Former Fed Official William Poole: Bank bailouts are 'grossly unfair'

Anthony Massucci
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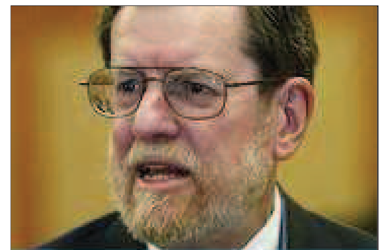
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As a former president of the Federal Reserve Bank of St. Louis, William Poole has a highly informed view of the Fed and the kinds of problems it has to grapple with. Right now, Poole says, the biggest challenge facing the U.S. economy is the "too-big-to-fail' issue." The government has taken on an "absolutely stunning increase in implicitly guaranteed assets," Poole says. "How good the guarantee is, remains to be seen."

"Before the financial crisis, there was some ambiguity about how far 'too big to fail' stretched to the banks," says Poole, who served as president of the St. Louis Fed bank from 1998 through 2008. "I don't think there was ever the expectation in the market that investment banks would be bailed out."

If another large bank or institution gets into trouble, in a manner similar to the breakdown of Lehman Bros., "it's going to take a brave Treasury Secretary and Fed chairman to let it go down," Poole says. "Even if times are relatively good and we're in a business-cycle expansion with things settling down, it will take a very brave Treasury Secretary, and it won't be obvious that it's the right thing to do, even then."

Nevertheless, when Federal Reserve Chairman Ben Bernanke spoke about 'too big to fail' on Oct. 1, he told Congress that the central bank is "well suited" to oversee colossal financial companies whose failure could endanger the entire economy. But Poole isn't as sure as Bernanke that the Fed can handle such a failure.

Poole currently serves as a senior fellow at the Cato Institute in Washington and as a distinguished scholar in residence at the University of Delaware. He spoke with *DailyFinance* on the phone from his home in Maryland about the bank bailouts and more, including a critique of "Fedspeak," the inflation threat, and rising unemployment.

***DailyFinance*: Are perceptions of the bailout still negative, or are folks not as upset as they were a year ago?**
Poole: It's clear that the general public is disgusted with the bailout. The general public understands that it's a grossly unfair and unreasonable situation for risks to be socialized and gains to be private. That's just common sense. What everybody seems to be hoping is that banks have learned a lesson, and I'm sure banks are going to be much more conservative.

But the same incentives for leverage are there that were there two years ago and three years ago that created this problem. In due time, some traders will be instructed to take those leveraged risks that come out with big profits, and it's going to be hard for others not to join in. It's going to be very hard for the Federal Reserve and others to stop them.

After the rate-setting Federal Open Market Committee's most recent meeting, it said the Fed may no longer need to use all of the economic tools available to it. How did you interpret that?

One thing I don't understand about the Fed is why they make trivial changes in language. Why do they do it? There's no real purpose in doing it. When Bernanke took office, he made a big point about clear communications. But the way you communicate clearly is not by indirection and by giving hints or foreshadowing. You use plain English to tell people what you're going to do. These hints and nods and winks may provide some wiggle room. That was probably [former Fed Chairman] Greenspan's strategy -- to not be too clear. What it does, is introduce more randomness into communication and more chance for misinterpretation.

How do you suggest the Fed could better handle FOMC statements?
The ideas that can't be explained in a paragraph or two in the statements ought to be explored more carefully in speeches and testimony. They should make the statement very simple and straightforward, not subject to a lot of second-guessing in terms of what they mean.

Some economists have suggested the Fed allow higher inflation to help boost U.S. economic growth. Do you agree?
The Fed's target inflation is around 2 percent. The market seems to have that priced in. To get to higher inflation deliberately would be a horrible mistake. I don't think [the Fed] would guide us there deliberately, but they may get there accidentally.

Where do you see unemployment topping out?
It would be easy for us to go over 10 percent. If the labor markets begin to strengthen a bit, that would lead to more people coming into the market, so you'll have people coming in and trying to look for jobs, who aren't immediately employed.

Anthony Massucci is a senior writer and columnist for DailyFinance. You can follow him on Twitter at hianthony.

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10-03-2009 @ 11:09AM

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10-03-2009 @ 4:45PM

brian fox said...

At first, I thought this guy was possibly thinking straight - then I get to the part where he responds to whether the banks had learned anything and suggested they were now more "conservative." As usual, these screwheads are totally out of touch - the only thing they are conservative about is giving loans while they hoard taxpayer bailout money to gamble in the market, increase leveraging, continue to work with derivatives , bundled securities, credit default swaps, and anything else that will make them fast, easy money.Oh yeah - and paying record bonuses. Does anyone but these vampires think the banks have changed anything about their behavior? If anything, they have gotten worse.

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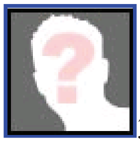3

10-03-2009 @ 11:01PM

S said...

BIG JOKES: Cato Institute, Competitive Enterprise Institute, and Center for Consumer Freedom.

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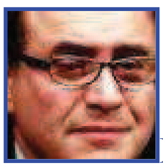
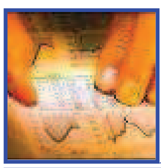
**More doom from Nouriel Roubini**

**Asian Markets: Nikkei hits 11-week low**

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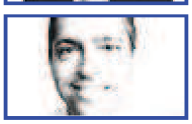 Anthony Massucci Senior writer and tech columnist

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