At the Cato Institute's 29th Annual Monetary Conference (Epilogue)

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I wrote about the thoughts of others Wednesday as I took notes on their talks. I don't type that fast, so my notes gives synopses of the talks given.

Now for my own thoughts. I have a sympathy for anyone that wants to take monetary policy out of the hands of the government, because they don't do it well. Some sort of hard money standard is necessary, whether gold, silver, or a commodity basket.

Ideals

I have one major ideal here, and I don't care as much how it is accomplished: get the government out of the monetary policy business. My secondary ideal is regulating banks properly.

A gold standard could do the job, but I am not wedded to the idea. Gold standards can be inflationary or deflationary. It depends on the price at which you link the currency to gold. Post-WWI, Britain pegged it too high, and got deflation. France pegged it too low and got inflation. Getting the right level would be important. Fortunately, we know where it trades now relative to the dollar, and that would be pretty close to the right level, if the stated gold levels of the Fed and the Treasury are accurate.

Practical

A full audit of the Fed is a minimum, as is an audit of the gold at Fort Knox. Do it once, so that all doubts can be dispelled.

I think that bank regulation for leverage and asset-liability management is more critical than monetary policy itself. Banking crises stem from inadequate asset-liability management. As James Grant pointed out from the historical example that he gave, deposits should back only self-liquidating assets. Longer term assets must be backed by matching funding, or equity.

Unseasoned asset classes (i.e., asset classes for which we have no real loss statistics because they have never had failure as a group) should be disallowed as investments for banks except against surplus. After that, risk based capital should be based off of strict actuarial studies, with a significant provision against adverse deviation, and no credit for diversification. And, don't allow banks to score their own riskiness, a la Basel. That is ridiculous; the fox guards the henhouse. If a bank has superior risk control, they will earn the results over time; they should not as a result lever up more.

Now, I really don't care if it makes banks unprofitable, or earn less than their cost of capital. In that case, we will get fewer banks, the margins of the remainder will rise, and you end up with a genuinely stable system with occasional bank failures that don't threaten the system as a whole.

There was one idea that I thought could be put into practice immediately, Treasury Trust Bonds optionally backed by gold. If nothing else, like TIPS, it would give the Fed another indicator on how credible their monetary policy is.

Conference Zeitgeist

The Taylor Rule got some respect. Many suggested that if it had been followed, we would not have gotten into this crisis. I'm a little less optimistic there, because bank regulation was co-opted allowing for too much risk to be taken relative to liquidity and capital.

Most felt that the Fed was the major player in causing the crisis, with the GSEs playing a lesser role. The overpromotion of home ownership, and the constant provision of liquidity to the markets led borrowers to become reckless amid asset price inflation.

Incentives also played a role. Managerial and shareholder liability at banks would help prevent reckless behavior. Wall Street worked better when it was a bunch of partnerships, rather than limited liability corporations.

Most thought that things are worse now than the '70s. The debt levels are higher, which makes demand punk, and businessman more skittish to expand and hire. Government policy is less predictable as well.

The speakers largely expect more inflation; more debt monetization is the path of least resistance. Politicians get what they want without a vote being taken. On the question of where to invest, everyone was an inflationist. Gold, silver, TBT, were trotted out. Personally, I'll stick with my stock investing.

People

Jeffrey Lacker showed courage in coming to the conference. He made a really good point that the Fed should focus on its liability policies, and limit itself to investing in Treasuries. The Fed gets bad press and popular dislike when it uses its assets for special lending programs and bailouts, leading to charges of favoritism.

Zoellick was a reasonable guy regarding the problems in the Eurozone. Germany has to figure out what it wants. To me, it boils down to this:

1. You can have a suboptimal euro that is not a good store of value, and bail less well-disciplined governments out via the ECB sucking in their debts, or,
2. You can have a smaller Eurozone en route to no Eurozone, or,
3. You can have a Federal Europe, and dissolve Germany into Europe as a state of the whole, as the 13 colonies did after the Articles of Confederation.

Personally, I would choose #2, because people in Europe identify themselves with their nations, not as Europeans. Political and economic systems must derive from cultural systems or they will not work in the long haul.

It was fun seeing my old professor, Dr. Steven Hanke. I reminded him of nine years earlier, when he gave a talk to the (then called) Baltimore Security Analysts Society, and we discussed why we thought the Euro would have a tough time surviving. Most of that discussion is now taking place.

Ron Paul was Ron Paul. He doesn't change much — that's one of his apolitical virtues.

John A. Allison was entertaining; he argued that capital levels are too low, and regulation too high. He thinks that you can't expect much, and don't get much from regulation. Especially interesting were the discrimination in lending allegations by the regulators that BB&T fought and won twice.

Conferences like this attract cranks. Lots of people with odd political agendas hoping to get noticed, others with odd business propositions.

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