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I KEPT MY EYES OPEN FOR 127 HOURS

December 13, 2010

Fed's Contrarian Has a Wary Eye on the Past

By SEWELL CHAN

KANSAS CITY, Mo. — All year, Thomas M. Hoenig has been saying no.

As the lone dissenter on the Federal Reserve committee that sets interest rates, Mr. Hoenig, the president of the Federal Reserve Bank of Kansas City, has been a persistent skeptic of just about everything the Fed's chairman, Ben S. Bernanke, has done to try to stimulate the flagging recovery.

Mr. Hoenig's latest, loudest objections, aimed at the Fed's risky $600 billion infusion into the markets to reinvigorate the economy, have made him a champion of the Fed's critics in Congress, on Wall Street and among business leaders, who, like Mr. Hoenig, fear that the central bank is risking runaway inflation, asset bubbles and a weakened dollar.

At 64, Mr. Hoenig has witnessed jolts in the nation's economic history that make him deeply skeptical of short-term fixes. He says he believes the Fed's tools for fixing the economy in the short run are limited and the potential for things to go disastrously wrong is very high.

If it were up to him, he would keep interest rates very low, but would not promise to keep them at essentially zero for "an extended period," as the Fed has announced. He says he thinks that trying to lower long-term rates, as the Fed is doing by buying bonds, is a mistake. The recovery, however slow and painful, he says, cannot be hurried.

As the longest-serving regional Fed president, his views are shaped by the uncontrolled inflation of the 1970s, the spike in land prices that followed and the ensuing banking and thrift crises.

To him, Mr. Bernanke's plan is "a dangerous gamble" and "a bargain with the devil," strong words that have rankled some officials of the Fed, where dissent is tolerated but not celebrated.

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In an interview on Dec. 6 in his office here, he did not appear to relish going against the grain, but lately he has not been running from the spotlight. “It’s never easy to disagree against a majority,” he said. “It’s hard. It’s not something that I take lightly.

“Some people think I should be more part of the group,” Mr. Hoenig said. “I’m not a group person.”

A month after the Fed announced its intentions to buy bonds and push down interest rates, investors have done the opposite by driving up long-term rates, hardly a help to a sputtering recovery.

Mr. Hoenig, who is likely to vote no again on Tuesday when the committee meets for the last time this year, said it was too early to say whether the market reaction and the uncertainty had vindicated his position.

“I don’t want to say that I’m right and someone else is wrong,” he said. “Only time will tell whether I’m correct.”

The son of a Midwestern plumbing contractor, Mr. Hoenig (pronounced “HAWN-ig”) spent his career at the Kansas City Fed. He is cautious, courtly and hardly a partisan, though he recently addressed Congressional Republicans at their invitation. In his unwavering dissents, seven this year, and in his wariness of Wall Street, his views seem rooted in the agrarian and populist tradition that is mistrustful of concentrations of power.

He has called for breaking up giant Wall Street banks and severely restricting their trading activities, a stance that has endeared him to some liberals. He is commonly characterized as an inflation hawk, a label Mr. Hoenig rejects as overly simplistic. If he is hawkish on anything, he says, it is financial stability.

“I don’t like having unemployment at 9.8 percent,” he added. “It’s just unacceptable.” He concedes, however, there is not much the Fed can do about it.

As a young economist, he witnessed the rampant inflation of the 1970s, which was curbed only after Paul A. Volcker became Fed chairman in 1979 and promptly raised interest rates to double-digit levels, setting off two painful recessions. The strong medicine worked; inflation has been largely under control since 1982.

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During the 1980s, Mr. Hoenig worked in bank supervision and regulation at the Kansas City Fed, where an agricultural crisis and land bubble prompted a string of bank failures. Those

included the collapse of Penn Square Bank in Oklahoma City in 1982, Mr. Hoenig's first experience managing a crisis, and later the Continental Illinois insolvency, then the nation's largest bank failure.

Mr. Hoenig said he believed the Fed had not always learned from its mistakes. By keeping interest rates too low for too long, in his view, the Fed contributed to the dot-com bubble that burst in 2001 and the even bigger housing bubble that popped in 2007. (Before this year, Mr. Hoenig had dissented four times, in July 1995, May and December 2001 and October 2007, all in opposition to lowering short-term interest rates.)

"It is my concern that, by understandably wanting to see things move more quickly, we create the conditions for repeating the mistakes of the past," he said.

Mr. Hoenig's mantra is that monetary policy works with "long and variable lags," meaning that the consequences of today's policies may not be felt until much later. By keeping short-term interest rates near zero, as the Fed has done since December 2008 — and which he supports but not indefinitely — the central bank is increasing the risk of inflation and instability down the road, he says.

But most Fed officials say they believe that Mr. Hoenig's worries are exaggerated. In a televised interview this month, Mr. Bernanke said he was "100 percent" confident of the Fed's ability to tighten monetary policy and raise interest rates when the time came, and called fears of inflation "way overstated."

Other economists say Mr. Hoenig's viewpoint has seemed inflexible.

"I find it hard to understand why Hoenig is still worried about inflation when the obvious trend is downward, toward lower inflation with a risk of deflation," said Joseph E. Gagnon, a former Fed economist who is at the Peterson Institution for International Economics in Washington.

Mr. Hoenig's contrarian disposition partly reflects his Midwest upbringing, far from the Wall Street-Washington axis of influence.

The second of seven children, Mr. Hoenig grew up in Fort Madison, Iowa. He attended a small college in Kansas, was drafted into the Army and served a year in an artillery unit in Vietnam, then received a Ph.D. in economics at Iowa State. He joined the Kansas City Fed in 1973 and became president in 1991.

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Lu M. Cordova, the chairwoman of the Kansas City Fed's board, said Mr. Hoenig did not seek attention. Indeed, he sought the board's guidance before he delivered a March 2009 speech, "Too Big Has Failed," which received widespread notice. "He really agonized about whether to speak out or not," she said.

Even critics of Mr. Hoenig acknowledge he has been prescient.

In a speech in 1999, shortly after Congress repealed the Glass-Steagall Act, the Depression-era law that separated investment banking from commercial banking, he warned that "in a world dominated by mega-financial institutions, governments could be reluctant to close those that become troubled for fear of systemic effects on the financial system."

Sure enough, in 2008, the Fed helped sell Bear Stearns to JPMorgan Chase, rescued the American International Group and, after the collapse of Lehman Brothers, bailed out the financial system.

The crisis has only made the biggest banks even bigger. "They have enormous power," Mr. Hoenig said. "Just look at their lobbying expenses. I use the word — and it's a fairly flammable word — oligarchy. These things are huge and powerful, and that's where the money is. This country through its history has abhorred concentration of financial power, and for good reason."

Tuesday's Fed vote will be Mr. Hoenig's last, because the presidents of the Fed's regional banks, other than New York, share votes under a rotation system. Mr. Hoenig does not have a vote next year, and he must retire after he turns 65 in September. As for his future, Mr. Hoenig, a train enthusiast who reads biography and history in his spare time, is certain that he will not follow other Fed veterans who have gone to work on Wall Street. "I can tell you one thing," he said. "I'll never work for a too-big-to-fail bank."

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