

The Three R's of Bank Policy

Prepared for the Federal Reserve Bank of Richmond
2010 Credit Markets Symposium

April 15, 2010

by

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Resources for Growth

- Go easy on accounting measures
- Subsidize earnings through low interest rates
- Promote continued investment

Banking Lessons from the Past: The 1938 Regulatory Agreement Interpreted

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We show that the interagency 1938 Uniform Agreement on Bank Supervisory Procedures set the precedent for dynamically varying supervisory standards to conform to national macroeconomic policies and political agendas. Our evidence indicates that the conferences leading to the Agreement were motivated and dominated by the Federal Reserve. Contrary to the goals of the other banking agencies, the Fed sought greater leniency in bank examination in order to stimulate bank credit creation. This precedent for softening examination standards was paralleled in 1991-1992 when the administration and regulatory agencies attempted to offset a proclaimed "credit crunch" by subordinating bank examinations to the perceived need for more bank credit. The implied risk of trading off bank safety for short-lived economic policies merits more open national debate.

The Treasury-Fed Accord: A New Narrative Account

Robert L. Hetzel and Ralph F. Leach

The fiftieth anniversary of Federal Reserve Independence Day was March 4, 2001. After World War II ended, the Fed continued its wartime pegging of interest rates. The Treasury-Fed Accord, announced March 4, 1951, freed the Fed from that obligation. Below, we chronicle the dramatic confrontation between the Fed and the White House that ended with the Accord.¹

Reallocate Assets

- Maintain credit supply commensurate with credit demand
- Prevent disintermediation and preserve lending relationships
- Provide bank capital and reserves to fuel charge-offs

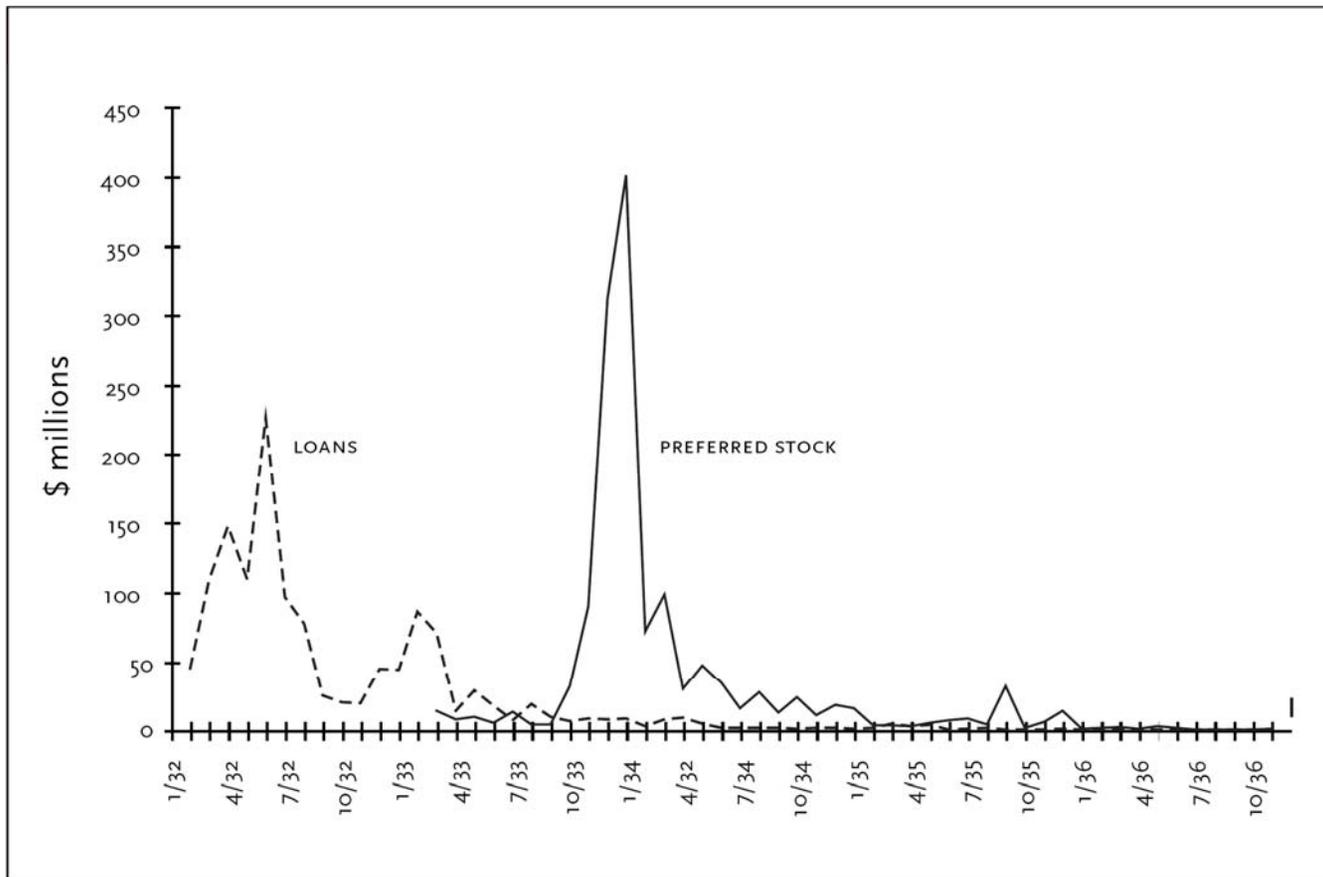


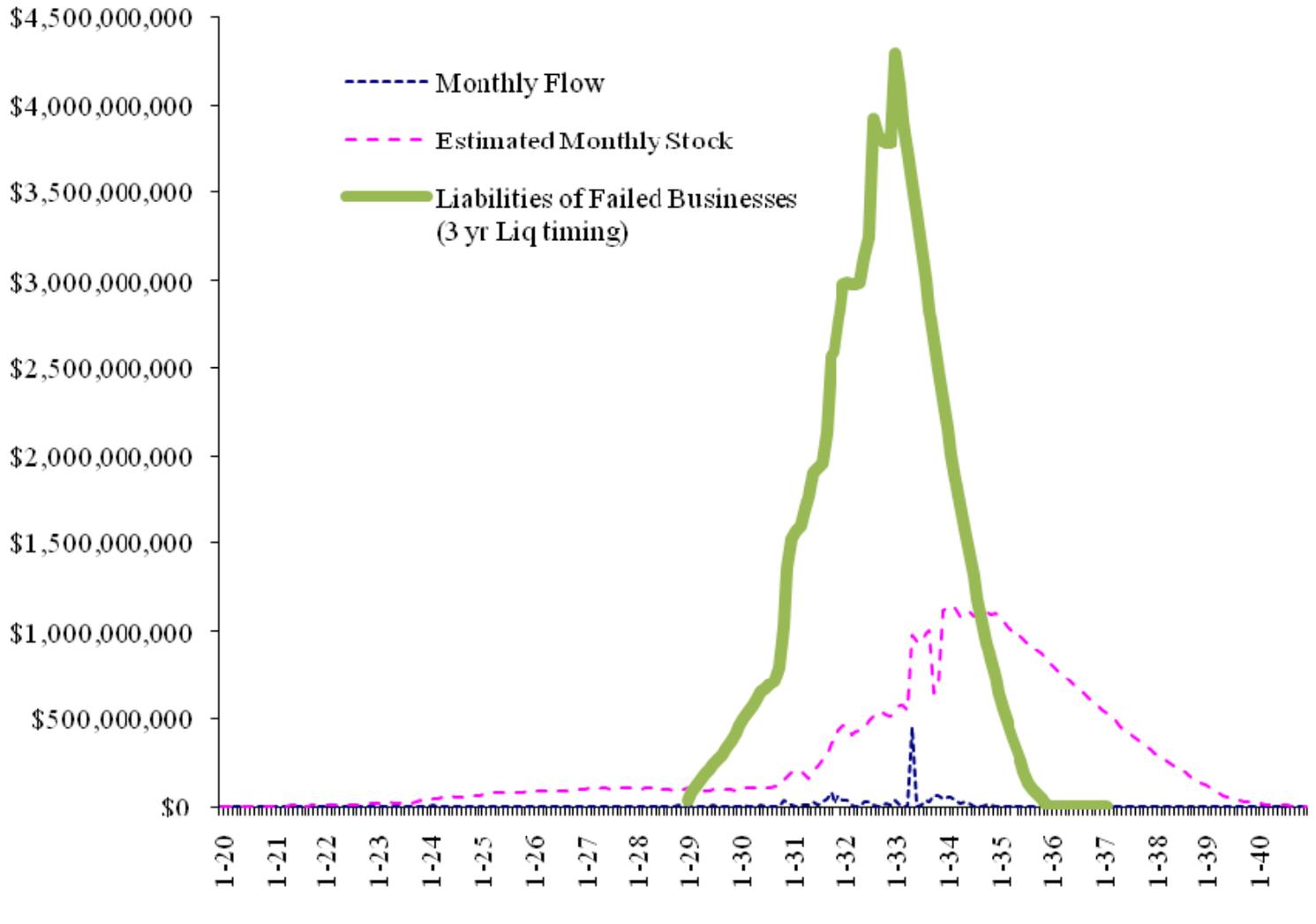
Figure 3.3 Amounts of authorizations under RFC loan and preferred stock programs, monthly, 1932–1936 [Source: RFC monthly reports to Congress, various issues.] [Note: Figures include only loans to open banks. Does not include loans to receivers or those made on preferred stock. The RFC preferred stock program began in March 1933. Preferred stock includes investments made through notes and debentures to banks in states that prohibited preferred stock investments.]

Mason, Joseph R. “The Evolution of the Reconstruction Finance Corporation as a Lender of Last Resort in the Great Depression,” in *Bailouts and Government Rescues*, Robert E. Wright, ed. New York: SSR/Columbia University Press, 2009.

Resolve Failed Institutions

- Quarantine bad banks to alleviate asymmetric information
- Improve resolution technology
- Get cash to creditors but avoid fire sales

National Bank and Commercial Failures and Liquidations



Source: Mason, Joseph and Kris Mitchener, "Blood and Treasure": Exiting the Great Depression and Lessons for Today," Oxford Review of Economic Policy, forthcoming 2010

US Policy Focus

- Mortgage Modifications
- Accounting Forbearance
- No Quarantine

- Subsidize Earnings
- Direct Credit and Capital

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Policy Response to Crises

Expansionary crisis response policies such as price inflation, competitive foreign exchange devaluations, subsidized credit, and even nationalization of strategic industries are known to be destructive to the long-term growth of developing countries primarily because they set the stage for crony capitalism or worse, absolute kleptocracies.

Such policies are always accompanied by moral hazard of political capture, where an accommodative central bank is turned into a functionary of the state that seeks to allocate funds to favored industries and, ultimately, inflate away the debt burden arising from the cost of doing so.

Source: Mason, Joseph and Kris Mitchener, "Blood and Treasure": Exiting the Great Depression and Lessons for Today," Oxford Review of Economic Policy, forthcoming 2010

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- Crystallize Ability for Congress to do the Same in the Future
- Maintain Policy Risk

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