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Ex-Fed official warns of another crisis

Economist tells DeSales crowd that budget decisions, bailouts may hurt recovery

By Gregory Karp

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The U.S. economy might be starting to recover but the nation might be headed for another financial crisis if the federal government and other policy-makers don't make the right moves on the federal budget, bank bailouts and inflation , a former Federal Reserve Bank official said this week.

William Poole, an economist and former chief of the Federal Reserve Bank of St. Louis, spoke Tuesday to about 500 people at DeSales University in Center Valley about "The Crisis After the Financial Crisis."

The first contributor to a potential follow-up crisis is the federal budget, which calls for spending more than it takes in. Deficit spending and adding to national debt are likely to grow as the nation copes with the demographics of an aging population.

Aging baby boomers put pressure on such programs as Social Security, Medicare and Medicaid, as more people draw money from those programs and there are fewer young people to contribute to them.

The shame is policymakers knew about the problem 30 years ago when the government had more options to deal with it, he said. "We've squandered that time. We did nothing," Poole said. "This is not a problem we can put off for very much longer."

Without more fiscal discipline by the federal government, the nation makes itself vulnerable and world markets could start to question the United States' creditworthiness. "That would be a truly disastrous situation," Poole said.

The solution is seldom found in government itself, he said. And history has shown that economies based on a centralized government don't produce prosperity. "We should rely much more than we do on market-based processes," Poole said. "If it requires a [government] subsidy, we shouldn't do it."

One solution, Poole said, might be a Constitutional balanced budget amendment, which would generally forbid the federal government from running budget deficits -- or planning to spend more than it plans to take in.

The second contributor to a potential crisis is the implicit guarantee that Uncle Sam won't allow large financial institutions to fail.

The "too big to fail" issue was highlighted in recent years by the bailout of banks under the previous and current presidential administrations.

Poole said it was like the American people were providing insurance for banks, but those banks didn't have to pay any insurance premiums to taxpayers.

That free ride leads to outsized risk-taking by banks -- if big risks fail, the government will bail out banks.

"It's a totally unacceptable situation in a market-based economy," Poole said. "It's a recipe for another big financial crisis."

The third contributor to a potential crisis is the threat of rampant inflation.

History has shown that governments printing money to solve economic problems -- as the United States is doing now -- can lead to high inflation in prices.

Poole said he agrees with the current Federal Open Market Committee, which has decided it's too early to raise short-term interest rates to fight potential inflation.

But it will have to be done, and there is lag time between when the Fed makes such a move and the desired effect, he said.

"You don't wait until you're at the stop sign before you jam on your brakes," he said.

Despite the doom-and-gloom nature of his talk, Poole finished on a positive note, saying he was "optimistic in the abstract." He explained that he has nothing in particular to be optimistic about; just that the United States has been through difficult times before, several events more difficult than the current financial crisis, and it always seems to find solutions and go on to greater prosperity.

Among other positions, Poole is a senior fellow at the Cato Institute, a non-partisan conservative think tank in favor of free markets.

His talk Tuesday was part of the Rev. Thomas J. Furphy Lecture Series at DeSales, held annually.

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