Fed's Kashkari Wants to Make the Banking System Safer

Minneapolis Federal Reserve President Neel Kashkari says reforms undertaken following the financial crisis made some progress toward reducing the amount of risk in the US banking system, but he believes the size and complexity of the nation's largest banks call for further changes.

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Pedro Da Costa: Hi I'm Pedro da Costa, Editorial Fellow here at the Peterson Institute for International Economics. And I have the pleasure of being joined by Neel Kashkari, President of the Minneapolis Federal Reserve Bank. Thank you for joining me.

Neel Kashkari: Thanks for having me Pedro.

Pedro Da Costa: So we just had this third symposium on "Ending Too Big to Fail." And, of course, one of the messages that I take away from your remarks and from your speech is that we have not solved the problem. And I take that from your focus on this that the problem has not been solved yet.

Now what gives you the sense that the problem of "Too Big to Fail Banks" still lingers given that some actually argue that some of the new regulations have done enough?

Neel Kashkari: Well, I go back and I think about this from what it was like in 2008 when I was at Treasury running the TARP program. And the huge wave that it sent, the huge shock that hit the US economy, almost plunged us into the Great Depression. And it required the overwhelming force of Treasury, the Federal Reserve, the FDIC, Congress, all acting in unison to prevent that from happening.

I look at today's regulations and they are very cleverly designed. I almost think they're too clever. It requires everything to line up just perfectly. And if all these bells and whistles line up, then we won't need to turn to the taxpayers again. I'm afraid that it's too complex and maybe not powerful enough.

And so we, in Minneapolis Fed, we're taking a fresh look and saying what's been accomplished, what are the alternatives? And by the end of the year, we're going to come up with our recommendation for the right solution for "Too Big to Fail."

Pedro Da Costa: So taking a step back, you're fairly new to this job. What drove you to this focus in the first place as you took up a new role?

Neel Kashkari: Well, it's interesting. The Minneapolis Fed has actually been working on "Too Big to Fail" for years, even decades.

Pedro Da Costa: Gary Stern.

Neel Kashkari: Gary Stern, one of my current colleagues, Ron Feldman, they wrote the original book called "Too Big to Fail" in 2004. And as soon as I got to the Minneapolis Fed, I started talking to the experts there and I asked them, "What are the big risks you're worried about?" And some of them said, "Hey, we're still worried about 'Too Big to Fail.'" I said, "Well that's interesting because I am too. Let's compare notes." And as we compared notes, I realized there's a lot more work to be done. And we're actually very well positioned to do some of that work on behalf of the American people.

Pedro Da Costa: Sure. And so I know that you talked about launching, you know, doing this assessment and getting to a blueprint closer to the end of the year. But to give us a little bit of a flavor, what do you think are the top priorities for bank regulation going forward specifically with regards to "Too Big to Fail?"

Neel Kashkari: I think it's a couple things. One, is, I think, more capital is clearly better than less capital. It's like building a wall against the tidal wave. You want to build as high a wall as you can afford. We're trying to assess how tall a wall, how much capital makes sense for society. And number two, reducing complexity.

These things, they barely make sense in a calm period. When you're in the middle of a hurricane, this complexity just works against you. You'd have to throw it out the window. So how can we come up with the most robust set of regulations that are the simplest, that have the best chance to work over decades as the financial system continues to evolve?

Pedro Da Costa: Now, I wanted to just shift a little bit toward the economy if we could and I wanted to ask you. How close do you see the Fed to its dual mandate in terms of the economy? Because we've seen some signs of improvement in the labor market, but at the same time, inflation has consistently undershot your target. And there's been this vacillation about raising interest rates with the Fed consistently prematurely suggesting that it was going to hike and then having to return back. How close are we to the dual goals of maximum sustainable employment and low inflation?

Neel Kashkari: Well, I think we're close, but it isn't clear how soon we are going to close that gap. And as you said, we've been undershooting on inflation now for three or four years pretty consistently. There have been some signs that we're moving in the right direction. And we're cautiously optimistic it will get there, but we can't take that for granted. And my perspective is as long as inflation is coming up short, if we have a chance to bring more Americans back into the labor force, we should do that because there are huge benefits to society of putting people back to work.

Coming out of the crisis, a lot of experts thought we have a lost generation of workers where people who were long-term unemployed became the permanently unemployable. Well, maybe we have a chance to bring some of them back in and contribute to the economy and contribute to society. And it's good for them and it's good for their families. If we can do that while inflation is still coming up short, I think that that's where we ought to be focused.

Pedro Da Costa: Sure. And so given that focus, why do you think that the market is so obsessed with a calendar date for the next rate hike?

Neel Kashkari: I gave a speech about this where I said this is like the summer of the shark back in 2001, which is if there's not much else to pay attention to in economic policy circles, then everybody pays attention to where the only action is even if that action isn't that significant in and of itself. And so, everyone is laser focused on every FOMC meeting now.

Pedro Da Costa: It's the most important chip in the casino.

Neel Kashkari: Exactly because Congress and Executive Branch aren't passing new legislation right now to really jumpstart US economic growth. If we can get the Executive and Legislative Branches in gear, then I think it will be a good thing. People will pay a lot less attention to the Fed.

Pedro Da Costa: So do you think that Governor Brainard has come up with this phraseology that seems to have caught on a little bit of "watchful waiting." Do you think that's a good framework for the Fed to keep in mind? Because it seems that the Fed has gotten into trouble by saying on the one hand it's data dependent and then falling into the trap of actually delivering some form of calendar guidance, right? So it seems that watchful waiting would be a way of getting out of that trap.

Neel Kashkari: I think so. I think Governor Brainard often comes up with very thoughtful ways of characterizing what we're doing and how we should be thinking about things. She also said we're data dependent. We're not data point dependent. I think she was right about that. And I do. I do think it's a mistake for us to go out there and say we're going to have one rate or two or four this year because people will then get very upset if that's not how the economy evolves.

When my colleagues say those things, what they're suggesting is this is our forecast for how we think the economy is going to evolve, which will support these number of rate hikes. Of course, we don't know with perfect certainty what the economy is actually going to do. But given how people are so focused on those predictions, I actually think they can be counterproductive.

Pedro Da Costa: Neel Kashkari, Thank you so much for stopping by the Peterson Institute and thank you for your time.

Neel Kashkari: My pleasure. Thanks for having me, Pedro.