The Limits of Monetary Policy: 'Monetary Policy Responsibility Cannot Substitute for Government Irresponsibility'

Remarks before a luncheon meeting of the Manhattan Institute and e21

Richard W. Fisher
President and CEO
Federal Reserve Bank of Dallas

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I am delighted to speak here in the hallowed halls of the Harvard Club of New York City. I have been a member of this club for over 35 years. I love its sturdy facilities, its history, the trophies from Teddy Roosevelt's African expedition of 1909–10 and … its mustiness.

The thing I prize most about this facility is that the rooms here are cheap. As I did last night, I always stay in what used to be called a "dorm room," one of the little rooms smack in the middle of this old building. These rooms are sparsely furnished, with only a sink and a bed and the smallest imaginable armoire jammed into approximately 130 square feet. I like them because there are no better-priced rooms in New York City. And because they are stone quiet. They are the only hotel rooms I know of in the city where the occupants cannot hear the grinding noise of trash trucks … when trash is actually being collected.

I am especially honored that both the Manhattan Institute and e21 are sponsoring this speech today.[1] Thank you, David [Malpass] for taking time out of your busy schedule to introduce me.

The Manhattan Institute and e21 are powerful proponents of the free-market capitalism that made our country the richest and the most successful democracy in the history of humankind. I took note of the institute's claim on its website that it sponsors thinking "literally and figuratively outside the Beltway." That's a good thing. The Federal Reserve is structured to balance "inside the Beltway" influences with "outside the Beltway" thinking. The governors of the Fed, in Washington, are appointed by the president of the United States and confirmed by the Senate. The 12 bank presidents, like me, who operate the System in the field and also sit on the Federal Open Market Committee (FOMC) with the Fed governors, are not. Instead, we are selected by, and serve at the pleasure of, boards of directors drawn from the citizenry of our districts. In my case, the Dallas Fed serves 27 million people who populate 360,000 square miles of Texas, northern Louisiana and southern New Mexico and whose economic output exceeds Australia's and is only slightly less than that of India.

On the policy front, the job of the Fed Bank presidents is to bring a Main Street perspective to the table. When I was asked by the Dallas Fed board to become president of the Bank, I then met with Alan Greenspan. I asked the Chairman how I could best serve the System. His answer was crisp: "Just speak to the truth," he said.

Today, I will speak to the truth as I see it. I speak only for myself and my colleagues at the Dallas Fed and not for anybody else on the FOMC or elsewhere in the System. I suspect this will immediately become clear.

Fiscal Matters

A week ago today, a new Congress was sworn in. New leadership took office in the Lower House, with the new speaker saying, “The American people have humbled us. … They have reminded us that everything is on loan from them.”[2] The Senate retained its leadership but underwent a sea change of composition.

At the other end of Pennsylvania Avenue, the White House announced significant staff changes, among them bringing in a highly respected former administration colleague from my days as a trade negotiator to be the president’s chief of staff.[3]

The new Congress and the new staff in the White House have their work cut out for them. You cannot overstate the gravity of their duty on the economic front. Over the years, their predecessors—Republicans and Democrats together—have dug a fiscal sinkhole so deep and so wide that, left unrepaired, it will swallow up the economic future of our children, our grandchildren and their children. They must now engineer a way out of that frightful predicament without thwarting the nascent economic recovery.

I have been outspoken about the limits of monetary policy as a salve for the nation’s fiscal pathology.[4] The Fed has done much, in my words, to provide the bridge financing until the new Congress gets to work restructuring the tax and regulatory incentives American businesses need to confidently expand their payrolls and capital expenditures here at home.[5]

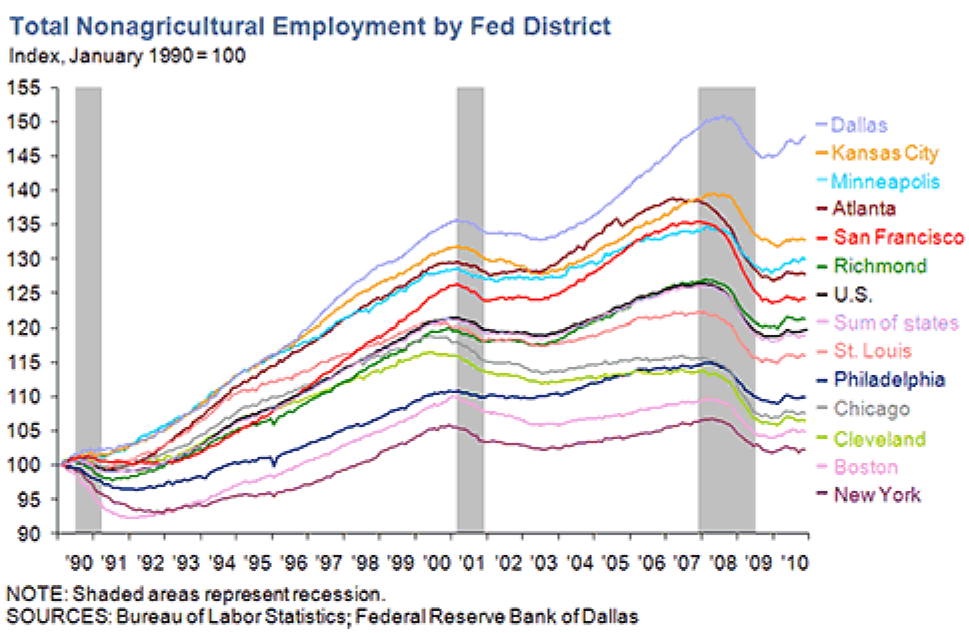
The Federal Reserve has held rates to nil. We have expanded our balance sheet to unprecedented levels. After much debate—which included strong concern expressed by one member with a formal vote and others, like me, who did not have voting rights in 2010—the FOMC collectively decided in November to temporarily undertake a program to purchase U.S. Treasuries that, when added to previous policy initiatives, roughly means we are purchasing the equivalent of all newly issued Treasury debt through June.

By this action, we have run the risk of being viewed as an accomplice to Congress’ fiscal nonfeasance. To avoid that perception, we must vigilantly protect the integrity of our delicate franchise. There are limits to what we can do on the monetary front to provide the bridge financing to fiscal sanity. Last Friday, speaking in Germany, [European Central Bank President] Jean-Claude Trichet said it best: “Monetary policy responsibility cannot substitute for government irresponsibility.”[6]

The entire FOMC knows the history and the ruinous fate that is meted out to countries whose central banks take to regularly monetizing government debt. Barring some unexpected shock to the economy or financial system, I think we have reached our limit. I would be wary of further expanding our balance sheet. But here is the essential fact I want to emphasize today: The Fed could not monetize the debt if the debt were not being created by Congress in the first place.

Those lawmakers who advocate “Ending the Fed” might better turn their considerable talents toward ending the fiscal debacle that has for too long run amuck within their own house. The Fed does not create government debt; fiscal authorities do. Deficits and the unfunded liabilities of Medicare and Social Security are not created by the Federal Reserve; they are the legacy of those who control the purse strings—the Congress, working with the president. The Fed does not earmark taxpayer money for pet projects in local communities that taxpayers themselves would never countenance; only the Congress does that. The Congress and administration play the dominant role in creating the regulatory environment that incentivizes or discourages job creation.

A look within the United States makes clear the overriding influence of fiscal and regulatory policy. Monetary policy is uniform across the 50 states; the base rate of interest paid on a business or consumer loan or a mortgage in Michigan, California, Ohio or here in New York is the same as that paid in Texas. Yet there is a reason that Michigan and California each lost more than 600,000 jobs over the past decade while Texas added more than 700,000 over the same period. There is a reason that the population of Ohio grew by only 183,000 residents over the past 10 years, while Texas grows by that number every five and a half months. There is a reason that with each passing census, the state of New York has been losing congressional seats and Texas has been adding them; a reason that, in the recent census, California failed to gain any while Texas gained four. There is a reason that, as reported in this morning's *Wall Street Journal*, college graduates—the best and brightest of the successor generation—are leaving New York and Cleveland and Detroit and moving to Austin, Texas.[7] There is a reason Texas now houses more Fortune 500 headquarters than any other state in the union. There is an underlying reason behind the graph placed before you that charts the disparate employment growth that has taken place in the 12 Federal Reserve districts over the past two decades.



That reason has nothing to do with monetary policy. It has everything to do with the taxation and fiscal and regulatory policies of the states. The cost of capital does not explain the different economic performances of the states; the cost of doing business has everything to do with those differences. However well-meaning tax and regulatory initiatives in the laggard states may have been when they were conceived and levied, they have had unintended consequences that have led to economic underperformance and job destruction.

Similarly, the key to correcting the underperformance of the American economy and American job creation does not rest with the Federal Reserve. It is in the hands of those who make fiscal and regulatory policy.

The Fed has reduced the cost of business borrowing to the lowest levels in decades. It has seen to it that liquidity is widely available to banks and businesses. It has kept the economy from deflating and it has kept inflation under control. This has helped raise the economic tide. Recent data make clear that the risks of a double-dip recession and deflation have ebbed and that economic growth and job creation are beginning to flow. Yet the ships of job-creating investment remain, for the most part, tied to the docks—or worse, choose to sail for foreign ports where tax and regulatory conditions are more favorable, very much in the same way that Ohio, Michigan, New York and California businesses and workers have navigated to Texas.

I don't believe this has much to do with the Fed. None of my business contacts, large or small, publicly held or private, are complaining about the cost of borrowing, the lack of liquidity or the availability of capital. All express concern about taxes, regulatory burdens and the lack of understanding in Washington of what incentivizes private-sector job creation. All are stymied by a Congress and an executive branch that have appeared to them to be unaware of, if not outright opposed to, what fires the entrepreneurial spirit. Many have begun to feel that opportunities for earning a better and more secure return on investment are larger elsewhere than here at home.

The Recent Election

Perhaps because I live so far outside the Beltway—among the Washington-skeptical, independent-minded people of the Eleventh Federal Reserve District—I was not surprised by the outcome of the recent election. As I watched it unfold, I thought of one of the better books I had read in the summer of 1998, at the recommendation of a friend, the eminent historian David McCullough. It was titled *Cod: A Biography of the Fish That Changed the World*, written by Mark Kurlansky, and was considered by the New York Public Library to be "one of the 25 best books of the year."[8]

Buried in the middle of that remarkable little book is a wonderful description of the causes of the American Revolution. Kurlansky wrote that "Massachusetts radicals sought an economic, not a social, revolution. They were not thinking of the hungry masses. … They were thinking of the right of every man to be middle-class, to be an entrepreneur, to conduct commerce and make money."[9] Referring to John Adams, John Hancock and John Rowe—everyone seemed to be named John in New England in those days—he posited that the revolution "was about political freedom." "But," he went on, "in the minds of its most hard-line revolutionaries, the New England radicals, the central expression of that freedom was the ability to make their own decisions about their own economy."[10] He concluded that "all revolutions are to some degree about money," reminding the reader that, reflecting upon France's revolution, the Comte de Mirabeau said, "In the last analysis the people will judge the Revolution by this fact alone [sic] … Are they better off? Do they have more work? And is that work better paid?"[11]

We now have a new, younger and—in the sense depicted by Kurlansky—more radical Congress working alongside a president as they seek to craft policies more responsive to the message given by the electorate. The new Congress was elected to cast off the status quo of what many have come to feel is excessive encroachment upon the people's freedom to make their own decisions about the economy. To do so successfully, this new, radical Congress and newly inspired president had better bear in mind Count Mirabeau's analysis. The people of the United States will judge them not by their rhetoric, not by their declarations, proclamations and statements of intent, but by whether their policies result in a people who are better off, have more work and are better paid.

The leaders of our government cannot attempt to talk their way out of the problem like their predecessors did. They must fix the problem. Now. If they fail to do so, then the election, for all its hoopla, will prove to have been nothing more than a case of putting old, rancid wine in new bottles.

Theirs is not an easy task. We have all become used to the false comfort of having government coddle us, whether we are rich businesses receiving subsidies or poor citizens sustained by government largesse. The election tapped into a foreboding sense that the cost of that comfort now exceeds its benefits, as manifest in looming megadeficits, deep if not unfathomable unfunded liabilities, egregious abuse of fiscal powers symbolized by earmarks and other methods used by politicians to grease the skids of their reelection.

Tapping into that foreboding in the recent election was the easy part. Talk of reform is cheap. Enacting reform will be painful.

A reader of Shakespeare will recall the dialogue between Glendower and Hotspur in *Henry IV*. Glendower claims, "I can call spirits from the vasty deep." And Hotspur replies, "Why, so can I, or so can any man; But will they come when you do call for them?"[12]

We shall see if the new Congress will prove worthy of the power the American people have "loaned" them, and, together with the president, actually draw the spirits of fiscal reform and sanity from the "vasty deep" to at long last implement meaningful fiscal and regulatory policy that incentivizes private-sector job creation here at home while arresting the hemorrhaging of our Treasury. If they do, then more Americans will find work and be better off, better paid and freer to make their own decisions about the economy.

If they don't, then woe to our children, their children and the American Dream.

I am tempted to end this cheery talk by saying, "Have a nice day!" and walking off the stage. However, I would hate to leave this podium with your having concluded that I am just another central bank curmudgeon. I am professionally programmed to worry. But I am also a red-blooded American, as are all my colleagues at the Fed. I draw on the wisdom of Marcus Nadler, one of the great minds of the Federal Reserve from a period when our economy endured an even more dire test. To counter the intellectual paralysis and down-in-the-mouth pessimism that gripped the financial industry after the Great Depression, Nadler put forth four simple propositions:

First, he said: "You're right if you bet that the United States economy will continue to expand."
Second: "You're wrong if you bet that it is going to stand still or collapse."
Third: "You're wrong if you bet that any one element in our society is going to ruin or wreck the country."

And fourth: “You’re right if you bet that [leaders] in business, labor and government are sane, reasonably well informed and decent people who can be counted on to find common ground among all their conflicting interests and work out a compromise solution to the big issues that confront them.”

This became known as Old Doc Nadler’s Remedy, and for my part, it is spot on. Every one of us preoccupied with what ails us should keep it in mind.

It may seem like the stuff of our wildest dreams to imagine getting ourselves out of our current nightmarish predicament. But I believe we can and we will. We are Americans. I believe deep in my soul that, when put to the test, Americans rise to the occasion no matter how great the challenge. We have done it time and again. We have no choice but to do it once more.

I think I have said enough, if not too much. In the musty, time-honored tradition of central bankers, I am now happy to avoid answering any questions you might have.

Thank you.

Notes

[1] The Manhattan Institute for Policy Research is a nonprofit think tank based in New York, while e21, Economic Policies for the 21st Century, is a nonprofit research group with offices in New York and Washington.
[2] See comments by John Boehner, speaker of the House of Representatives, in his speech to the opening session of the 112th Congress, Jan. 5, 2011, http://boehner.house.gov/News/DocumentPrint.aspx?DocumentID=218986.
[3] Lawyer and businessman William Daley, who was commerce secretary under President Clinton, was named White House chief of staff on Jan. 6.
[4] See “Storms on the Horizon,” speech by Richard W. Fisher, May 28, 2008, www.dallasfed.org/news/speeches/fisher/2008/fs080528.cfm.
[5] See “Recent Decisions of the Federal Open Market Committee: A Bridge to Fiscal Sanity?” speech by Richard W. Fisher, Nov. 8, 2010, www.dallasfed.org/news/speeches/fisher/2010/fs101108.cfm.
[6] See “Trichet Urges Budget-Cutting,” by Brian Blackstone, *Wall Street Journal*, Jan. 8, 2011, http://online.wsj.com/article/SB10001424052748704739504576067352757709020.html.
[7] See “College Graduates Flock to Sunbelt,” by Conor Dougherty, *Wall Street Journal*, Jan. 12, 2011, http://online.wsj.com/article/SB20001424052748704515904576076254294271720.html.
[8] *Cod: A Biography of the Fish That Changed the World*, by Mark Kurlansky, New York, N.Y.: Penguin Group, 1998.
[9] See note 8, p. 93.
[10] See note 9.
[11] See note 9.
[12] *Henry IV, Part 1,* by William Shakespeare, Act 3, Scene 1.