A Need for Innovative Fiscal Policy
(With a Nod to John Stemmons, Ronald Reagan and Paddy McCoy)

Remarks before the Stemmons Corridor Business Association

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The views expressed are my own and do not necessarily reflect official positions of the Federal Reserve System.

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It is a great pleasure to speak to the Stemmons Corridor Business Association. I had the good fortune of knowing John Stemmons. He was one of my father-in-law's closest friends, and his son, Johnny, who was taken from us way too early in life, was a cherished friend of mine. Mr. Stemmons looked like John Wayne and had the business acumen of Trammell Crow, who, as many of you know, was an early business partner of John's. Without John Stemmons, Trammell Crow could never have developed the Trade Mart and all of his other innovative concepts that helped the Stemmons Corridor and Dallas become vital economic hubs.

Only John Stemmons would have had the foresight to donate 100 acres of recovered flood plain to the people of Texas, saving the state the cost of acquisition of a vital transportation artery and allowing him to develop this corridor into the great property it became. He was a giant of a man and an exemplary proponent of the free-market capitalism that made our city and our state and our country great.

It is somehow fitting that you asked me to speak here today, just two days after the 100th celebration of Ronald Reagan's birthday. Old John Stemmons loved President Reagan. In 1984, the Republican convention was held here in Dallas. My father-in-law, Congressman Jim Collins, was also a good friend of the president. During the convention, Mr. Collins invited me to join Mr. Stemmons and a handful of their friends to visit with Mr. Reagan. The president was in remarkable form and, great raconteur that he was, told this story:

Paddy McCoy, an elderly Irish farmer, received a letter from the Department for Works and Pensions stating that he was suspected of not paying his employees the statutory minimum wages and that an inspector would be sent to the farm.

On the appointed day, the inspector turned up. "Tell me about your staff," he asked of Paddy.

"Well," said Paddy, "there is the farmhand. I pay him 240 a week and he has use of a free cottage."

"That's good," said the inspector.

"Then there's the housekeeper. She gets 190 a week, along with free board and lodging."

"That sounds fine," said the inspector.

Paddy went on. "There's also the half-wit. He works a 16-hour day, does 90 percent of the work, nets about 25 pounds a week when all is said and done, but takes down a bottle of whiskey and, as a special treat, occasionally gets to sleep with my wife."

"That's disgraceful, Paddy," said the inspector. "I need to interview the half-wit."

“Well,” said Paddy, “you’re looking at him.”

John Stemmons laughed so hard he cried. As rich and as prominent as he was, he identified with the Paddy McCoys of the world. He took delight in doing things as independently as possible; he was a great example of individual initiative in a world that has become increasingly dependent on government intervention and what we have come to know as an “inside the Beltway” mentality—a mentality that too often fails to grasp the essence and magic of Stemmons-like entrepreneurship that is the hallmark of American success.

I am going to take advantage of this platform to remind you that the Federal Reserve System is uniquely 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. Herb Kelleher, the founder of Southwest Airlines, is the current chairman of the Dallas Fed board, which includes eight others ranging from Renu Khator, the dynamic president of the University of Houston, to Joe Kim King, a goat rancher who is the CEO of Brady National Bank, a rural bank with $80 million in footings.

As a Federal Reserve Bank president, I play a dual role under the watchful eye of my board of directors. I am the CEO of a $100 billion Bank that lends and provides cash to and supervises and regulates local banks. We provide myriad services to the 27 million people who populate 360,000 square miles of Texas, northern Louisiana and southern New Mexico—27 million hardy citizens whose economic output exceeds the output of Australia and is only slightly less than that of India.

On the policy front, my job is to bring a Main Street perspective to the table. When I was asked by the Dallas Fed board six years ago to become president of the Bank, I 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.

John Stemmons would have given me the same advice.

So today, I will speak to the truth as I see it. As I always do, 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.

Only a month ago, 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.”[1] The Senate retained its leadership but underwent a sea change in its composition.

At the other end of Pennsylvania Avenue, the White House revealed significant staff changes while also announcing a new attitude toward the business community. The administration pledged to clear the underbrush that hampers businesses’ job creation by rooting out laws and

regulations that, in the words of the president, "are just plain dumb," and by vowing to now bring federal spending under control.[2]

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.[3] The Fed has done much, as I see it, 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.[4]

The Federal Reserve has held short-term interest rates to nil. We have expanded our balance sheet to unprecedented levels, with the effect of holding down mortgage rates and the rate of interest paid on Treasuries and the myriad financial instruments that are priced off of Treasuries, including corporate debt. 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 will be 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. The head of the European Central Bank, Jean-Claude Trichet, said it best recently while speaking in Germany: "Monetary policy responsibility cannot substitute for government irresponsibility."[5]

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 are pushing the envelope with the current round of Treasury purchases. I would be very wary of expanding our balance sheet further; indeed, given current economic and financial conditions, it is hard for me to envision a scenario where I would not use my voting position this year to formally dissent should the FOMC recommend another tranche of monetary accommodation. And I expect I will be at the forefront of the effort to trim back our Treasury holdings and tighten policy at the earliest sign that inflationary pressures are moving beyond the commodity markets and into the general price stream. I am a veteran of the Carter administration and know how easily prices can spin out of control and how cruelly markets can exact their revenge. I would not want to relive that experience.

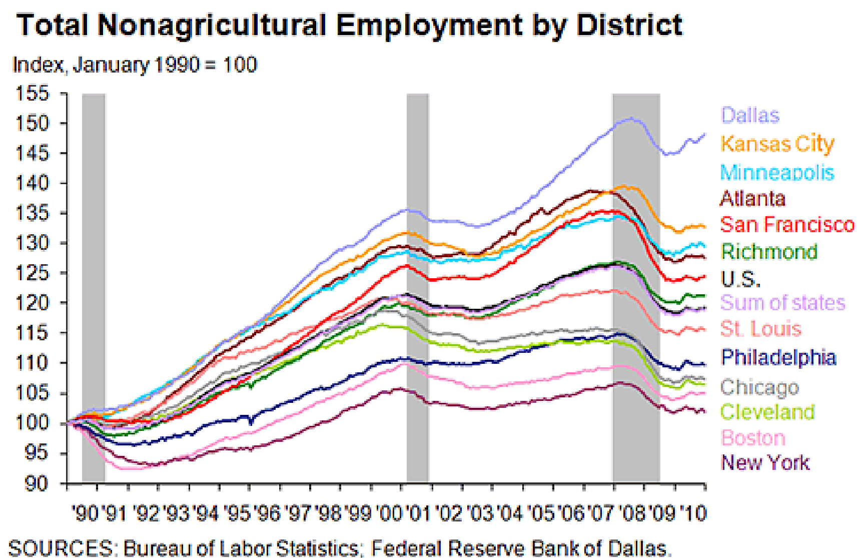
But here is the essential fact I want to emphasize and have you think about today: The Fed could not monetize the debt if the debt were not being created by Congress in the first place.

The Fed does not create government debt; Congress does. Deficits and the unfunded liabilities of Medicare and Social Security are not created by the Federal Reserve; they are the legacy of

Congress. 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.

It seems to me that 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.

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 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 documented in the Jan. 12 issue of the *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.[6] There is a reason no state in the union houses more Fortune 500 headquarters than Texas. There is a reason for the disparate employment growth that has taken place in the 12 Federal Reserve districts over the past two decades, data that are documented in the graph at your place setting.



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 presently 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, with some exceptions, tied to the docks—or worse, are choosing 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.

U.S. nonfarm payrolls fell by 8.75 million jobs from their peak in January 2008 to their trough in February 2010. Estimates are that the population of Americans of working age increased by 4.4 million during the same period, creating a shortfall of over 13 million jobs. Since February 2010, the shortfall has only gotten worse: Although employers have added approximately 1 million new jobs, the working-age population has increased by an additional 1.7 million. All in all, we have approximately 6 million more people of working age than we did when the recession began—and a net loss of 7.7 million jobs. Divining policies that will encourage the private sector to increase hiring by enough to make up some of this lost ground is both an urgent and a daunting task.

I don't believe the Fed is constraining job creation. 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. Just this morning at 7:30, for example, the National Federation of Independent Business released results from a survey of 2,144 randomly selected small businesses. It said, "Ninety-two percent [of those surveyed] reported that all their credit needs were met or that they were not interested in borrowing."[7]

A recent Wells Fargo/Gallup Small Business Index survey reports that about 80 percent of those who were reluctant to hire said they were afraid revenues wouldn't increase enough to justify the expense.[8] The problem is not the availability of credit. The problem for businesses, small or large, is generating enough final sales at a profit; the need is for revenue that exceeds the expense of incurring that revenue.

You can't have stronger sales if you don't have stronger job creation. We will not have robust job creation until businesses are confident they can earn a good return on the investment they must make to add new workers. Employers live in a world in which they are free to invest their monies in expanding operations and hiring workers anywhere in the world, in any place they have the best opportunity to earn a superior return on investment. This is one of the legacies of the Reagan era—of having won the Cold War and having the majority of previously closed or dysfunctional governments choose prosperity as their goal rather than the economic suppression of their people. To achieve that prosperity, they need job-creating investment. To attract that investment, they provide incentives through tax and regulatory incentives and other means.

Whereas before we lived in a world of mutually assured destruction, we now live in a world of mutually assured competition. We have no choice but to create the conditions that incent businesses that operate in the United States to compete using American workers. This requires rethinking by Congress—the sole body with the power to shape our nation's taxes and spending and write regulatory laws to condition economic activity. Our lawmakers must do so in a manner that both stimulates the desire of businesses to put Americans back to work at the earliest opportunity and provides meaningful assurance that long-term fiscal imbalances they have wrought will be brought under control, assuring the long-term viability of the U.S. economy.

Before the recent mid-term election, most all of my business contacts claimed that taxes, regulatory burdens and the lack of understanding in Washington of what incentivizes private-sector job creation were inhibiting the expansion of their payrolls. They felt 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 felt that opportunities for earning a better and more secure return on investment are larger elsewhere than here at home.

Perhaps because I live so far outside the Beltway—among the Washington-skeptical, independent-minded people of the Eleventh Federal Reserve District—I was therefore 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."[9]

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." 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." 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?"[10]

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. Or string out needed remedies until after the next election. 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 mega-deficits, 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?"[11]

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. Like John Stemmons, 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 the current nightmarish predicament. But I believe we can and we will. We are Americans. 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.

Thank you.

Notes

[1] 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.

[2] Lawyer and businessman William Daley, who was commerce secretary under President Clinton, was named White House chief of staff on Jan. 6.

[3] See "Storms on the Horizon," speech by Richard W. Fisher, May 28, 2008, www.dallasfed.org/news/speeches/fisher/2008/fs080528.cfm.

[4] 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.

[5] See "Trichet Urges Budget-Cutting," by Brian Blackstone, *Wall Street Journal*, Jan. 8, 2011, http://online.wsj.com/article/SB10001424052748704739504576067352757709020.html.

[6] See "College Graduates Flock to Sunbelt," by Conor Dougherty, *Wall Street Journal*, Jan. 12, 2011, http://online.wsj.com/article/SB20001424052748704515904576076254294271720.html.

[7] See "NFIB Small Business Economic Trends," by William C. Dunkelberg and Holly Wade, National Federation of Independent Business, February 2011, www.nfib.com/Portals/0/PDF/sbet/sbet201102.pdf.

[8] See "Many Small Businesses Hiring Fewer Workers Than Needed," by Dennis Jacobe, Wells Fargo/Gallup Small Business Index, Feb. 4, 2011, www.gallup.com/poll/145946/small-businesses-hiring-fewer-workers-needed.aspx.

[9] *Cod: A Biography of the Fish That Changed the World*, by Mark Kurlansky, New York, N.Y.: Penguin Group, 1998.

[10] See note 9, p. 93.

[11] *Henry IV, Part 1,* by William Shakespeare, Act 3, Scene 1.