Value of Selfless Research

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Introduction and Summary

Selfless research in finance has led me to discover the real truth that ***optimal governance*** is necessary for prosperity amid stability to preserve democratic capitalism which is cherished by the civilized world. Optimal governance is defined by policies that will enhance ***national competitiveness***, which can be measured objectively by trade balance, reserves and strength of the currency.

Selfish financial research, consistent with the maximization of utility of net-worth, is predicated on self-aggrandizement and self-entrenchment. This research has perpetuated a pseudo truth (market dogma), which presumes that markets can self-discipline with little government oversight.

My research has defined and established a ***unique field*** of ***optimal financial governance***. The prevailing ***market dogma*** presumes that the market is supreme to self-discipline without government oversight. Since its inception, my field has thus become the antithesis of the prevailing market dogma.

My research has made a nonpareil impact in the real world by establishing publicly:

- That the market dogma is driven by a few self-aggrandizers based on trading strategies to usurp wealth from the vast majority of effective producers of globally competitive goods and services.[1]
- That the market cannot self-discipline to maintain the long-run financial stability because greed has been rationalized by the theory of maximization of own wealth (with no regard to adverse impact of individual actions on collective welfare) through hammering of talented minds in the revered academy of economics and finance.[2]
- That the market dogma causes continual instability like financial depressions that can erode welfare of even the market dogmatists more severely than the relative reduction in their wealth under optimal governance.[3]
- That optimal governance is vitally necessary for prosperity amid stability to preserve democratic capitalism that the civilized world cherishes.[3]

The market dogma has been the lodestar of the academy of economics and finance.[4] My experience shows that this academy has welcomed any research which promotes the market dogma, such as,

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[1] Acharya, S. (2005), "Prosperity: Optimal Governance, Banking, Capital Markets, Global Trade and Exchange Rate," Citizens Publishing: http://www.pro-prosperity.com/Citizens%20Publishing/TableOfContents.pdf

[2] Acharya, S. (2008), "Utility of Wealth, Governance and Competitiveness," Pro-Prosperity.Com, http://www.pro-prosperity.com/Research/UtilityWelfareDemocracy.pdf

[3] Acharya, S. (2008), "Optimal Governance for Prosperity amid Stability: A New Economic Paradigm for Democratic Capitalism," Pro-Prosperity.Com, http://www.pro-prosperity.com/Research/Prosperity%20Amid%20Stability%20-%20A%20New%20Economic%20Paradigm.pdf

empirical studies to infer patterns in the market behavior and theories that rationalize the market behavior. But it does not tolerate questioning of the market dogma itself. It welcomes other research that does not connote inefficacy of the market dogma. To preserve its self interests consistent with its market dogma, the revered academy has inevitably relegated my research on optimal governance. There is hardly any published research on optimal rules of financial governance.

The academy has successfully promoted its philosophy of free markets with little government oversight to lawmakers, while relegating and blocking research on optimal governance.

The free market philosophy was first staved by an optimal bank governance policy that stemmed from my research during the Savings and Loans crisis when I was an Assistant Professor at the New York University: to foreclose banks even with positive capitals when the capital of a bank falls below a minimum threshold of capital-to-assets ratio. The Congress promptly enacted this optimal policy as law in the Federal Deposit Insurance Improvement Act of 1991. The Congressional Budget Office had then offered me a visiting scholar position to help formulate optimal rules for government sponsored enterprises like Fannie Mae and Freddie Mac.

The market dogmatists were then alarmed. They adopted very sophisticated strategies and immensely succeeded till 2007 to suppress publicity of my research on optimal governance and to help banks circumvent the bank foreclosure rule that was already adopted into law. I narrate later the details on this issue by citing my experience at government regulatory institutions, banks and ratings agencies.

As a seeker of the real truth−who noticed a deliberate suppression of the truth about the necessity of optimal governance for prosperity amid stability, who foresaw a simmering financial catastrophe under the veneer of hooted GDP and employment growth, and who had developed preemptive optimal rules to avert his anticipated impending financial crisis−I had to communicate my research directly with the lawmakers starting 2003. Communication with the lawmakers necessitated non-trivial commonsensical articulation of the optimal policies for governance of banks and markets that have been operating with complex financial strategies under the market dogma.

My research and communication with lawmakers in November 2007 led to the U.S. government adopting a new optimal policy in early 2008−withdrawal of federally insured bank deposits lent to privately held hedge funds−that crushed the market dogma and publicly established the necessity of optimal governance for prosperity amid stability:[4]

"We agreed that urgent decisions implementing these principles should be made to root out the irresponsible and often undisclosed lending at the heart of our problems." British Prime Minister Gordon Brown, Washington Post, October 15, 2008.[5]

[4] Acharya, S. (November 17, 2007), "Sub-optimality of Lending Taxpayers Money to Hedge Funds," Pro-Prosperity.Com, http://www.pro-prosperity.com/Research/Sub-optimality%20of%20Lending%20Taxpayer%20Funds%20to%20Hedge%20Funds.pdf

[5] Brown, Gordon (2008), "Out of the Ashes," Washington Post, October 17, 2008, http://www.washingtonpost.com/wp-dyn/content/article/2008/10/16/AR2008101603179.html

The market dogma was perhaps predicated on irresponsible and undisclosed lending, like bank CEOs lending hundreds of billions from the federally insured deposit base to privately-held hedge funds to upstage the markets, even temporarily, to wangle wealth from passive pension plans and mutual funds. The market dogma has been thus selfish. The selfish market dogma creams the incomes and savings of the vast majority of effective producers to enrich a few unproductive schemers. The effective producers then become heavily indebted, which stifles their motivation to create, innovate and produce. This erodes national competitiveness, increases trade imbalance and weakens the currency.[3]

Optimal governance is predicated on enhancement of national competitiveness.[3,10] Selfless research on optimal governance, therefore, endeared the U.S. Congress and triumphed over the selfish market dogma:

"The inability of [Market Dogmatist] Friedman's successors to say anything useful about what's happening in financial markets today means their influence is finished." Professor James Galbraith, University of Texas, Bloomberg News, December 23, 2008.[6]

"The Chicago School bears the blame for providing a seeming intellectual foundation for the idea that markets are self- adjusting and the best role for government is to do nothing."[4] Professor Joseph Stiglitz, Nobel Laureate, Columbia University, Bloomberg News, December 23, 2008.[1]

Significant achievements of my research on optimal governance include the following (discussed more in detail later):

1. An optimal bank foreclosure rule–to close a bank despite having a positive capital if the capital level fell below a minimum optimal threshold value of capital-to-assets ratio derived in the 1989 Journal of Finance paper–was enacted into the FDIC Improvement Act of 1991. This was also adopted into Basle I Accords.

2. An optimal capital penalty rule based on internal bank-specific model, proposed in a Federal Reserve Memo,[7] was adopted in Basel II accords in 2003 to permit banks to estimate their own loan losses to make reserve provisions so as to adjust capital levels and to face a "capital penalty" or excess capital requirement, in lieu of any difference between the ex ante estimated loss and ex post realized loss.

3. Predicted in 2003 the current home mortgage crisis and financial depression and communicated about the necessity of a preemptive optimal safe banking policy to the US Congress on March 31, 2003 to avert the simmering crisis with a warning that at least a trillion dollars would be lost by taxpayers if the proposal were not implemented.[8] The market dogmatists including Nobel

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[6]Lippert, John (2008), Bloomberg, "Friedman Would Be Roiled as Chicago Disciples Rue Repudiation," http://www.bloomberg.com/apps/news?pid=20601109&sid=a3GVhIHGyWRM&refer=home

[7]Acharya, S. (1990), "A Simple Loan Loss Forecast Rule," Federal Reserve Memorandum, http://www.pro-prosperity.com/Research/BanksInternalIncentiveCompatibleLoanLossEstimate.pdf

[8]Acharya, S. (2003), "Safe Banking," Journal of American Academy of Business, and memorandum to the U.S. Congress, http://www.pro-prosperity.com/Global%20Economy%20Chatterbox/Warning-USCongress-In-2003-On-Home-Mortgage-Debacle.html

Laureates in Economics and the President of American Economic Association were emphatic at the same time in 2003 about having solved all the problems underlying financial depressions.[9]

4. Predicted brewing depression,[10] under the veneer of government-hooted GDP and unemployment growth and inflation, when the Federal Reserve Board and other central banks around the world were concerned about rising inflation and taking aggressive steps to raise interest rates to contain inflation. The Federal Open Market Committee meeting of August 7, 2007 left the interest rate unchanged at 5.25%.[11] Federal Reserve Governor Poole in a talk on August 16, 2007 opposed to lowering the rate from 5.25%.[12] Nevertheless I communicated my warning made since 2003 about the brewing home mortgage crisis and about a possible recurrence of the Great Depression in a memo to several Senators on August 24, 2007.[13] The FOMC meeting on September 18, 2007 made a U-turn to lower interest rate by 50 basis points to 4.75%.[14] My call for an optimal need of a zero interest rate since 2003 has now been heeded as of the latest FOMC meeting on December 16, 2008 that set the rate to almost zero [0-.25%].[15]

5. Presented analyses of how (i) the current monetary decision making model used by central banks was being fooled by hedge fund manipulation and (ii) how to bring down inflation through a globally concerted strategy of simultaneously cutting down the interest rate and withdrawing the massive quantum of federally insured deposit funds lent to privately held hedge funds.[16] Following my communication on October 2, 2008, the Federal Reserve made a historical decision to directly lend businesses by buying commercial papers.[17] The Federal Reserve Board then on drastically cut the interest rate and central banks made a joint statement.[18] The prices fell precipitously and US Federal Reserve lowered the interest rate to near zero. I am deeply humbled by the spectacular accuracy of my predictions based on selfless research. The market dogmatists pleading for higher interest rate to contain inflation were blinded due to self-interests in the hedge fund game to earn the ask-bid spread from rising prices and higher interest rates on the profits so

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[9] Krugman, Paul (2009), "Fighting of Great Depression," New York Times, January 5, 2009, http://www.nytimes.com/2009/01/05/opinion/05krugman.html

[10] See footnote 3 and also Acharya, S. (November 12, 2007), "Making America More Competitive and Efficient," memo sent to the U.S. Federal Reserve Chairman and the Treasury Secretary.

[11] Federal Reserve Board (August 7, 2007), "Minutes of the Federal Open Market Committee," http://www.federalreserve.gov/FOMC/minutes/20070807.htm

[12] Poole, William (August 16, 2007), "Poole Says Only `Calamity' Would Justify Rate Cut Now," Bloomberg News, http://www.bloomberg.com/apps/news?pid=20601087&sid=a6TRNdqQlM6Y&refer=home

[13] Acharya, S (August 24, 2007), "US Senate was warned in 2003 about the current home loan crisis," memo sent to Senators Barack Obama, Chris Dodd, and Hilary Clinton.

[14] Federal Reserve Board (September 18, 2007), "FOMC Federal Reserve Press Release," http://www.federalreserve.gov/newsevents/press/monetary/20070918a.htm

[15] Federal Reserve Board (December 16, 2008), "FOMC Federal Reserve Press Release," http://www.federalreserve.gov/newsevents/press/monetary/20081216b.htm

[16] Acharya, S. (October 2, 2008), "Urgently needed: Direct Lending and Debt Relief," memo sent to US Senators, http://www.pro-prosperity.com/Direct-Lending-at-Lower-Rate-Debt-Relief.html

[17] Wall Street Journal (October 7, 2008), "Federal Reserve to Buy Commercial Paper," http://www.smartmoney.com/breaking-news/smw/?story=20081007094827

[18] Federal Reserve Board (October 8, 2008), "Joint Statement by Central Banks," http://www.federalreserve.gov/newsevents/press/monetary/20081008a.htm

earned. But promotion of self-interests was causing deep financial anguish for the vast majority of effective producers due to rising costs of borrowing and higher consumer prices. Selfless research on optimal governance saw this as a danger to prosperity and stability of the nation propped by the vast majority of effective producers.

6. Staved the market dogma as the government stopped "irresponsible and undisclosed lending" from taxpayer insured deposit base to hedge funds.[5] Many hedge funds–that were thriving by borrowing from taxpayers to take highly leveraged bets to cause volatility in the markets and to wangle wealth from passive pension plans and mutual funds–closed due to margin calls or redemption requests from investors. But the nation drifted towards a new path towards optimal governance for prosperity amid stability. The real truth that optimal governance is needed to preserve democratic capitalism triumphed over the pseudo truth perpetuated by market dogma.

7. Proved in a paper in 2003 that "safe banking" was optimal to avert enormous potential losses to taxpayers estimated to be at least one trillion dollars.[8] The US Congress held testimonies and the regulatory agencies held conferences on efficacy of the market dogma to bury my optimal safe banking proposal in late 2003.[19] The real truth that safe banking is optimal has finally prevailed when the current financial meltdown forced the U.S. government (i) to insure the money market funds totaling $3.2 trillion, making them "safe banks"[20] and then (ii) to begin the process of forming federally uninsured "universal banks" by merging the commercial banking units at Citigroup and Morgan Stanley.[21]

8. Sub-optimality of short-selling of financial securities.[22] I have argued in a research paper that the current short-selling practice permitted by the Security and Exchange Commission creates new stock illegally through back-doors in violation of the existing corporate law with respect to the outstanding stock. I have sent it to several senators including Mr. Barack Obama and Mr. John McCain and to the President on February 16, 2008.[23] I have received a letter from President-elect Barack Obama acknowledging my research and prodding SEC to reform its practice.[24] Senator John McCain has chastised the SEC for permitting illegal practices that fed Wall Street greed and even advocated removal of the SEC Chairman.[25] The SEC deliberated on the issue to ban short-

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[19] Caruana, Jaime. (November 1, 2003), "Keynote Speech at the Market Discipline Conference," Federal Reserve Bank of Chicago and BIS. Spillenkothen, Richard. (November 20, 2003), "*Corporate governance, risk management, and internal controls," testimony b*efore the Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate.

[20]Friedman, Josh (September 20, 2008), "US to Give Money Market Funds Cover," Los Angeles Times http://articles.latimes.com/2008/sep/20/business/fi-moneyfunds20

[21] Harper, Christine and Bradley Keoun (January 9, 2009), "Morgan Stanley said to begin buying Citi Brokerage," Bloomberg News, http://www.bloomberg.com/apps/news?pid=20601087&sid=adzqTCwwvtjw&refer=home

[22] Acharya, S. (2008), "Sub-optimality of Short-selling," Pro-Prosperity.Com, http://www.pro-prosperity.com/Research/Sub-Optimality%20of%20Short%20Selling.pdf

[23] Acharya, S. (2008), "An illegal and sub-optimal practice (short-selling) is worse than being unethical," memo sent to Senator Barack Obama.

[24] Letter from Mr. Barack Obama, dated June 19, 2008, in response to my memo on short-selling of financial securities.

[25] Muskai, Michael and Noam N. Levy (September 19, 2008), "McCain Says he'd fire SEC chief," Los Angeles Times, http://articles.latimes.com/2008/sep/19/nation/na-candidate19

selling of financial stocks, temporarily. The SEC is currently debating on setting optimal norms based on discussion with its global counterparts.

9. President-elect Barack Obama has written that optimal rules of governance can only come from outside [selfless researchers], not from Washington and has asked to keep writing.

10. A top Chinese government official, on the U.S. on the State Department leadership mission, visited with me at office to discuss optimal banking and capital regulation. This was due to the value of my talk about optimal exchanges rate and nonperforming bank assets at a conference in the Hong Kong Monetary Authority.[3]

11. Optimal policies to revive boom in the economy, sent to President-elect and Congressional leaders, was downloaded from my website, Pro-Prosperity.Com, by many government agencies.[26]

Democratic capitalism may not be the best forms of governance, but there is no better alternative. The trust of people on democratic capitalism has eroded, however, because the market dogma has undermined prosperity and stability. My research on optimal governance has proven to be the only way to restore prosperity amid stability which is needed to preserve trust in democratic capitalism that every civilized society cherishes. I have argued in my research that the immense loss to the market dogmatists due to financial depression is far greater than the reduction in wealth under optimal governance. This argument must have dawned on the Congressional leaders, the President and the Presidential candidates to consider seriously the optimal policies stemming from my research.

Establishing a New Field of Research: Optimal Governance for Prosperity and Stability

Discovery of the latent truth is a motivation for any research. My doctoral thesis was on valuation of latent information. But the Savings and Loans crisis of the late 1980's inherently drew me to quest for the following:

- To search for the latent cause of banking crises that had once led to the Great Depression.
- To derive optimal rules of financial governance to avert any financial catastrophe to society.

This quest led to a publication on optimal bank reorganization policies and pricing of federal deposit insurance published in the Journal of Finance that became the basis of optimal bank foreclosure rule enacted by the US Congress in FDICIA 1991 to close banks whenever their capitals fell below a minimum threshold capital-to-assets ratio. Before enactment of this rule, no solvent bank was allowed to be closed and no academic research existed to discourse on optimal bank reorganization policies.

[26] Acharya, S (December 25, 2008), "An Optimal Strategy to Revive Economic Boom with Enormous Profits to Taxpayers," Pro-Prosperity.Com, http://www.pro-prosperity.com/US-Interest-Rate-Policy.pdf

My research has ultimately led to the discovery of a fundamentally ***new theory*** to develop optimal rules of financial governance to beget prosperity amid stability of the vast majority of ***effective producers*** of globally competitive goods, services and ideas.[3] Only the effective producers can make a country prosperous and stable and that only they can feed and protect the rulers (political representatives and the establishment) as well as the laggards and the poor. Prosperity amid stability of the vast majority of effective producers is thus paramount to keep a nation competitive. My research defines national competitiveness objectively by three parameters (i) trade balance, (iii) exchange reserves, and (ii) strength of the currency. Declining national competitiveness - decreasing values of the parameters - lowers the standard of living, decimates household prosperity, and increases the possibility of instability due to, for example, riots. Research on optimal financial governance is thus crucially important for a nation and for every one of us living in a civil society.

I have thus consciously and rightly defined a new and unique field of research, despite the risk of forfeiting short-term rewards that come from publications aligning with the market dogma. This risk to my career and family is the selfless sacrifice I was determined to face while striving to establish the truth. After graduation from the Indian Institute of Technology, I was appointed at 24 in the Associate Professor grade as Scientist-C at a prominent institute of research established by the British and operating under the Council of Scientific and Industrial Research of the government of India. The director of the institute (a Ph.D. from University of Illinois, Urbana-Champaign) waived past experience required for the post to recruit a rookie. I am still in the same grade at UIC, which shows the sacrifice I have endured for not kowtowing to the prevailing market dogma.

My field of optimal financial governance has faced heavy odds of winning against the dogmatic fortress of the academy of economics and finance. The market dogmatists, heading the U.S. Treasury and the Federal Reserve, got the Glass Steagall Act repealed in 1999 to facilitate federally insured banks to lend heavily their off-balance sheet subsidiaries and their privately held hedge funds to trade on stocks and bonds in order to wangle wealth from passive pension plans and mutual funds and to usurp the trading profits as unseemly executive bonus. The Congress had sagaciously enacted the Glass Steagall Act in 1933 to prevent the excesses of laissez faire capitalism from destabilizing the economy that once caused the Great Depression. To convince the Congress to repeal the Glass-Steagall Act, the market dogmatists had produced reams of publications on how the market could self-discipline to convince the government to deregulate the market.

A selfless researcher would never make a biased inference about the efficacy (optimality for taxpayers) of deregulation based on pre-1999 data generated by regulated markets. But the prestigious journals in the academy of finance and economics have published reams of such papers to perpetuate a dogma that the market could self-discipline without government regulation. Some of these journals have, to serve their own interests, obviously rejected some of my seminal research on optimal governance and on avoidance of moral hazard that has gripped the financial industry now. My communication to the US Congress did not receive the needed attention until 2005 when Senator Barack Obama (now president-elect) picked up the points as the economy faltered, poising to erupt the looming crisis I had predicted. Senator John McCain as well as President George W. Bush also received my communication. The Congress could eventually see selflessness in my research and the alarming accuracy of catastrophic consequences that have unfolded one by one due to a relegation of the optimal rules I had proposed.

My responsibility towards taxpayers, who ultimately foot my bill for research, propelled me to continue to report findings on optimal rules of governance to the US Congress including President-elect Obama. On April 23, 2007, I had communicated to the Congress an analysis of how the dangerous hedge fund game could lead to a recurrence of the Great Depression. On November 17, 2007 I wrote how the bank CEOs could be lending hundreds of billions of federally insured dollars to their off-balance sheet subsidiaries and to their privately held hedge funds to make highly leveraged risky bets and how this could be suboptimal (financially suicidal) to taxpayers. The Government Accountability Office subsequently made a more detailed study on such leveraged hedge fund bets as posing systemic risk to the economy in February 2008.[27]

Until June 2006, the Fed was raising interest rates and had kept it at 5.25% till September 18, 2008 to fight the rising inflation.[28] The inflation was rising due to hedge fund bets on commodities, as the media persuaded investors to shift holdings from financial securities to commodities. Passive investors were losing heavily in their pension plans and mutual funds invested in financial securities while facing the brunt of rapidly rising prices of food and energy due to highly leveraged hedge fund bets based on the federally insured bank deposits.

My research showed that the hedge funds were successfully fooling the Federal Reserve's monetary model designed to set higher interest rate as the inflation rose. The Federal Reserve was oblivious of the adverse effect of the highly leveraged hedge fund bets based on federally insured funds and a looming catastrophe due to a collapse of the financial system. Selfless research had uncovered the "invisible hand" of the self-enrichment driven market dogma as pure manipulation of the system to wangle wealth from the vast majority of effective producers as credits piling for a few.

The point of my research is not who gains or who loses, but the viability of the system of democratic capitalism that everyone in the civil world relishes and wants. My research showed that unless prosperity amid stability of the vast majority of effective producers was maintained, the usurped credits due to market dogmatic shenanigans would wither away. I argued that to serve their best interests, the market dogmatists should embrace optimal rules of governance. The Congress and President-elect Barack Obama seemed to heed to such arguments. During his campaign, Mr. Obama has stressed that prosperity of millionaires and billionaires could not be sustained without prosperity of the middleclass working people:

"The last thing we can afford is four more years where no one in Washington is watching anyone on Wall Street because politicians and lobbyists killed common-sense regulations. Those are the theories that got us into this mess. They haven't worked, and it's time for change….the last thing we can afford is the old theory that says we should give more to billionaires and big corporations and hope that prosperity trickles down to everyone else…we

[27] Government Accountability Office (January 2008), "Hedge Funds: Report to Congressional Requesters," http://www.gao.gov/new.items/d08200.pdf

[28] Federal Open Market Committee (2008), "Fend Funds Rates," http://www.federalreserve.gov/fomc/fundsrate.htm

can choose an economy that rewards work and creates new jobs and fuels prosperity from the bottom-up." Barack Obama, October 27, 2008, Canton, Ohio.[29]

Senator McCain is also on my mailing list. He too has stressed about the foundation being the American worker and the Wall Street greed and mismanagement being the culprits of the financial meltdown:

"This foundation of our economy, the American worker, is strong but it has been put at risk by the greed and mismanagement of Wall Street and Washington…Government has a clear responsibility to act in defense of the public interests, and that is exactly what I intend to do. We are going to make sure that American's accounts are protected." John McCain, September 16, 2008, Tampa, Florida.[30]

Root Cause of the Financial Meltdown

Post mortem analysis of the root cause of the financial market meltdown has been summarized succinctly in a thorough ***American Enterprise Institute*** article: "government policies created the incentives for both a housing bubble and a reduction in the bank capital and home equity that could have mitigated its effect."[31]

I agree with the AEI analysis entirely. But how did the government follow such policies and why?

After the enactment of the optimal bank foreclosure rule in FDICIA 1991, the government regulators permitted bank holding companies to effectively circumvent the rule via formation of firewalled financial subsidiaries.

An Example of circumventing the minimum bank capital requirement: Form a BHC with 8 dollars of equity and 92 dollars of federally insured deposits at the parent company level. This meets the government's minimum 8% capital-to-assets requirement (8:100) for not foreclosing the parent company. The BHC then forms a legally valid firewalled subsidiary by infusing the entire 100 dollars of the parent company's assets as equity of the subsidiary and borrowing another 900 dollars of the federally guaranteed debt at the level of the subsidiary. The subsidiary now has 10% capital-to-assets ratio (100:1000) that satisfies the minimum threshold capital requirement under FDICIA 1991. But on a consolidated basis, the BHC has only 8 dollars of equity and the rest 992 dollars of federally insured debt or a capital-to-assets ratio of 0.8%. This leads to a gross violation, by the consolidated BHC, of the optimal bank closure rule as per FDICIA 1991. But the government has explicitly permitted such thinly capitalized BHCs under the technical consideration (motivated by deregulation, self discipline and market

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[29]Feller, Ben (October 27, 2008), "Obama Promises in Ohio to Restore Prosperity," Associated Press, http://www.truthout.org/102708T

[30] Bentley, John (September 16, 2008), "McCain: Greed of Wall Street to Blame for Meltdown," CBS News, Tampa, Florida.

[31] Wallison, Peter J. (November 25, 2008), "Government Policies and the Financial Crisis," AEI Online, http://www.aei.org/publications/filter.all,pubID.29015/pub_detail.asp

dogma) that neither the parent nor the subsidiary violates the optimal foreclosure rule. It is true that both the parent and the subsidiary satisfy the optimal foreclosure rule on a technical basis. But the consolidated BHC does not satisfy the optimal foreclosure rule. Bank executives, driven by the principle of maximizing the utility of their own wealth which is consistent with the theory of the academy, exploit the sophistry of the holding company structure to circumvent the optimal foreclosure rule on a consolidated basis. This transgression creates enormous risk for taxpayers who insure the deposits.

My Experience: In a meeting with a top executive at Citicorp in 1994, I pointed out the above violation of FDICIA-1991 due to multi-leveraging through holding company sophistry, while on a mission as a Financial Economist at the Federal Reserve Board in 1994. The bank executive retorted, "Dr. Acharya, do you want to throw me out of the 32nd floor?" Two senior officers from the Federal Reserve Board visiting with me pacified the bank executive, but remained totally oblivious of the gross effective violation of FDICIA 1991. This event dawned on me that the eulogy bestowed on me at the Federal Reserve Board was perhaps a sly subterfuge to block my memos on optimal governance from reaching the Congress.[32]

As an employee at the Federal Reserve Board, I would not obviously write to the Congress. But I realized that communication of my research on optimal governance with the governing lawmakers was crucial for establishment of the truth. I returned to academia (UIC) in 1995, but faced an impossible task of advancing the truth about optimal governance through the academy of economics and finance which has been guided by an antithetic market dogma.

After coming to UIC, my goal continued to be to thwart rooting of the root cause of the Great Depression that I vividly saw through selfless research and experience at Citicorp. The venerable academy of finance and economics was obviously blinkered by its self-interests of perpetuating the market dogma:

"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, 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.'" Paul Krugman, Nobel Leaureate, New York Times, January 4, 2009.

About the same time in 2003, when the market dogmatist president of the American Economic Association made the above declaration, got a negative feedback on my Safe Banking paper from the Journal of Banking and Finance. The journal was not willing to entertain warning about an impending financial depression and with an optimal policy proposal to avert the crisis preemptively. The JBF referee felt that I was disgruntled about the vested interests, mentioned in my Safe Banking paper. Yes, I was really disgruntled because the market dogmatists were hell bent to suppress the real truth that I had

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[32]See where Citi has reached: A Corruption of Capitalism: CNBC's Dylan Ratigan, host of "Fast Money" and "Closing Bell," tells TSC's Debra Borchardt that Citigroup's potential deal with Morgan shows just how bad things are and does not expect the bank to last.
http://cosmos.bcst.yahoo.com/up/player/popup/?rn=289004&cl=11534899&src=finance&ch=633473

discovered: that the economy needed optimal governance and that the root cause of the Great Depression had taken deep root in the banking industry.

My safe banking research is fundamentally novel as it obviates the federal deposit guarantee that is the underlying source of the moral hazard (gambling at taxpayer expense) lure for banks. To serve their own best interests, bank executives would of course subvert the minimum capital foreclosure rule enacted in FDICIA-1991. The fully embedded market dogmatists in the academy were not prepared to entertain my optimal bank governance rules, even as an alternative to their dogma, lest my vivid analysis would make it obvious to the Congress to enact my safe banking proposal.

My safe banking policy will accomplish the following important outcomes that are vital for prevention of depression-like financial meltdowns:

- Thwart moral hazard and gambling with federally insured deposits.
- Prevent continual bailout of failing financial institutions that cost taxpayers dearly.
- Stop continual injection of money that degrades the value of dollar and erodes the effective household income.
- Stop cannibalization of savings in passive pension plans and mutual funds.

The erosion of effective household income and savings leads to depression that ultimately decimates the wealth of creditors. Then creditors stop lending whatever they are left with, as it is happening now. Then the employers dependent on credit cut back, leading to a domino of rising unemployment, home foreclosure, and further erosion of remaining credits in the system. The market dogma has thus caused the current depression, as they had caused the Great Depression.

The market dogmatists have amassed wealth in the form of credits through a federally guaranteed banking system with a confidence that the Congress would be forced to bailout the banking industry should there be systemic failure as we now face. To protect myopic self interests, the market dogmatists would obviously block publicity of my safe banking proposal especially through journals they propagate.

I had to publish my safe banking paper in a different refereed journal to submit a published paper to the US Congress for consideration due to the gravity of the problem. I sent the paper to the Congress in March 2003 with a warning that the at least one trillion dollar in losses might be incurred if the safe banking proposal were not implemented. The S&L crisis cost taxpayers an estimated $300 billion of losses. Since the economy had grown three times, I estimated at least a trillion dollar in losses if the Congress did not act preemptively. The Congress held testimonies and the Federal Reserve Board held a conference on market discipline in late 2003. I was invited to the conference. The market dogmatists then succeeded in drowning my optimal safe banking proposal because it was antithesis of market self-discipline and deregulation.

But my quest continued for establishing the real truth that optimal governance was necessary to prevent depressions. This quest led to a discovery of a new theory of optimal governance for prosperity amid stability, where I argue that the creditors can lose more due to a depression-like event than the reduction in the accumulation of wealth under optimal rules of governance. Communication of such arguments January 2005 (while publishing a book on these issues) with the U.S. President and with Congressional leaders must have convinced policymakers that my selfless research was indeed vital for prosperity amid stability of the country and the world. Hereafter, the market dogmatists lost their game. President Bush asked Dr. Ben Bernanke, the only economist who had written a thesis on the Great Depression, to intern at the White House in April 2005 and then to become the Chairman of the Federal Reserve by defying the prevailing expectations, especially by ignoring the candidates proposed by Dr. Alan Greenspan.

Dr. Alan Greenspan has recently admitted failure of his dogma of market self-discipline and deregulation. He has attributed the meltdown to once in a century credit tsunami.[33] But the venerable American banks melted down because they lent almost all of the federally guaranteed deposits to hedge funds privately-held by bank executives and to firewalled bank subsidiaries to make huge leveraged bets to create market volatility to usurp the savings from passive pension plans and mutual funds. Prime Minister Gordon Brown of the U.K. writes on October 17, 2008 in Washington Post that such "irresponsible and undisclosed lending" is the reason for failure of banks.

The hedge funds had amassed so much, thanks to new government debt that mostly flowed to owners of such funds, that they had to lend the accumulated credits to the home mortgage sector to take advantage of the historically low default rate. I had stressed in my classes at UIC during 2005 about an impending collapse in the home mortgage sector. The housing policy being a root cause of the failure of financial markets – pointed out by AEI - was indeed designed to find a berth (home mortgage sector) to stash the unseemly wealth usurped by the hedge funds.

I had written about the pseudo home ownership and the American Ponzi Scheme in my letter to the U.S. President in January 2005. The Bush Administration deserves kudos, though, for taking many steps, consistent with the proposals made in my January 2005 memo. But these steps were too late to prevent an inevitable collapse of the market as well as the dogma itself.[34]

The collapsing hedge funds led to a crushing of the financial markets as well as of the market dogma. As the financial markets and the market dogma failed, political leaders around the world made vociferous calls to supplant the market dogma with optimal rules of financial governance.

Conclusion

The goal of my research has been discover any new economic theory for development of optimal rules of financial governance to engender prosperity amid stability and to preemptively avert catastrophes like great depression. My research has indeed produced a new economic theory of optimal governance for prosperity amid stability, which is now being considered seriously around the world.

My research bared the dogmatic "invisible market force" as a sophistry to wangle wealth from the vast majority of effective producers to a few who support the academy of economics and finance to perpetuate the market dogma.

That the market dogma abjectly failed to serve the economy has been widely accepted by political leaders and the media. The need for optimal rules of financial governance is now loud and clear. The immense impact of my research shows that the market dogmatists cannot fairly reward me. With profound respect for the academy of economics and finance that trained me with the skills needed to think and search for the real truth, I should state that the self-interest to perpetuate the market dogma has become the bane of the academy. The academy has willy-nilly accepted novelties of optimal rules for financial governance enunciated in my papers, but has often opined about unsuitability for publication. For example, a novel and important idea on safe banking propounded in 2003 to avoid moral hazard and enormous losses to

[33] Smith, Aron (October 23, 2008), "Greenspan: It is a credit tsunami," CNNMoney.Com, http://money.cnn.com/2008/10/23/news/economy/committee_regulatory/index.htm

[34] Acharya, S. (January 29, 2005), "Enhancing American Competitiveness," Letter to President Bush, Pro-Prosperity.Com, http://www.pro-prosperity.com/USPresident013105.html

taxpayers was rejected because it was antithesis of the prevailing market dogma of the reviewer. The unique form of safe banking I had proposed is now considered paramount by governments and political leaders around the world, judging from downloads of the paper and policy actions taken during the crisis so far. This is the power of the truth discovered through selfless research, not through self-interest based dogma. I should state this with due humility as I have no intention to even imply disrespect to others.

My research is truly selfless. It is now in the midst of a high stake game with many financial policy actions being classified by the US Congress. The Federal Reserve Board recently rejected a request from the New York City Mayor Michael Bloomberg to release, under the Freedom of Information Act, the names of recipients of about $2.3 trillion that the FRB has lent certain financial institutions. The Federal Reserve Board got the information classified by the US Congress.

These are trying times. Hubris should have no role to play now. Timely publicity of new ideas should be done to avoid colossal losses of trillions of dollars, if not unwanted instability.