competitiveness. They are hell-bent on suppressing the truths, discovered through research by rejecting publication of my papers in the journals they control.

7. The failed Experts have engendered a second-class status for society by (a) rejecting publication of truths on existence of first-best (efficient) constitutional policies discovered in my research in their controlled journals via a blind review process they have ordained, (b) instituting a promotion and remuneration system in profession-centric university departments to subjugate and eventually eliminate researchers like me who discover first-best (efficient) constitutional policies by (i) not publishing such research in their controlled journals and (ii) promoting to positions of power only those individuals whose research kowtows with the second-best theory or who are incapable of challenging the decree of the Experts.

8. The failed Experts have thus established a "fail-safe system" to purge the opponents of their doctrine - which guarantees first-best existence for themselves and second-best survival for the effective producers in society. This allows them to continue living a first-class existence by subjecting the society that props them to a second-class survival. They have done so by effectively propagating mere falsehood via their mumbo-jumbo economic models published in their controlled journals which systematically and deliberately reject publication of truths antithetic to their established positions. This is why their controlled journals have failed to publish papers written by a researcher in the Academy who has not only presaged the Catastrophe but also proposed policies to avert the crisis preemptively. The Experts have not only failed, they have also deceived the Academy, people and the nation whose support they, ironically, bank on to become experts.

Silver Linings in the Dark Cloud of Expert Failure

1. Fortunately, the fail-safe system established by the current experts has proved to be unsustainable within a constitutional democracy. The failed Experts have been already exposed. The Experts

have so far remained nonchalant for making their Academy a fountain of falsehood. But the Academy will wake up to correct the system of selection of Experts.

2. The blind review process is proved to be unconstitutional, inefficient and detrimental to national competitiveness.[21] The ability of failed Experts to perpetuate their first-best existence by ordaining a second-best society can be foiled only by supplanting the blind review process with open reviews of academic papers. Only the open review system will make the reviewers rejecting truths discovered in research accountable to society.

3. True Experts emerging in an open review process will not fail to protect the hard-earned wealth of the effective producers of globally competitive goods and services that prop a nation and its currency. There should be no hesitation of intellectual leaders to accord their reviews openly.

The above arguments show that the current Experts are not interested in discovering and propagating truths discovered in research, which is a unique uncompromising mission of the Academy. They are rather hell-bent to protect their own views to perpetuate their self-interests by propagating myths based on narrow mumbo-jumbo models, which do not represent the real world economy. The Academy has to remain a fountain of truth to serve the best interests of society that props it. Not even the powerful Experts can perpetuate their expertise for long by continuing to bite the hand that feeds them. The current Experts have failed for not recognizing this truth. They have deceived the Academy, the nation and the people.

IV. Determining the Root Cause of the Financial Crisis

The minority FCIC view criticizes the majority's conclusions for not pointing out the true causes of the Catastrophe. The minority FCIC report presents the root cause as the US Housing Policy triggering unscrupulous lending and borrowing. But no US Housing Policy can force borrowers to receive funds unscrupulously if the lenders did not have sufficient credits to lend. By blaming the US Housing Policy, the FCIC (minority or majority) has not really uncovered any mystery about how credits were abundantly created, globally, for such credits to flow to the US banks to lend the same frivolously. Neither has the FCIC uncovered how the US banks took the abundantly supplied credits as their debts without raising their capitals.

Furthermore, the FDICIA-1991 stipulates regulatory minimum bank capital requirements. If the banks got enormous credits as new debts, how did the regulators allow the banks to take such huge debts without raising their capitals?

Conclusions like the US Housing policy prompted unscrupulous lending and borrowing (as the FCIC minority view suggests) or that the Experts failed (as the majority FCIC view emphasizes) obfuscate the real truth about how a manmade (avoidable) Catastrophe occurred.

My research shows that the financial Catastrophe occurred because of the following:

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[21] See "Blind Review of Academic Papers Unconstitutional and Detrimental to National Competitiveness," http://pro-prosperity.com/Blind-Review-Academic-Papers-Unconstitutional-Uncompetitive.html

1. **<u>The prevailing unconstitutional and inefficient system of money and finance</u>** ordained by the Masters of Universe – the failed Experts and their cohorts Wall Street and elsewhere - is creating massive credits for the Masters by depriving the effective producers of globally competitive merchandize, service and creative ideas.

   As a vivid example, my remuneration is hardly 25% of that of the failed Experts, one average. I have been stuck in a position of Associate Professor. I had this rank in my first job at the age of 24, when a Director (Dr. N. K. Jain) at the Council of Scientific and Industrial Research in India hired me. Dr. Jain was a Ph.D. from the University of Illinois at Urbana-Champaign and was an eminently learned person.

   Enhancements in pays and position appropriate for me in lieu of the enormous contribution of my research to my Academy and country have been obviously usurped by the failed Experts and their cohorts in my department due to their power to ordain an unconstitutional and inefficient (second-best) system for the country by systematically rejecting the truths I have discovered and pursued for establishing a first-best or economically efficient constitutional economy. My previous department head has stated that he has no basis of evaluation of my unusual research for five years and then wrote to the dean that I have done no research in finance. That dean has left, but only after making this head the Associate Dean for Academic Affairs and bringing in a new head of finance department who has just written that my research is unsatisfactory because of lack of any analytical foundation. No department in my college of business was willing to hire the new head of finance, but the then Associate Dean of Academic Affairs had made an offer without any departmental votes that the college was bound to honor that offer. Before departing the college of business, the dean has not only accepted the previous finance head's statement that I had done no research in finance during the last five years, but also foisted a new head of the finance department who would trash my research and still earn more than two times of my salary. I will not be surprised if such usurpation is the norm elsewhere.

2. **<u>Regulatory permission to bank holding companies to take the abundantly supplied credits as new debts even by transgressing the FDICIA-1991 through multi-leveraged holding company structure</u>**. Such permission was contrary to my research on minimum consolidated bank capital for bank holding companies mimeographed at the Federal Reserve in early nineties and argued with top bank and Fed officials during my tenure at the Fed during those years, as detailed earlier.

3. **<u>Suppression of truths discovered in my research</u>** that (i) proves unconstitutionality and inefficiency of the current system of money and finance (ii) shows the existence of an economically efficient constitutional system of money and finance, and (iii) that obtains a regulatory minimum consolidated bank capital requirement that would not allow the bank holding company structure to transgress minimum capital rule enacted in the FDICIA-1991. The previous section shows how the failed Experts have blocked publication of this research.

My research did not merely focus on finding the sources (root causes) of a looming financial crisis. It was also about averting a looming crisis through preemptive policies for governance of banks and capital markets, obtained within a general equilibrium model of the economy, which the Experts have been attempting to bury by purging me from the Academy. It is, therefore, important to examine whether a resourceful and powerful FCIC–with all the Experts at its command–has really succeeded in determining the root causes of the Catastrophe or it has simply narrated some symptoms of the crisis to bury the truths discovered in my research. This examination is crucial to establish the veracity of my claims about my research. It would also determine the capability of powerful Experts in burying fundamental truths discovered by a scholar.

I have recently had an opportunity of a conversation with the author of the FCIC minority report, Mr. Peter J. Wallison.[22]

i. Neither in the verbatim conversation with the author of the FCIC minority view nor the minority report itself answers how the US Housing policy could force banks to lend if the banks did not have the credits available to lend.

ii. The minority report posits that credits flowed from foreign countries to the US banks. It says that such credit flows prompted US banks to lend frivolously to unscrupulous borrowers due to the US Housing Policy. But Mr. Wallison gave up the conversation when I asked how credits expanded globally to flow to the US banks and how the traditionally responsible US banks could be frivolous.

iii. Mr. Wallison could not answer how even the mighty U.S. Congress could, to say figuratively, force the bulls (banks) to produce milk (lend irresponsibly).

Unscrupulous lending and borrowing obviously occurred before the Catastrophe precipitated. According to the UK Prime Minister Gordon Brown's column published in Washington Post in October 2008,[23] undisclosed and irresponsible lending by banks to privately-held hedge funds caused the crisis. I had already written a paper in October 2007 to the US President and Congressional leaders about how lending of taxpayer insured funds and Federal Reserve created funds through banks to privately held hedge funds was financially suicidal to taxpayers.[24] This paper was widely circulated among G20 countries. Mr. Gordon Brown's Washington Post column and the Volker Rule introduced by President Obama to stop proprietary trading by banks are obviously based on my 2007 paper, because literature or news report predates my 2007 paper. In fact, my 2007 paper on clandestine lending must have induced the Congress to ask the Government Accountability Office to produce a paper, which was complete in early 2008, to show enormous risk to taxpayers due to such clandestine lending as I had first written in late 2007. This must have led Mr. Henry Paulson, the then US Treasury Secretary, to clamp down on lightly capitalized and ultra-leveraged bank holding companies.

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22 See the attached conversation with Mr. Peter J. Wallison, the Arthur F. Burns Fellow in Financial Policy Studies at the American Enterprise Institute, a member of the Financial Crisis Inquiry Commission who dissented from its majority report.

23 See "Out of the Ashes" by U.K. Prime Minister, Washington Post, October 17, 2008, http://www.washingtonpost.com/wp-dyn/content/article/2008/10/16/AR2008101603179.html

24 See "Sub-optimality of Lending Taxpayers' Money to Hedge Funds," http://pro-prosperity.com/Research/Sub-optimality%20of%20Lending%20Taxpayer%20Funds%20to%20Hedge%20Funds.pdf

The unscrupulous lending and borrowing cannot explain how the current system creates enormous credit for some by squeezing out the vast majority of effective producers of globally competitive goods, ideas and services. In accounting terms, the total credit must always equal to the total debt in an economy. Without knowing how credit grows, one cannot explain how borrowers can borrow unscrupulously. The root cause of the meltdown can be understood only by figuring out (i) how credit expanded and (ii) how the thinly capitalized banks lent the expanded credit.

My research shows that credit expanded through unconstitutional usurpation, globally, and banks lent the unconstitutionally expanded credit through a multi-tiered capital structure to benefit the privately held hedge funds.[25] My research proves that this system is unconstitutional and economically inefficient. It is detrimental to national competitiveness. It creates more billionaires even after financial meltdowns.

The old bank subsidiary-based minimum capital norm permitted the BHCs to leverage their holding company structure to expand their credit multi-fold by violating the minimum regulatory requirement on a consolidated basis and by imputing enormous financial risk on taxpayers.

1. My co-authored research published in the Journal of Finance in 1989 obtained an unprecedented equilibrium preemptive rule to foreclose banks whenever the capital levels of a bank fell below a minimum threshold.

2. This bank foreclosure rule was promptly enacted by the US Congress in 1991 and later adopted in the Basle Accords.

3. This research induced the Federal Reserve to ask me to join the Fed. I took a two year leave of absence from the NYU, but stayed on at the Fed for more than five years. I had discovered during those years and in meetings with senior bank executives that they had effectively transgressed the bank foreclosure rule via the holding company structure.

4. I wrote many papers on minimum capital requirements based on consolidated capital of bank holdings companies who then exhibited heated opposition to adoption of these results and received the support of Fed officials. I had to leave the Federal Reserve to communicate with the Congress the equilibrium results with all the logics of economics articulated in plain English. It took me many years to articulate in plain English my own dynamic stochastic programming model of a game among leveraged, profit-maximizing companies operating with potentially more information than others in a free-market economy without government intervention except enforcement of constitutional laws. I spent most of my time analyzing how the mega players have traded in the markets they have designed and controlled and how they could make enormous profits while 99% of mutual funds underperformed according to academic research and how the prominent academic researchers (Experts) were eerily silent about the remarkably unconstitutional and inefficient system I had uncovered. More importantly, I learned about moral hazard seeping through the Academy when the scholars I had immensely respected were frivolously rejecting profound results obtained in my research.

[25] See "Constitutional System of Money and Finance," http://pro-prosperity.com/Research/Constitutional-Monetary-Finance-System.pdf

5. The 2008 financial meltdown was due to (i) a mass failure of bank holdings companies' multi-leveraged capital structures and (ii) the Academy's deliberate suppression of my research, now christened as ***Optimal Holding Company Organization and Capital Structure under Constitutional Governance***.[26]

6. The only thing the media now publishes about the gargantuan Expert failure is that the government regulators had no rules or tools to regulate the bank holding companies. The Financial Crisis Inquiry Commission (FCIC) has concluded in its majority report that the 2008 crisis was manmade, the Federal Reserve Board was responsible for it, and that the Academy's experts failed to presage it, let alone prescribe preemptive policies to avert it.

7. The new rules-tools (obtained in my research) were indeed adopted before the actual crisis engulfed the US economy in 2008. Here are the events: The US Treasury Secretary in early 2008 admonished the bank holding companies publicly that they raise their capital ratios, lest they would face shutting down by the government. The warnings were issued directly after publication of a Government Accountability Report in early 2008 which (using internal bank-specific data) confirmed my research findings on how the BHCs' multi-leveraged capital structure was piling enormous risk on the taxpayers. I had informed the Treasury in late 2007 about this research for which they had sent me a "thank you" note. The new rules-tools were adopted in the Dodd-Frank Financial Regulatory Bill passed in 2010, but only after the Americans lost more than twenty trillion dollars of their wealth.

8. The Experts have won Pyrrhic victory over suppression of truths discovered in my research! The Experts are earning salaries and perquisites which are multiple times of my emoluments. They have failed according to the Congress instituted-FCIC in performing their duties. Their teachings cannot have constitutional or economically efficient foundation, unless they cite my research. The Experts are economically inefficient and detrimental to the competitiveness of a nation that supports them. They are still in a state of denial. It is not in their interest to accept the truth that my research has proved that the system they have professed with their research and benefited enormously from is unconstitutional and economically inefficient for the nation. The truths discovered in my research debase their views crafted by their research. The truths I have discovered debase their stand in society. Their self interest prevents them from publicizing these truths I have discovered by accepting my papers for the journals they control. Using their prejudiced judgment to assess my research or career is detrimental for a public university, the state of Illinois and the nation.

V. Normative Nature of My Research

If the truths discovered in my research were accepted by journals and publishing houses controlled the Experts, the US Congress would have adopted them into law on time and the Americans would have not

[26] http://pro-prosperity.com/Research/OptimalHoldingCompanyOrganizationCapitalStructure.pdf

lost twenty trillion dollars of their hard earned wealth and the US economy would not be in shaky grounds. The US Congress and even the real world like normative policies or formulas:

i. <u>Normative or prescriptive policies</u> through a general equilibrium are very hard to obtain. For example, despite vast resource and talent, the Academy of Economics and Finance has not yet discovered normative policies for corporate dividend payouts or capital structures.

The Academy has produced widely accepted norms to price derivative securities, relative to the fundamental securities. But models for pricing of fundamental securities (Capital Asset Pricing Model and Arbitrage Pricing Theory) have been resoundingly rejected by data.

If the fundamental securities are mispriced because of the inability of the Academy to produce a normative pricing model that proves effective with real world data, the derivative securities too will be mispriced. Such mispricing bedeviled the markets in 2008: The Credit Default Swaps (which are put or default options on fundamental mortgage securities) were severely underpriced by AIG. This prompted Goldman Sachs to buy a lot of CDS from AIG. AIG went broke when mortgage defaults swelled. Goldman Sachs sold mortgage securities short to increase the value of its CDS with AIG. AIG eventually lost its funds and could not honor all its guarantees to Goldman Sachs. The Federal Reserve bailed out AIG, which then paid off its CDS underwriting obligations to Goldman Sachs. <u>**This shows how mispricing of the fundamental securities (like mortgage loans) can severely misprice the derivatives based on them (like the CDS) and the capital markets can nosedive to cause a financial depression for all**</u>. The Nobel Prize winning derivative pricing model of the Academy failed because the other Nobel Prize winning models for fundamental security pricing (CAPM and APT) never worked.

ii. The fundamental security pricing models are theoretically based on valuation of a <u>portion of total risk</u> of a security. The portion of total risk that is priced by these models and that forms the prevailing wisdom in investment and trading by the vast majority of mutual funds and traders everywhere (who have learned the skills from the Experts in the Academy) is called <u>market risk</u>. The extant wisdom, spread by the Academy based on publications of books and journal articles, prices only the market risk by leaving behind a part of the total risk (called <u>unique risk</u>) as not valuable in equilibrium.

iii. <u>**My research, based on a more general model of the economy, shows how the total risk (market risk and unique risk) is valuable in equilibrium**</u>. This is unlike the extant models in the Academy that spread wisdom for the vast majority through journal articles and books written by failed Experts and promoted by publishing houses controlled by the mega traders. By suppressing the wisdom discovered in my research (that the total risk of a fundamental security is valuable), mega traders can continue trading on the valuable total risk to gain from the vast majority of investors and traders, who are hooked on trading based only on market risk due to the prevailing Academic wisdom gained from publications and teachings of failed Experts.

iv. The mega traders have succeeded so far in inducing the failed Experts to continue their sway over the Academy with quid-pro-quos like heavily endowed professorships and generous consultancy assignments. The Experts ensure to penalize and purge me for uncovering the truth about valuation of total risk in a more general equilibrium model to benefit the vast majority of investors, pension plans and mutual funds. This shows how and why the mega traders, their endowed Experts and their controlled publishing houses are not swayed by the Academic mission of discovering and publishing truths to benefit the nation and people who prop even the experts. They are driven only by their vested interests. They are, therefore, not publishing my research which has discovered profound normative rules for pricing and governance in a general economic equilibrium model to broaden the Academic and common wisdom for investment and trading through valuation of total risk of securities. The normative rules discovered my research shall establish a free and fair market with the same wisdom available to all. The fairness (equality of law under the constitution) is not desirable to the mega traders.

v. The U.S. Congress has quickly adopted the <u>normative bank foreclosure</u> rule discovered in my research with Dreyfus as soon as the paper was accepted by Experts in 1989. The Congress even asked me then to consult on setting optimal policies for governance of Fannie Mae and Freddie Mac. Even my internal Fed memo on a <u>normative incentive compatible mechanism</u> for estimation of loan loss reserves by banks was quickly adopted by the Congress and Basel Accords among banks. After receiving my paper on Safe Banking in 2003, the US Congress had asked the Fed to testify and hold a conference of Experts on safety and soundness of banks. My Safe Banking paper grew out of my research that was blocked by top journals controlled by the Experts. People and governments need normative policies and formulas uncovered in general equilibrium or robust models. But, to preserve their self interests, the failed Experts have deceived the Academy, people and governments by denying publication of normative policies that I have discovered in more general equilibrium models.

vi. The Experts have so far used publications in top journals controlled by them as instruments to convince the Congress for policies. On one hand, they blocked my research on capital norms for bank holding companies and for efficient resolution of moral hazard in banking, which I had discovered and pursed with the Congress before the Catastrophe. On the other hand, they testified before the Congress that the banking system was safe and sound, before the Catastrophe. Their obvious strategy is very clear: to have first-best existence for themselves and their cohorts with preordained second-best existence for the effective producers of global competitive merchandize, services and ideas.

VI. Conclusion: Course of Action for the Academy and Nation

The Academy is a fountain for discovery and propagation of truths through research. The Academy of Economics and Finance has succeeded in its mission as my research has discovered profound truths in a more general equilibrium model of the economy than ever written before. But the normative equilibrium policies, which I had obtained before the financial Catastrophe of 2008 like <u>safe central banking</u> and <u>minimum consolidated capital for bank holding companies</u>, were adopted by the US government only after the Catastrophe.

The Federal Crisis Inquiry Commission (FCIC) has found that the crisis was manmade (avoidable) due to a failure of Experts including those at the helm of the Federal Reserve.

This FCIC finding is consistent with my experience of how the failed Experts, controlling top journals and book publishers, have denied publication of profound normative policies discovered in my research. The failed Experts are now attempting vigorously to bury the truth that my research had discovered before the Catastrophe normative policies which could have averted the crisis and which were indeed adopted by the government after the Catastrophe. The failed Experts hope to purge me from the Academy because they continue to reject my papers through their ordained blind review system to prompt their cohorts in the profession-centric departments to deny me promotion and salary raise to frustrate me enough to leave the Academy.

The Academy, nation and people are facing real grievance due to such shenanigans of the failed Experts. The US economy was severely struck by a financial Catastrophe in 2008 because the Experts prevented adoption of the same normative policies (as the government adopted after the Catastrophe) which I had discovered before the Catastrophe in an equilibrium within a more general model of the economy than any other existing in the extant literature and pursued with the Congress to avert the crisis preemptively. The Federal Reserve has characterized the Catastrophe of 2008 as worse than the Great Depression. The US economy is in severe doldrums despite the Federal Reserve printing trillions of dollars and keeping the interest rates at historical lows. The federal and state governments are facing serious budget deficits due to a rapid decline in taxes after unemployment rose and incomes fell.

My research and experience in the publication process vividly shows how the Experts and their patrons controlling the journals and publishers have deceived the academic mission to discover and propagate truths through research to serve the Academy, people and nation that prop even the Experts. My research shows how the Experts and their patrons benefit immensely from the prevailing system of money and finance and why their self-interest dissuades them to publish my research, which proves this system as unconstitutional and inefficient and obtains a new economically efficient and constitutional system.

The failed Experts have succeeded to perpetuate their shenanigans because they have established a system to control the Academy through blind reviews to purge scholars whose research challenges the existing system and to create new Experts who guarantee the preservation of status quo. This established system imposes serious grievances on people, the nation and the Academy-like the Great Depression and an impending new Depression after the Great Recession of 2008.

The only way to extricate the nation, people and Academy from the shenanigans of the failed Experts is to establish a **Center of Constitutional Capitalism**, founded on the truths discovered in my research on economically efficient constitutional governance. But the CCC can succeed only if my position and remuneration dovetail with the immense contribution of my research, as compared to the failure of the established Experts. The failed Experts obviously have no locus standi to pass judgment on my immensely successful research. Success of my research can be credibly judged by what the nation and society have gained and how much more they could have gained without the failed Experts' shenanigans.

My timely and persistent pursuits directly with the US Congress and Presidents have indeed exposed the Experts' shenanigans. Without such pursuits, the failed Experts, backed by the recommendation of the current Federal Reserve Chairman for their tome on "Slapped By Invisible Hands" published by Oxford University Press would have forced people to believe that the Catastrophe of 2008 was a slap by the invisible hands (god), not manmade (avoidable) as pronounced by the representatives of people. Had I been given a raised Academic position and an official center like CCC, my pursuits on time could have persuaded the Congress to preemptively adopt the rules emerging from my research to save the lost trillions of dollars of hard earned wealth.

The nation will not succeed until the Academy stands up to wean the control away from the failed Experts by establishing a CCC founded on the truths discovered in my research on an economically efficient and constitutional system of money and finance, in order to facilitate emergence of true Experts in finance and economics to guide the economy successfully. It is telling that the Director of the European Center of Economic Research has expressed an interest in collaborating with me.[27] He has expressed liking for my paper on economically efficient constitutional governance, but has also stated that my paper leaves little undone for collaboration, except maybe just testing of my model. This research has been consummated and cannot be recreated in a different form for the Academy and the nation to move on after purging me. The Academy cannot teach constitutional and efficient system of money and finance without my research. It is necessary for the Academy to found a CCC on my seminal research. I have to state this truth at a cost of sounding selfish because my mission of serving the Academy, nation and people is genuine, as credibly demonstrated so far.

[27] See the attachment.

My email response to International Economic Review

Dear Professor Cole,

Discovery of truths - for example, (i) proving economic inefficiency and unconstitutionality of the current system of money and finance and (ii) obtaining an economically efficient constitutional system within a general equilibrium model - is scientific.

What is unscientific? Suppression of the discovered truths by stating falsely that the discovered truths are unscientific.

This paper really has a more general model of economics than any ever written with a micro-economic foundation to determine macro-economic policies which are very profound to the economies worldwide.*

The paper is filled mostly with theorems and proofs to obtain many significant results in equilibrium.

It is unconscionable that such a paper is rejected because some statements sound to the referee as "unscientific" and "controversial."

The proofs of the theorems are either right or wrong. I know they are right because I have numerically demonstrated the existence of the equilibrium results and plotted graphs to show that they are accurate; this extra work is available on request. No one (including the referees of the top journals) has discovered any error in the proofs or in the economic intuition behind the results.

So, what is "controversial" or "unscientific" about any theorem or proof in the paper?

Theorems/proofs/results cannot be unscientific. An author who has published significant papers in the IER as well as in the Journal of Finance does not like making unscientific statements. Please present any example of an unscientific statement that is not strictly based on the results/proofs/theorems. I would be more than willing to eliminate those statements if you agree to publish the paper.

I must tell you frankly, Professor Cole, that the U.S. Congress has already pronounced "uselessness" of economists because none of the top journals in economics or finance published any article that saw the financial crisis, which has been described by the Federal Reserve as worse than the Great Depression, let alone prescribe preemptive policies to avert the crisis. These journals were indeed presented with research (by yours truly) that not only foresaw the crisis, but also proposed preemptive policies to avert the same. They rejected this research simply because its general model debases their views derived from their narrower models, exactly the same way as the IER is doing now (unless you amend your views).

It is ironical, if not mind-boggling, that the profession of finance-economics is taking flak for not being able to presage the crisis, let alone prescribe preemptive policies to avert it, despite highly paid researchers controlling "top" professional journals, while the truth is that the research that would have brought immense repute to the profession is being rejected simply because it debases the views that some authors have formed and propagated by using their narrower models.

The attached memo describes a forthcoming financial tsunami; the White House and US Treasury have responded to thank for the ideas and suggestions.

I strongly urge you to change your view based on the reality that my model is more general than ever written in the fields of finance and economics offering a micro-economic foundation to develop profoundly important macro-economics policies.

With best regards,

Professor Sankarshan Acharya
Director, Center of Constitutional Capitalism

*Hundreds of copies of this paper are being downloaded worldwide from pro-prosperity.com, mostly by educational institutions and governments. The International Economic Association, European Financial Management Association and the World Conference have included the paper in their forthcoming conferences with special notes of interest from the chairs.

Referee report for manuscript 23420

Dear author, after reviewing your manuscript these are my comments:

- The manuscript reads more like an essay than the style of the papers published in a journal like the IER.
- The topic is very interesting but the approach to the topic is not entirely economic. It seems to me that this manuscript would be a better fit in a journal more focused in topics that combine law and economics.
- In my opinion, the language of some of the comments is not stated in a scientific way and appears controversial.

INTERNATIONAL
ECONOMIC
REVIEW

3718 Locust Walk
University of Pennsylvania
Philadelphia, PA 19104-6297
Telephone: 215 898-5841
Fax: 215 573-2072

April 5th, 2011

Professor Sankarshan Acharya
Department of Finance
University of Illinois at Chicago
17636 W Neuberry Ridge Dr
Lockport, IL 606441

MS # 23420 "An Economic Theory of Constitutional Governance"

Dear Professor Acharya:

I am sorry for the delay in reaching a decision on your submission. Unfortunately, I had three referee requests on it refused, and then just recently, an individual who had agreed to referee decided after some delay that he could not do it. I have one referee report on your paper "An Economic Theory of Constitutional Governance" which is quite negative. I have read your paper myself, and have concluded that it is not well suited to a top general interest economics journal like the *IER*. Therefore, I have decided to reject your submission.

Given that space constraints are especially severe for a general audience journal like the *Review*, and not having a more enthusiastic report, I have decided not to seek a revision. I am sorry to have to relate this news. I hope you find the referee report of value and that you will continue to think of the *Review* as an outlet for your work.

Sincerely,

Harold Cole

Harold L. Cole
Editor, *IER*
Email: ier@econ.upenn.edu

ECONOMETRICA

PUBLISHED BY **THE ECONOMETRIC SOCIETY**

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www.econometricsociety.org/thejournal.html

October 26, 2010

Professor Sankarshan Acharya
University of Illinois at Chicago
Department of Finance
Lockport, IL 60644

Dear Sankarshan,

I am sorry to report that the editorial board of *Econometrica* has completed its review of your paper, MS# 9615-1 "An Economic Theory of Constitutional Governance" and that we have decided that we will be unable to publish the paper.

Please do not take the very rapid decision as a more severe criticism of your work than the ordinary rejection after four months. We can only accept a very small fraction of submissions. The quick rejection simply reflects the fact that a member of our board was able to consider the paper and make a decision as soon as the paper arrived.

Please accept my apologies for not providing reports explaining the decision. This does not reflect that we did not consider the paper seriously. It indicates that the paper was read personally by a member of our editorial board rather than by an outside referee.

I would like to be able to give every author useful critical feedback. Let me explain why we have nonetheless adopted the practice of rejecting a substantial number of papers without sending reports. There are two difficulties with sending out for reports on all papers. First, many authors end up wasting months waiting to hear a decision that could have been made in a day. Second, the services of very good referees are in limited supply and we feel it is important to avoid abusing this resource, and to avoid the alternative of using mediocre referees which we feel does not achieve anything better than a rejection of this form. We believe that members of our editorial board will have more time to read papers and can read more papers personally if they are allowed to recommend that a paper be rejected without taking the time to write a report for the authors. We only do this if the member of the editorial board (often me or a coeditor, sometimes an associate editor) is able to read the paper immediately upon receiving it and is confident in his or her assessment. I feel that this system results in us doing better assessments (because more papers are being refereed by the people we trust most) and providing faster feedback. Many authors agree that it is far better to hear bad news right away than to wait six months for a decision. It is a drawback of this system that authors do not get feedback on why the paper was rejected. I have chosen to accept this drawback because I think the system improves the quality of our review process, because there are a large number of economics journals that provide reports on (almost) every submission and for authors who particularly desire feedback, and because I do not think that it is feasible to provide reports on the papers we reject immediately – this is where the process saves time. If I required reports with an immediate rejection, the coeditors and I would just go back to waiting for reports before reading papers and associate editors would go back to putting newly arrived papers on the bottom of their pile. In most cases we are not rejecting papers because they have a particular flaw.

Again, I am sorry to have to give you the bad news. I thank you for giving us the opportunity to consider your paper and wish you luck in finding an alternate outlet for your paper.

Sincerely,

Stephen E Morris

Stephen Morris, Editor
Econometrica

From: "Acharya, Sankarshan" <sacharya@uic.edu> Subject: Re: RFS/NYU/NY Fed Conference Dual Submission Date: Fri, October 15, 2010 10:17 am To: "Alexander Ljungqvist" <aljungqv@stern.nyu.edu>

Dear Professor Ljungqvist,

The paper rejected earlier by the RFS had a different title, "Optimal Holding Company Organization and Capital Structure," and the one submitted for the FRBNY-RFS conference was "Optimal Holding Company Organization and Capital Structure under Constitutional Governance." So, the newer paper technically was different with a new focus, though with the same underlying math. The other paper "An Economic Theory of Constitutional Governance" was never submitted in any form to the RFS, until I sent it to the FRBNY-RFS conference.

What I have stressed in my previous email is the non-consideration of a paper for review and returning the fees out of anger, or frivolous/cursory "reviews" or whatever on the part of the editors. If it does not bother the editors, it is their prerogative.

Sincerely,

Professor Sankarshan Acharya
University of Illinois at Chicago

On Fri, October 15, 2010 2:42 am, Alexander Ljungqvist wrote:
> Dear Prof Acharya:
>
> Thank-you for your email. If your paper was previously rejected at the
> RFS, as you now say, then of course it should not have been submitted for
> dual-review at this conference. The rules on this were quite clear. Here's
> the relevant rule from the Call for Papers:
>
> "3. Papers submitted for dual consideration must not be under review at
> another
> journal or the RFS, nor can they be considered for dual submission if
> previously
> rejected by the RFS."
>
> I'm sorry if there was a misunderstanding by you or one of your
> co-authors. The submission was reviewed by us on the understanding that it
> conformed to usual publication practices.
>
> Yours sincerely,
>
> Alexander Ljungqvist
> Editor, RFS
>
>
> ----- Original Message -----
> From: "Sankarshan Acharya" <sacharya@uic.edu>
> To: "Alexander Ljungqvist" <aljungqv@stern.nyu.edu>
> Cc: sacharya@uic.edu
> Sent: Friday, 15 October, 2010 00:44:50 GMT -05:00 US/Canada Eastern
> Subject: Re: RFS/NYU/NY Fed Conference Dual Submission

>
> Dear Professor Ljungqvist,
>
> Actually, this paper on Optimal Holding Company Organization and Capital
> Structure WAS REJECTED by a previous editor of RFS. He did not even get
> it reviewed and returned the submission fee!
>
> This paper grew out of my direct experience at top banks and at the
> Federal Reserve. The banks and regulators colluded officially to mask the
> minimum bank capital requirement, set by the FDICIA-1991, via firewalls of
> the bank holding company structure.
>
> Regulators permitted BHCs to not necessarily have the FDICIA minimum
> required capital on a consolidated basis, as long as their subsidiary
> banks had the minimum capitals. I knew the serious problem directly since
> 1994 at a top level meeting with bank executives and regulators. It was
> then that this paper was first written to show the existence and
> optimality of the holding company structures and then to evaluate the
> minimum capital requirement on a consolidated basis.
>
> The Congress had indeed enacted, in FDICIA-1991, an unprecedented bank
> foreclosure rule based on my research published in the JoF and had even
> consulted me at that time.
>
> When I knew of the transgression of the FDICIA-1991 foreclosure rule via
> the BHC structure in 1993-94 in a top level meeting, I has directly
> confronted with top bank executives and Fed officials about the violation.
>
> The Federal Reserve then constituted a BAND of "researchers" in league
> with the academy to reject my papers with frivolous referee reports or
> with no report at all. The band colluded even to block presentations of
> my papers at major conferences to mask the regulatory-banking shenanigans.
>
> So what happened? The BAND abjectly failed to block the truths discovered
> by my research. I got a letter from the U.S. Treasury in 2007
> appreciating my research on the need to set minimum capital requirement on
> a consolidated basis, and on a number of other rules. The Treasury
> Secretary then goaded all banks to raise sufficient capital, starting late
> 2007 and early 2008. Those tottering banks that could not raise
> sufficient capital or did not receive government support failed.
>
> At least $20 trillion dollars of wealth has been wiped out worldwide.
> Investors have lost trust with banks, Wall Street, regulators and the
> academy that failed spectacularly to foresee the crisis, let alone propose
> preemptive policies to avert the financial meltdown. The BAND suppressed
> my research of immense value to the nation, but the blame has been leveled
> against the entire academy of finance and economics.
>
> The BAND could not block the truth. It could claim a Pyrrhic victory in
> blocking an insignificant messenger. Even the banks could not block this
> truth too: The government and Congress have instructed regulators to make
> sure that bank holding companies have sufficient capital on a consolidated
> basis!
>
> Was the previous RFS editor in the BAND that waged a war with a mere
> messenger of truth discovered though selfless research? Why else would he
> be angry if he did not want to mask the truth that someone from the

> academy had indeed discovered a policy proposal though robust research to
> avert the financial crisis?
>
> Why would the fellows at FRBNY now reject research that is vitally
> important to the current crisis to block its presentation in a conference,
> if they do not want to hide the truth about their spectacular failures and
> deliberate efforts to suppress my research that could avert the calamity
> to a nation and to the academy?
>
> I do not know what happened to the other paper, entitled "An Economic
> Theory of Constitutional Governance
> (http://pro-prosperity.com/Research/moralhazardliberty.pdf)," that I had
> submitted to the FRBNY/RFS conference. [This was joint with a verbally
> presented paper, "Constitutional System of Money and Finance."] This
> paper lays an economic foundation for a constitutional system of money and
> finance by showing that the existing system is unconstitutional. This
> paper shows that the current unconstitutional system is the cause of
> continual market crises. This paper proposes a new constitutional system
> to avert potential future catastrophes.
>
> The currently passed Financial Regulatory Bill preserves the prevailing
> unconstitutional system, as if to guarantee a recurrence of the Great
> Depression.
>
> Is this research on constitutional system of money and finance really so
> irrelevant/unoriginal to the Federal Reserve conference or to the RFS that
> it deserves to be rejected on a cursory look? Your explanation that the
> papers were rejected because of a cursory review by FRBNY-RFS reviewers is
> very consistent with how they have been rejected earlier by "top" journals
> including the RFS.
>
> I immensely value an independent and impartial process of publication of
> original research, despite the spectacular failure of all "top" journals
> in the academy of finance and economics in publishing research that
> foresaw the crisis and that proposed policies to avert the same - policies
> that have been enacted later into law after enormous losses to almost all,
> including the academy of finance and economics and top journals.
>
> If the RFS is still interested in these papers, it needs to consider them,
> suo moto, because it has already rejected formal submissions based on
> cursory reviews, at least to recompense for any remorse about rejecting
> papers with cursory reviews or with no review at all.
>
> Sincerely,
>
> Professor Sankarshan Acharya
> Department of Finance, UIC
> +1 815 524 5196
> ------------------------------------
> This missive is not personal even for this selfless researcher wishing to
> make the academy a fountain of truth and integrity. Truth alone triumphs
> and prevails. http://pro-prosperity.com/USPresidentTruthTriumphs.html
>
>
> On Fri, October 1, 2010 5:34 pm, Alexander Ljungqvist wrote:
>> Dear Professor Acharya:
>>

>>   I want to thank you for submitting your paper "Optimal Holding
Company
>> Organization and Capital Structure under Constitutional Governance" to
>> the RFS under the dual review process with the RFS/NYU/NY Fed
>> Conference.
>> The RFS has decided against going forward with your paper under this
>> system. However, I want to emphasize that your paper HAS NOT been
>> rejected by the RFS. You are free to submit, unchanged if you like, via
>> the standard submission system. If you do so it will be reviewed and
>> edited as any other first-round submission.
>>   The RFS does not consider this termination of the dual submission
>> process
>> to be a rejection in part because conference reviews tend to be very
>> cursory. What this means is that your paper has not undergone a rigorous
>> review at the RFS. You should thus be careful not to read too much into
>> this outcome.
>>   You will hear separately from the conference organizers about
whether
>> your paper could be included in this year's conference program.
>>   We appreciate your submission under the dual review system and
wish you
>> well in your research endeavors.
>>
>>   Yours sincerely,
>>   Alexander Ljungqvist
>>   Editor, RFS
>>
>>
>
>
>

---------------------------- Original Message ----------------------------
Subject: An Economic Theory of Constitutional Governance
From: "Acharya, Sankarshan" <sacharya@uic.edu>
Date: Wed, March 3, 2010 7:08 am
To: "Christian Hellwig" <jet@econ.ucla.edu>

Dear Professor Hellwig,

Thanks for the prompt feedback.

The basis of your rejection is broadly three-fold:

(1) Discrete decision making is being made in a continuous time model.
(2) Some statements (where and which ones?) are not stemming from the model.
(3) Some statements in the paper sound political.

Here are my responses:

(1) It is realistic to make decisions at discrete times while the valuation goes on continuously. Why not? Money grows almost continuously whereas market participants including traders invariably make decisions at discrete points in time. In any case, this point is moot because my DP model reduces to a one-period decision making model. The results are robust. I obtain exact functions and plots to demonstrate each result (I can make this available on request). Further complexity is neither necessary nor enlightening.

(2) Please tell me which statement does not follow from the mathematical proofs within the paper. Are you saying that I have stated a result in the introduction that is not proved within the body of the paper? If so, which one? I have numbered the results on the first page. Please pick the ones that you think do not follow from the math proofs based on the model.

(3) My model has a role for a not-for-profit government minimizing the cost to taxpayers and roles for debt holders and equity holders of a firm. The government plays its role implicitly to enforce debt contracts and to ensure arbitrage pricing in a free trading environment. [Otherwise, an ingenious reviewer would ask who enforces contracts within a decision making model.] In the case of banking firms, the government (with such role) effectively becomes a surrogate for debt holders; this is important to show if such a role additionally leads to a guarantee of the bank debt. To guarantee or not to is the crux of my equilibrium result; this is at the center of financial meltdowns and the Great Depression.

There is nothing political in assigning a role to government within an economic model. This is very necessary for a modeler to claim what the government should or should not do.

The comment that the paper somehow sounds "political" is silly because I have no political affiliation to even contemplate political statements. I have justified a role for a not-for-profit government seeking to minimize the cost to taxpayers within my model. My justification is based on the common longing of people as expressed by their political representatives.

By saying that my paper sounds political, are you implying that an ideal economic model should be dissociated from the common longing of people? I disagree.

The prominent economists, their prestigious journals and their followers running Wall Street and government have spectacularly missed the current financial meltdown, let alone devising any preemptive policies to avert the crisis. This is a true statement, based on a column in a prestigious newspaper written by a Nobel Prize winning economist, if you do not believe others. Some prominent economists have written that the recent financial meltdown was due to an invisible hand that slapped us all.

I have not only predicted the crisis in 2003, but also proposed policies to avert it preemptively, communicated the same to the US Congress at that time, and have been pursuing with the Congress since then to adopt those policies. The reasons for the market and banking failure written in those papers have proved to be the ones that have indeed caused the crisis. A prominent banker associated with the Swiss Banking Federation called me twice to tell that every one of my predictions came true and that my policy prescriptions should be implemented. My website, Pro-Prosperity.Com, has a chronology of the unfolding events vis-a-vis my research papers and policy memos written to governments.

Your review has turned very political: Accepting a paper that did predict the crisis and propose remedial policies would amount to a formal acknowledgment of the spectacular failure of top economists and their professed journals.

Even my undergraduate students follow easily the arguments made within the introduction of my paper that economic depressions are likely when public policies are based on (lobbied with) economic models that maximize profits of firms without any role for the government. No other economist has modeled such a role for government to derive public policies as I have done with a micro foundation, especially to avert financial depressions. I knew at the time of submission that you would actually reject my paper, precisely because you would not admit this truth.

It is not surprising to me that all the "prestigious" journals and all the masters of universe running Wall Street and government regulatory agencies using such journals to make government policies have spectacularly missed the Great Recession. I am afraid that the recession is receding to Great Depression II, thanks to such journals and their reviewers. I know how the major banks and their hedge fund clients are locked up with unsustainable leverages.

Sincerely,
Sankarshan Acharya

---------------------------- Original Message ----------------------------
Subject: JET: decision on your submission
From: "Christian Hellwig" <jet@econ.ucla.edu>
Date: Tue, March 2, 2010 11:23 pm
To: "Sankarshan Acharya" <sacharya@uic.edu>

Dear Professor Acharya:

I am sorry to inform you that, after consulting with an associate editor, I have decided to reject your submission, MS 2010119, entitled "An Economic

Theory of Constitutional Governance" for publication in Journal of Economic Theory.

I attach a copy of the associate editor's decision letter below, and will provide my own comments here. In the end, I found it hard to connect the discussion in the introduction to a concrete theoretical contribution that I would find of interest for publication. Let me be more specific about this:

- Your introduction comments on a wide range of things and suggests an analysis based on a general equilibrium asset pricing model. The heavy reference to recent economic events is, in my opinion, not suitable for a theoretical contribution that might be motivated by events, but should transcend those and provide the basis for a more systematic rather than anecdotal understanding.

- Your model then consists, essentially of a contracting model between debt and equity holders. While there may be interesting points in this analysis, they are clouded by modeling issues and assumptions (including the way in which the paper mixes discrete and continuous time). This makes the model and results hard to interpret and connect to the verbal discussion.

- It may be worthwhile linking this part of the analysis to much of the recent work on dynamic contracts, firm financing, and firm dynamics with various agency frictions (Albuquerque-Hopenhayn REStud, Clementi-Hopenhayn QJE, DeMarzo-Fishman, Biais-Mariotti-Rochet-Plantin REStud, various papers by Sannikov). These papers trace out the implications for optimal firm financing and the division between debt and equity in a dynamic contracting environment that shares some similarities with this paper.

Please note that we receive more than 600 submissions a year; our target acceptance rate is 10% and many good papers get rejected.

Thank you for giving us the opportunity to consider your work.

Sincerely,

Christian Hellwig
<jet@econ.ucla.edu>
Journal of Economic Theory

Attachments:

Decision letter

Associate Editor Report on "An Economic Theory of Constitutional Governance"

The paper contains an interesting discussion of timely issues and makes several good points. However, the paper is written in a way which is not a good fit for the JET, both in terms of the writing and the mathematical exposition. For instance, the model appears to be cast in a strange mix between discrete and continuous time, the paper makes several strong assumptions, and the discussion seems more political certain places. Therefore, I recommend that the paper is rejected from the JET.

I hope that this fast turnaround is some consolation for the disappointing outcome and limited feedback.

---------------------------- Original Message ----------------------------
Subject: Re: fin416.spring.2011: Required cumulative feedback towards class participation grade.
From: "jeff casas" <bighurtwhat84@yahoo.com>
Date: Sun, March 27, 2011 5:45 pm
To: "Sankarshan Acharya" <sacharya@uic.edu>

Professor Acharaya,

We have come a long way in this class. When we started i was completely lost and struggling with the question of weather or not to drop the class. I initially found the material to be extremely difficult and too hard to understand. This changed a lot for me after the first exam. I spent over 14 hours working on it and did not stop until i was sure that i had the problems correct. Since then I have increased my out of class study time and now feel like i come to class thoroughly prepared to be faced with a new and difficult, but not insurmountable, problem. This is not only the toughest class i have taken at UIC but also my favorite one. I feel that so much of college is wasted on learning trivial facts that will be completely useless for the vast majority of students. This is one of the very few classes where i dint feel that way. I want to become a trader and being that i live in Chicago options would be on the top of the list of things i will likely learn to trade. That being said, i find the information in this class to be extremely valuable and i am confident that i will use the knowledge i acquire in this class as i move forward in my life.

regards
Jeff Casas