Book review

Finance and Philosophy: why we are always surprised
by Alex J. Pollock, Paul Dry Books, Philadelphia, USA, 2018, $21.95

For most people, including the readers of Housing Finance International the title of this book is perhaps not instantly engaging. It sounds "heavy" and in an era of soundbites this is hardly an attribute to engage those who want instant returns. However, in reality this is a highly accessible book with 18 chapters over its 169 pages, i.e., less than 10 pages a chapter and easily read on a piecemeal basis as time and interests allow. Moreover, there is much here for the busy housing finance professional whether based in the USA or elsewhere.

As HFI members will know, the author, Alex Pollock, was President of the International Union from 1999 to 2001 and he was President and CEO of the Federal Home Loan Bank of Chicago 1991-2004. He is now a Senior Fellow at the R Street Institute in Washington DC. He has worked in finance for over 50 years – and through a number of economic cycles! Given his background it should be no surprise to learn that the book is USA focussed albeit he frequently reaches wider for examples and comment. His writing style is light and engaging and reading this book is not hard work!

There are many chapters to choose from but the first five provide a good basis for brief comment along with two or three others. Pollock begins by highlighting in Chapter 1 the fundamental uncertainty that exists in financial markets and that even when we think we have learned a lesson and applied the antidote the future often confounds us. This then leads to Chapter 2 inevitable mistakes with him arguing that the unlikely or even impossible is almost certainly to arise. In Chapter 3 Bubbles and Liquidity, Pollock highlights their frequency and asks the question –what is the nature of a price? As he notes price has no objective existence but turns on what parties might agree. He then goes on to comment in Chapter 4 on the temptation to lever in more debt relative to equity – at which point he calls out Fannie Mae and Freddie Mac as the snakes who eat the apple of risk and run up leverage. Pollock is clearly no fan of either nor the Federal Reserve Bank which he calls the "most dangerous financial institution in the World" (Chapter 9). Indeed, in his Chapter 5: Economics is not a Science he cites Ben Bernanke and colleagues' failure to anticipate the 2008 bubble and downturn (it might be said, along with many others including the author himself as he admits in Chapter 16).

It's in 16 that he spells out what he calls the Cincinnatian doctrine, the mix between "normal" market functioning and state interventions and in which he notes the latter is only ever temporary to allow the economy to get through crises. The extended period of quantitative easing and indeed in the UK of the Help to Buy policy are good examples of how difficult the state finds it to exit from its interventions. He reminds us that in 2006 he was on a panel at the International Union World Congress in Vancouver (I was there too) in a session on Housing Bubbles and Bubble Markets where many experts were proclaiming the housing boom was "solid". As he notes "predicting is hard, especially the future".

In the closing chapters Pollock argues for a systemic risk advisory committee in the USA with strong institutional memory and a deep understanding of financial history which might, with luck, anticipate future problems. Given what he argues earlier this does seem unlikely even though there is certainly an irrefutable case for building and holding an understanding of the past so that error may at least be reduced. The closing chapter is on Virtue and Finance and here he draws upon John Kay's arguments in favour of old-fashioned banking. Kay asks why banking looks so profitable before it collapses and answers this by saying it is a business that combines a high probability of a small profit with a low probability of a large loss (which then wipes out all the profits). Pollock argues the answer to all the problems of banking are not detailed financial regulations and he aligns with Kay in arguing for financial virtues of loyalty and prudence which might then offset the limits of knowledge, the uncertain markets in which we operate and the inevitable mistakes that are made.

Pollock closes this excellent and thoughtful book with a compendium of aphorisms –sayings – all of which could be usefully used in presentations and speeches. I liked his old bankers saying, "the credit quality is inversely proportional to the size of the cufflinks" and which I would now update by adding "and watches". Pollock is clearly on the conservative end of the spectrum and we might disagree on the role of intervention (and the fact that ironically the USA with strong home owner tax benefits, even though reduced, is still one of the most state supported markets in the world). However, there is a lot of common sense and good home truths in the book. It should be widely read by all those in the finance market and its regulators.

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