UDaily

Poole, UD distinguished scholar, offers lessons from the financial crisis

10:01 a.m., April 14, 2010----If you don't want to history to repeat itself, you must study it to learn a lesson. That was the takeaway from the presentation “What Have We Learned from the Financial Crisis?” by William Poole, former president of the Federal Reserve Bank of St. Louis and Distinguished Scholar in Residence at the University of Delaware, given at UD's 20th annual Hutchinson Lecture in macroeconomics held Thursday, April 8, in Purnell Hall.

William Poole delivers the Hutchinson Lecture.

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Lesson 1: Observe the cardinal rule of risk management -- maintain a substantial capital base.

“For years and years, the cardinal rule of risk management has been to match, at least to a considerable degree, the maturities of assets and liabilities,” said Poole.

“We understood that maturity mismatch was a core issue in the failure of so many savings and loans in the late 1980s and early 1990s. We also understood that risky portfolios ought to have a substantial capital base. A capital ratio of three to four percent never made good sense, but that was the level of capital maintained by Fannie May, Freddie Mac, Bear Stearns, Lehman Brothers and many others.”

Poole criticized federal government incentives as a contributing factor, but ultimately did not place blame there.

“The federal government did not make private firms create these bad portfolios,” said Poole. “The senior management and directors of these firms are responsible.”

As a remedy, Poole noted the importance of establishing appropriate incentives, including adjustments to current public policy options.

“Getting the incentives right will not guarantee financial stability, but will work in the correct direction,” he said.

Lesson 2: Contingency planning is essential to dealing effectively with a crisis.

“An actual crisis can never be foreseen accurately,” admitted Poole. “But the planning nevertheless provides the basis for responding appropriately when the crisis actually occurs.”

Poole cited the government response to 9/11 as an example.

“The effective Fed response to 9/11 was to a considerable degree a consequence of the planning for Y2K,” he said. “Nobody imagined an event like 9/11 would occur but it turned out all the Y2K planning really paid off during the crisis of 9/11.”

Lesson 3: Increase our economic literacy.

Citing an exchange he observed by members of Congress, Poole alleged there is an appalling lack of economic literacy in the legislative body.

“It appears that most members do not understand how the federal bank can create money,” he said.

Poole also claimed there was no substantial effort to prepare members of Congress as to what might have been done in response to the financial crisis.

Referring back to his earlier comments on establishing appropriate incentives and holding senior executives accountable, Poole also questioned the lessons students -- those future senior executives -- are learning in school. “When the crisis broke, I couldn't help but ask myself this question: what are universities teaching in their economic and MBA programs?”

Although Poole has not had the chance to answer this question, having only recently returned to research and a university setting, he did have a hypothesis.

“Economic and financial history is not one of the hot courses these days,” he said. “As I recall, by the time I left the Brown University faculty in 1998, economic history was not being taught at all.

“Modern finance has made enormous contributions and mathematical modeling is a powerful tool, but it seems to me there does need to be some study of economic history in every MBA curriculum.”

Citing the text *This Time Is Different: Eight Centuries of Financial Folly* by Carmen M. Reinhart and Kenneth S. Rogoff, Poole stressed the importance of sharing lessons learned.

“A lot of this has happened over and over and over again,” he said. “If we are to make progress in creating a more stable financial environment, surely lessons of experience need to be passed on to each new generation of students.”

Poole ended his lecture by taking questions from the audience.

Poole is Distinguished Scholar in Residence in the Department of Economics at the University of Delaware, senior fellow at the Cato Institute and senior adviser to Merk Investments.

He retired as president and CEO of the Federal Reserve Bank of St. Louis in March 2008. In that position, which he held from March 1998, Poole served on the Federal Reserve's main monetary policy body, the Federal Open Market Committee. During his 10 years at the St. Louis Fed, Poole presented over 150 speeches on a wide variety of economic and finance topics.

Before joining the St. Louis Fed, Poole was Herbert H. Goldberger Professor of Economics at Brown University. He served on the Brown faculty from 1974 to 1998 and the faculty of the Johns Hopkins University from 1963 to 1969. Between these two university positions, he was senior economist at the board of governors of the Federal Reserve System in Washington.

He was a member of the Council of Economic Advisers in the first Reagan administration, from 1982 to 1985. Poole was born and raised in Wilmington, Del.

The Hutchinson Lecture series, which is sponsored by the Department of Economics in UD's Alfred Lerner College of Business and Economics, was established in 1990 to honor the distinguished academic career of the late Harry D. Hutchinson, a professor of economics who taught at UD from 1959-89.

Hutchinson received his doctorate in economics from the University of Michigan and worked at UD for thirty years until his retirement. His career was distinguished by excellence in teaching and scholarship, particularly in the area of macroeconomics. His textbook, *Money, Banking & The U.S. Economy*, was the foundation for many students' introduction to financial institutions. Hutchinson died on July 28, 2005.

Each year a distinguished scholar and policy-maker is invited to present the Hutchinson Lecture. Previous lecturers include Paul Volcker, former chairman of the board of governors of the U.S. Federal Reserve System; Donald Kohn, vice-chair of the Federal Reserve System; Charles Plosser, Anthony Santomero and Edward Boehne, all presidents of the Federal Reserve Bank of Philadelphia; Laurence Seidman, Chaplin Tyler Professor of Economics at the University of Delaware; and David Hartzell, Distinguished Professor of Finance and Real Estate at the University of North Carolina-Chapel Hill and a UD graduate.

Poole, this year's speaker, presented the Hutchinson Lecture in 1999.

Article by Kathryn A. Marrone
Photo by Duane Perry