Testimony
of
William Poole
Distinguished Scholar in Residence, University of Delaware

U.S. Joint Economic Committee
Hearings on Monetary Policy Issues
March 27, 2012

Testimony of William Poole

Chairman Casey, Vice Chairman Brady, members of the Committee, I am pleased to be here this morning to comment on monetary policy issues raised by the draft Sound Dollar Act. My biographical information is attached to the end of my statement. For present purposes, the most relevant part of my career is my ten years as President and CEO of the Federal Reserve Bank of St. Louis.

Mandate for Price Stability

I applaud congressional support for a clear assignment of responsibility to the Federal Reserve to achieve price stability, defined as a low and stable rate of inflation. I encourage Congress to make the mandate explicit by incorporating in law the decision of the Federal Open Market Committee to define the goal as 2 percent inflation. As the FOMC emphasized in its statement on this goal, price stability does not preclude policy actions in furtherance of other goals provided that they are consistent with price stability. In fact, policy actions to mitigate undesired changes in employment can only be successful over time in an environment of price stability and market confidence in the Fed's pursuit of that goal.

Unfortunately, clarity of the goal of price stability in the Sound Dollar Act is muddied by reference to Fed "monitoring" asset prices. In pursuit of the goal of price stability, the Fed monitors many different measures of economic performance, including asset prices. It would be unfortunate if mention of asset prices in the law created undue pressure on the Fed to act in some way or other as asset prices change. Obviously, asset price bubbles can be a serious problem. However, there is no settled understanding of how the central bank or anyone else can reliably identify an asset price bubble as it is occurring.

Nor does the policy literature provide any guidance as to what the central bank should do if it wants to influence asset prices. The history of central bank and Treasury meddling in the foreign exchange market provides clear evidence of the harm that can be done by government intervention designed to influence an asset price. I urge you in the strongest possible terms not to include mention of asset prices in any legislation directing the activities of the Federal Reserve.

I do not disagree that monetary policy has important effects on the international value of the dollar. However, requiring that the Fed report on the effects of its policy on exchange rates is an invitation to mischief. Fed policy has important impacts on a wide range of variables, including exchange rates. The appropriate place for the Fed to discuss the impact of its policies is in the semi-annual monetary policy hearings. There is ample opportunity for members of Congress to question the Fed chairman on a wide range of issues, including the effects of policy on exchange rates.

Assets to be held by the Federal Reserve in the System Open Market Account (SOMA)

I strongly support restriction of assets in the SOMA to direct obligations of the U.S. Treasury. Without getting into an analysis of all of the non-Treasury assets the Fed has purchased, consider the mortgage-backed securities portfolio.

Since World War II, the U.S. Government has engaged in a variety of credit programs—for better or worse, I might add. These include farm credit, student loans, Export-Import Bank loans, Small Business Administration loans and so forth. Congress makes judgments about the amount of such credit to be offered, program objectives, eligibility, interest rate and other loan terms, disclosure and so forth. These judgments belong with Congress and not with the Federal

Reserve because the judgments inherently have a political component to them. Congress authorized Fannie Mae and Freddie Mac, for example, and the process by which they have been brought into federal conservatorship under provisions of law.

The Federal Reserve has set its own rules for buying MBSs. Other aspects of federal aid to the hard-hit housing sector have been matters for Congress and the President, but not the Fed's purchases of MBSs. Suppose the Fed's initial decision to purchase $1.25 trillion of MBSs had instead been a recommendation to Congress for legislation to do the same thing, except that the Treasury would administer the program and hold the portfolio. What would some of the questions have been as Congress debated the proposal?

Given the federal budget situation, would it have been wise to issue $1.25 trillion of government bonds to provide the resources to purchase a portfolio of MBSs of like size? Should the entire $1.25 trillion have been used for MBSs, or should some expand SBA loans, or help students struggling with student loans? There were many other possible ways of using an extra $1.25 trillion of federal credit. Moreover, the program was financed not by sale of Treasury securities but by money creation. Was that wise? Shouldn't these and other issues have been debated by Congress?

Beyond that, who has benefited from the Fed program to accumulate and maintain a large portfolio of MBSs? A significant fraction of mortgages issued in recent years has been refinacings. I have refinanced my mortgage twice, for example. Who can refinance? Only those with substantial equity in their properties, despite the decline in house prices, and those with good credit ratings. I qualify on both counts. Why should the Fed be helping me and others in fortunate circumstances such as those I enjoy?

I suggest that the JEC request a study from the Federal Reserve to report on the characteristics of the mortgages in the MBSs in the SOMA. I understand that the required data are readily available through CoreLogic. I believe that the benefits of Fed purchases of MBSs have gone primarily to homeowners in comfortable circumstances and to banks and title companies that collect fees from mortgage financing. The program has done little to spur homebuilding. The monetary effects of expanding the SOMA would have occurred in equal measure if the Fed had purchased Treasury securities instead of MBSs.

The bottom line is that use of the credit resources of the U.S. Government should be decided by Congress and not by an appointed body such as the Federal Reserve. For the Fed to make these decisions embroils it unnecessarily in political decisions and has no monetary policy purpose.

Emergency Powers

Section 13(3) of the Federal Reserve Act provides that the Federal Reserve can extend credit to a wide range of participants "in unusual and exigent circumstances." I urge this Committee to study what this phrase means or ought to mean.

I looked into this issue in 2009 because I believed at the time that the Fed had abused its emergency powers during the financial crisis. At my request, a lawyer friend of mine prepared a memo on the legislative history and legal meaning of "unusual and exigent circumstances." He prefers to remain anonymous; thus, the author of the memo, which is attached at the end of my remarks, is listed as "anonymous."

The meaning in the law of "unusual and exigent circumstances" is nicely illustrated by the situation of a police officer at the door of a house who has good reason to believe that a crime is occurring in the house. Ordinarily, the officer must obtain a search warrant before entering.

However, if a crime is being committed, the officer ought to enter and can do so legally without obtaining a search warrant.

In the context of a financial emergency, a crisis over a weekend does not permit time for the Federal Reserve to appeal to Congress to act. However, whenever there is time for Congress to act the Fed ought to recommend to Congress appropriate emergency action. The Fed ought not to make the judgment that Congress is unable to act because of the politics of the situation.

To an outside observer, what seemed to have happened is this. During the peak of the crisis in September 2008 and the months immediately following Treasury Secretary Henry Paulson and Fed Chairman Ben Bernanke believed that Congress would not act as required to stem the crisis and that the Fed needed to rely on an expansive interpretation of its emergency powers. I believed at the time that the Fed's responsibility was to go to Congress for credit programs beyond the weekend emergencies that led to the bailouts, wisely or not, of Bear Stearns and AIG.

In an op-ed article posted on the Cato Institute web site in July 2009, I discussed the Fed's MBS purchase program and its Commercial Paper Funding Facility (CPFF). The Fed announced the CPFF program on October 7, 2008 and made the first loans about 3 weeks later. The Fed announced the MBS program November 25, 2008. The first appearance of MBSs on the Fed's balance sheet was in mid January 2009.

The CPFF and MBS programs should have been authorized by Congress, assuming they should have been authorized at all. Neither the CPFF nor the MBS program reflected a weekend emergency. The financial crisis called for quick and decisive action, but not immediate action decided in a matter of hours. If there was an emergency at all, it was because of congressional unwillingness or inability to act and not because Congress did not have time to act. If Congress were unable to act, because of its concern about the politics of the CPFF program to provide credit to large corporations, should a federal agency make its own decision on what is necessary, committing taxpayer resources amounting to hundreds of billions of dollars? Worse yet, while legislated programs would have been financed by sale of new Treasury securities, the Fed's programs were financed by monetary expansion—printing money.

The two programs were large. The CPFF reached a peak of $350 billion in mid January 2009; the MBS program eventually amounted to $1.25 trillion. This enormous credit expansion was financed by printing money.

The assumption that Congress could not act in a timely fashion is challenged by the relatively prompt enactment of the Troubled Asset Relief Program, proposed by Secretary Paulson in mid September 2008 and signed into law by President Bush about 2 weeks later. The American Recovery and Reinvestment Act of 2009, which President Obama signed into law less than 30 days from taking office, is another example of prompt congressional action during the financial crisis.

The Fed should better define its lender of last resort policy, but the most important part of doing so is for Congress to deny the Fed the power to hold assets other than Treasuries in the SOMA. If the expansive power remains available to the Fed, in time of crisis politicians, the Fed and market participants will assume that the Fed will use the power. Without the power to hold assets other than Treasuries in the SOMA, the Fed could not have bailed out Bear Stearns. Anyone opposed to Fed bailouts ought also to favor restriction of the SOMA to Treasuries.

FOMC Voting Membership

I myself would not change this provision in the Federal Reserve Act. Current arrangements have worked satisfactorily and the clarity of ultimate political control from Washington is appropriate. It would be most unfortunate if reserve bank presidents came to be appointed by the President of the United States and confirmed by the Senate. Running appointments through Washington would damage the Fed's political independence. Although a Washington appointments process is not in the Sound Dollar Act, it would be all too easy for that to be the end result of a an apparently "minor" amendment to the draft act during the legislative process.

Consumer Financial Protection Bureau (CFPB)

It is an abomination that this entity was placed off budget by sticking it in the Federal Reserve. The Fed should have fought the arrangement. Congress often emphasizes that the power of the purse and transparency are essential to democratic governance. Quite frankly, members of Congress who voted for this arrangement should be embarrassed. I fully endorse the proposal to establish the CFPB as an agency outside the Federal Reserve.

Memorandum on "unusual and exigent circumstances"

MEMORANDUM

DATE: July 7, 2009

TO: William Poole

FROM: Anonymous

RE: Unusual and exigent circumstances

ISSUE:

What is the meaning of the phrase "unusual and exigent circumstances," found in the Federal Reserve Act, Section 13(3)?

BRIEF ANSWER:

"Unusual and exigent circumstances," as it relates to the Federal Reserve Act, refers to unforeseen financial circumstances that require immediate action or remedy, particularly when necessary to ensure the survival of a business entity. While there is no legislative history showing, what Congress intended this phrase to mean, case law demonstrates what "exigent circumstances" meant at the time in the context of financial conditions.

DISCUSSION:

I. THE LEGISLATIVE HISTORY AND APPLICATION OF THE 1932 AMENDMENT TO THE FEDERAL RESERVE ACT DO NOT PROVIDE ANY DEFINITION OF THE PHRASE "UNUSUAL AND EXIGENT CIRCUMSTANCES."

The legislative history of the Federal Reserve Act amendment does not explain the meaning of the phrase "unusual and exigent circumstances." The 1932 act that amended the Federal Reserve Act was actually a combination of two House of Representatives bills: H.R. 9642, a proposed highway-building project aimed at putting unemployed Americans to work, and H.R. 12445, which proposed broader lending powers for the Reconstruction Finance Corporation, a government agency created during the depression to support economic recovery.

75 Cong. Rec. 4,893, 12,244 (1932). The two bills were later brought together under the number of the first. *Id.* at 15,095-96. The provision amending the Federal Reserve Act was not in either original bill; its first appearance came as part of a proposed alternative bill in the Senate. *Id.* This version included the Section 13 amendment as a replacement for a provision granting broad powers to the Reconstruction Finance Corporation to loan to corporations and individuals. *Id.* Because it was proposed late in the process as part of an alternative resolution, well after the filing of the committee reports, the provision was never discussed in committee. In addition, the amendment was a small and relatively minor part of the bill, and the phrase "unusual and exigent circumstances" or anything similar was never discussed in the debates. The bill was passed without Congress providing any guidance for the construction of "unusual and exigent circumstances."

The history of the section's implementation is no more informative of the meaning of this phrase. Prior to the collapse of Bear Stearns, the Federal Reserve Board of Governors had not invoked Section 13(3) since 1936.[1] When the Board of Governors decided to extend credit to JPMorgan for the purchase of Bear Stearns, it never provided an explanation as to what constituted unusual and exigent circumstances, or why they existed, but instead merely asserted that they existed.[2] Minutes of the Board of Governors of the Federal Reserve System, Mar. 14, 2008. Also, because of the long-time dormancy of Section 13(3), there has not been any case law addressing the construction of this particular clause within the Section. Neither the history of the statute nor the history of its usage provides any clear definition of what Congress meant by "unusual and exigent circumstances."

---

[1] David Fettig, *Lender of More Than Last Resort*, The Region, Dec. 2002, at 18. In the four years after its inception, Section 13(3) was only used to make 123 small loans totaling just $1.5 million. *Id.* The later-added Section 13(b), which was enacted in 1934 and repealed in 1958, authorized loans to private corporations without an exigent circumstances requirement, and was employed to a much larger extent. *Id.* at 18, 19, 43-46. Thus, the recent use of this provision is truly unprecedented, due to both the amount of money involved and the prior dormancy of this power.

[2] This may, in fact, be all that is required under Section 13(3). *See infra* p. 5.

II. DEFINITIONS OF EXIGENCY AND EXIGENT CIRCUMSTANCES IN OTHER LEGAL AUTHORITY FROM THE PERIOD PROVIDE A USEFUL DEFINITION OF THE PHRASE IN A FINANCIAL CONTEXT AS APPLIED IN SECTION 13(3).

Black's Law Dictionary (3d ed.), published in 1933, did not have a definition of "unusual and exigent circumstances." It did, however, have a definition of exigency: "Demand, want, need, imperativeness; emergency, something arising suddenly out of the current of events; any event or occasional combination of circumstances, calling for immediate action or remedy; a a pressing necessity; a sudden and unexpected happening or an unforeseen occurrence or condition." Black's cited a District Court case which further defined exigency, equating it to emergency, and describing it as "something which arises suddenly out of the currents of events" and "any event, or occasional combination of circumstances, which calls for immediate action or remedy." *United States v. Atlantic Coast Line Co.*, 224 F. 160, 166 (E.D.N.C. 1915). In that case, a law prohibiting railroad telegraph operators from working for more than nine continuous hours, except in case of emergency, was held to permit an operator to remain at the switchboard longer than nine hours when his relief was unexpectedly and irretrievably deposed, with no way to bring in a substitute. *Id.* While these provide a useful definition of exigency at the time the 1932 amendment was enacted, it does not define the phrase in the context of the Federal Reserve Act.

However, there is case law addressing a similarly worded section of the United States Code that provides some insight. Under 41 U.S.C. §5, the Government is required to advertise for contract proposals "for a sufficient time" before contracting for goods or services, except for under certain circumstances, including "when the public exigencies require the immediate delivery of the articles or performance of the service."[3] In *Good Roads Machinery Co. of New England v. United States*, an action to recover for equipment sold under a contract with the United States, the Government argued that its own contract with the plaintiff was invalid

[3] The term "public exigencies" is somewhat dated – the language of this statute dates back to 1861. Act of Mar. 2, 1861, ch. 84, Sec. 20, 12 Stat. 220. However, the definition used by the Court parallels exigency and exigent circumstances in general.

because there was no bidding period for the contract. 19 F.Supp. 652, 653 (D.Mass. 1937). Referencing the statute, the Court defined "public exigency" as "a perplexing contingency or complication of circumstances; or a sudden or unexpected occasion for action" necessitating immediate delivery of the goods or services. *Id.* at 654. The Court held that the Great Depression, and the related need to put people to work, constituted a public exigency, as evidenced in part by the fact that the Government had at the time "recognized that a sudden and unexpected occasion for action had arisen, and were directing their best efforts to solving the complicated and perplexing problem of unemployment." *Id.* Under this section of the U.S. Code, financial conditions arising out of an economic crisis are sufficient to be considered an exigency.

Another case provides a direct example of a legal determination of exigent circumstances based on the financial health of an individual corporation. In *Carson v. Allegany Window Glass Co.*, a minority stockholder sought to have the defendant corporation placed in receivership due to self-dealing by the president-majority stockholder of the corporation. 189 F. 791 (D.Del. 1911). While there was no statute authorizing the appointment of a receiver when the corporation in question is solvent, the Court recognized that "[s]pecial and exigent circumstances[4] may, in the absence of a statute, warrant and justify a receivership of a corporation, although solvent…." *Id.* at 796. The Court did not find that a simple shareholder dispute over how the current board or president conducted business constituted special and exigent circumstances, and stated that such a finding would require facts clearly disclosing "such fraudulent, willful or reckless mismanagement…as to produce a conviction that further control of the corporation by the same board would result in the destruction of its business and insolvency, or cause great and unnecessary loss to its creditors or stockholders." *Id.* The fraud and misconduct, however, are not the exigent circumstance, but the cause of the exigent circumstance; what the Court stressed as being the trigger for exigency is "the probability of

---

[4] It is noteworthy that the language used in this 1911 case is nearly identical to the language used in the 1932 amendment.

serious and substantial disaster or ruin to the corporate enterprise." *Id.* at 797. Therefore, in the context of determining whether to transfer control of a corporation, the Court looked to whether the conditions under those currently in control created a need for immediate action to protect the corporation. By analogy, in the context of determining whether to grant an emergency loan under Section 13(3), it follows that "unusual and exigent circumstances" would exist if extraordinary and unforeseen financial conditions left a corporation with a lack of funds that necessitated immediate action.[5]

CONCLUSION

The phrase "unusual and exigent circumstances" in Section 13(3) of the Federal Reserve Act is not clearly defined within the act. The legal definition of exigency in general is any situation or combination of circumstances that creates an immediate and pressing need for action. Drawing analogies from other cases in the financial field addressing exigent circumstances, it appears that Section 13(3) refers to situations in which loans are necessary to prevent the catastrophic failure of a corporation, and that a national economic crisis can give rise to exigent circumstances.

[5] It is worth noting that Section 11(r) of the Federal Reserve Act, added in 2002, permits the Board to come to utilize its 13(3) powers in situations where there are less than five members present.[5] 12 U.S.C. 248(r). This provision was part of a larger bill aimed at providing insurance in the event of terrorist attacks. While the legislative history does not address the provision amending the Federal Reserve Act specifically, one can assume the reason for it was so that the Board could take immediate action in response to a financial crisis so exigent that even a delay to contact other Board members by phone "or other electronic means" would be too long (as reflected in 11(r)(1)(A)(ii)(IV)). As it was geared towards emergency situations, the requirements under which the Board may utilize its 13(3) powers with less than five members present are stringent: the present members (there must be at least two) must unanimously determine that exigent circumstances existed, that the borrower is unable to secure credit through other means, that action is necessary to prevent "serious harm to the economy or the stability" of the U.S. financial system, that they have been unable to contact the other board members by any means available, and that waiting any further to do so would be impossible.

William Poole Biographical Information

William Poole is Senior Fellow at the Cato Institute, Distinguished Scholar in Residence at the University of Delaware, Senior Advisor to Merk Investments and a Special Advisor to Market News International.

Poole 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, he served on the Federal Reserve's main monetary policy body, the Federal Open Market Committee. During his ten years at the St. Louis Fed, he 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 received his AB degree from Swarthmore College in 1959, and MBA and Ph.D. degrees from the University of Chicago in 1963 and 1966, respectively. Swarthmore honored him with the Doctor of Laws degree in 1989. He was inducted into The Johns Hopkins Society of Scholars in 2005 and presented with the Adam Smith Award by the National Association for Business Economics in 2006. In 2007, the Global Interdependence Center presented him its Frederick Heldring Award.

Poole has engaged in a wide range of professional activities, including publishing numerous papers in professional journals. He has published two books, *Money and the Economy: A Monetarist View*, in 1978, and *Principles of Economics*, in 1991. In 1980-81, he was a visiting economist at the Reserve Bank of Australia and in 1991, Bank Mees and Hope Visiting Professor of Economics at Erasmus University in Rotterdam. At various times, he served on advisory boards of the Federal Reserve Banks of Boston and New York, and the Congressional Budget Office.

Poole appears frequently on the speaking circuit and is well known for his commentary on current economic and financial developments.

Poole was born and raised in Wilmington, Delaware. He has four sons.