BANK TAKEOVERS

It’s a ‘vile’ business: Ex-Fed chief

LEGENDARY former Federal Reserve chairman Paul Volcker, lecturing in Singapore, did not hide his disapproval on banks having to be bailed out by state takeover.

“These kinds of measures — government guarantees and intervention — are extremely disheartening. They are not consistent with the vibrant private markets that you associate with the world’s financial system,” said Mr Volcker, who headed the United States Federal Reserve from 1979 to 1987.

“But, however disheartening, I’m afraid they are necessary.”

Speaking yesterday at a lecture organised by the Lee Kuan Yew School of Public Policy — where Mr Volcker sits on the governing board — the former economist underlined the gravity of the ongoing crisis by urging that governments have little choice but to inject equity into wobbly financial institutions, and deal with the repercussions later.

The United States administration, a staunch believer in the free market mechanism, would traditionally have shunned such a move but is now following suit after a series of European nations followed Britain’s lead on Monday.

Critics of such direct government intervention decry the moral hazard, potential irresponsible lending and bank insolvency that it might bring.

“We’ve had a number of crises — five, six, seven crises in the last 25 years. But we’ve always managed to walk on top of them without great damage to the real economy. Now this crisis is an exception,” said 81-year-old Mr Volcker, a lifelong Democrat, who has endorsed Senator Barack Obama in the US Presidential election.

During a Q&A session, one question that repeatedly cropped up in various forms was whether the financial turmoil in recent weeks — which had come on with alarming speed since the September 15 collapse of Lehman Brothers — could have been averted had the US government stepped in to save the investment bank.

While he had no answers to such a hypothetical question, Mr Volcker felt the US government’s “experiment” with Lehman Brothers would have caused it to think twice before letting any banks fold from now on.

“The moral hazards are overwhelmed by the intensity of the financial crisis ... Should this just left to the free markets? The risk is too great, I don’t think the government had much alternatives,” Mr Volcker said.

In 2005, he had sounded the alarm bells in an annual economic summit, saying that the underlying “huge imbalances and risks” — including the budding current account deficit — in the US economy were a recipe for disaster.

As to why none of the “brilliant minds” in Wall Street paid heed to his warning, Mr Volcker mused: “These brilliant minds were making money.”

Recounting what a top banker told him just last year, Mr Volcker added: “He was saying, ‘So long as the music plays, we will continue to dance.’”

Besides the “excessive” rewards for risk-taking, Mr Volcker pinned the blame squarely on the rise of financial engineering — the practice of devising complex financial products, which caused the financial markets to “become so opaque that it was difficult to analyse the risks”.

It would be a while before the global economies recover from this latest setback. But as the governments pick up the pieces in time to come, Mr Volcker was certain what needs to be done — although he was not quite sure exactly how.

“They have to restructure the compensation system; Reward success in the longer run, less reward for success in the short run. Politically, something needs to be done, but nobody knows what to do.”