



Economist: Bernanke's Call To Address Systemic Risks Misses A Key Element -- Excessive Asset Price Swings

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EDITORS AND REPORTERS: Goldberg's complete response to Bernanke's speech to the Council on Foreign Relations today is available at http://www.unh.edu/news/cj_nr/2009/mar/goldbergcomments.cfm. He also is available to speak with reporters and can be reached at 603-862-3385 and michael.goldberg@unh.edu.

DURHAM, N.H. – Federal Reserve Chairman Ben Bernanke's recommendations made today to address the systemic risks in the financial system are missing a key element – addressing excessive asset price swings, according to Michael Goldberg, the Roland H. O'Neal Professor and an associate professor of economics at the University of New Hampshire.

"Bernanke does not mention that systemic risks in the financial system stem in large measure from boom-and-bust fluctuations in asset markets. Instead, he emphasizes the need to deal with a lack of transparency, over-leverage in the system, too-big-to-fail financial institutions, and the procyclicality of capital and regulatory requirements. To be sure, addressing these problems will help to reduce systemic risks," Goldberg says.

"But, no one would deny that the sharp downswings in housing and equity prices, which followed long upswings that moved excessively far above historical benchmark levels, helped to trigger and fuel the crisis. As the downswings continue, there is a real danger that they may also become excessive and drag the economy and the financial system into an even deeper crisis," he says.

"The connection between excessive price swings in asset markets and financial risk and crisis suggests that understanding these price swings should play a central role in shaping current efforts to re-regulate the financial system. However, for the most part, this has not been the case," Goldberg says.

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A professor at the UNH Whittemore School of Business and Economics, Goldberg has proposed new ways to regulate the financial sector, including the development and promotion of a guidance range of non-excessive values in financial markets. This range would lead bulls to moderate their positions and bears to strengthen theirs if prices were above the official range, and vice versa if prices were below it.

Goldberg has presented his recommendations for regulating the financial sector to some of the world's foremost economists and business experts. Most recently, he and Roman Fryman, professor of economics at New York University, who co-authored "Imperfect Knowledge

Economics: Exchange Rates and Risk" with Goldberg, spoke at the "Emerging from the Financial Crisis" conference sponsored by the Center on Capitalism and Society at Columbia University. Goldberg and Fryman's analysis and recommendations are available at <http://www.unh.edu/news/docs/022009goldberg.pdf>. A synopsis is available at http://www.unh.edu/news/cj_nr/2009/mar/lw3goldberg.cfm.

Goldberg's recommendations on regulating the financial sector are based on his and Fryman's ground-breaking research and development of the Imperfect Knowledge Economics (IKE) model that asserts that exact models of purposeful human behavior are beyond the reach of economic analysis. He argues that the longstanding empirical failures of conventional economic models stem from their futile efforts to make exact predictions about the consequences of rational, self-interested behavior. Such predictions disregard the importance of individual creativity and unforeseeable sociopolitical change, thus usually failing to predict how markets behave.

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