Speeches by Bob McTeer

Reflections and Confessions of an Erstwhile Economist
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My invitation to speak here today reminded me of SEA conventions I attended in the 1960s as a student at the University of Georgia. Professor James Waller took me to the first one. It was my first plane ride, and the first leg was from Athens to Atlanta on a four-seater, including the pilot and co-pilot seats occupied by Georgia students. The doors weren't sealed, and the air rushed in, cold and loud.

Another memorable Southern was in Atlanta in 1963. I was on my way home for the quarter, and someone slit the top of my 1957 Ford convertible and stole all my clothes. I was parked near Georgia Tech.

I also remember one here in New Orleans in 1967. I was supposed to do job interviews, but I hooked up with two Georgia buddies—Chuck Maurice and Phil Gramm—who had recently joined the Texas A&M faculty. Their new friend Bob Ekelund had his car, which was a distraction. The upshot was that I forgot to do job interviews. Which is how I ended up at the Fed.

About the only thing I still recall from those meetings is that economists revealed a preference for scotch over bourbon. Later, at banking conventions, I learned that bankers serve cheap bourbon and scotch but expensive gin. I've been suspicious of bankers and economists ever since. I'll leave the drinking habits of bank economists for another time.

My high school English teacher wanted me to study law like her son. I thought accounting would be a good pre-law major and the combination would make me rich. My business-law class disabused me of the first notion and my accounting class did it for the second. I didn't realize that the accounting profession and the law would collide early in the new millennium.

My attraction to economics began in Professor Waller's Money and Banking class—James Waller, my mentor. I hope some of you remember him. He was responsible for my majoring in economics, for my going to graduate school and for my thinking that I would make a splendid professor. By the way, I also met my wife, Suzanne, in his class. He came to our wedding.

These good things happened because, for some reason, I was good at those T-Account transactions in Money and Banking. Money creation, multiple expansion, the impact of open market operations. That sort of thing. I was even pretty good manipulating the equation of exchange and the graphs of the simple Keynesian model.

Professor Waller, a slow-walking, Southern-talking, white-haired curmudgeon who looked like Colonel Sanders, was not a patient man. He would cover something in class one time and tell the students to see me after class if they didn't get it. He made me his "grader" and recommended me to his students as a tutor. I was even the economics tutor for the football team. That didn't last long since I didn't get hazardous-duty pay.

Since I've bragged about my money and banking arithmetic, I must confess to being seriously deficient in real math. I didn't have the math background needed for graduate economics, but I didn't realize it until too late. I remember my shock when I first learned that a line on a graph could be expressed as an equation, and vice versa. I wondered why anyone would ever want to do such a thing. Given this Achilles' heel, I knew I would never thrive as an economist's economist in the cruel publish-or-perish world. I was destined to forever bear the stigma of being "nonquantitative."

I would like to argue that academic economists often overdo quantitative analysis, which sometimes amounts to window dressing. My hunch is that this causes many economists to miss opportunities to have more influence in the so-called real world. I would like to argue that, but I can't because I don't have the standing. Only economists who've demonstrated math virtuosity in numerous publications can make that argument credibly. Only Nixon could go to China.

Larry Summers, current president of Harvard, former Treasury secretary and former boy-wonder economist, is such a person. Here's how he put it in 1991:

Too often researchers, referees and editors fail to ask these scientific questions. Instead, they ask the same questions that jugglers' audiences ask—Have virtuosity and skill been demonstrated? Was something difficult done? Often these questions can be answered favorably even where no substantive contribution is being made.

I only recently became aware of the debate over the role of economists in influencing the real world that is associated with George Stigler and Milton Friedman. To oversimplify, the Stigler position is that economists should talk mainly to other economists at a lofty level and try to extend the frontiers of the science. It's a waste of time trying to educate laymen in economic principles with a view toward improving public policy. Economists should not preach to non-economists, who already know all they want to know about their self-interest. They aren't likely to respond favorably to an altar call. As they say about putting lipstick on a pig, it's a waste of time, and it annoys the pig.

The other view, dating back at least to Adam Smith and generally associated with Milton Friedman, is that economists should try to educate the public on basic economics, which would ultimately lead to better public policy. Economists can stay in their ivory tower most of the time, but they should come down occasionally to share their knowledge and insights with the local Rotary Club. They should learn to communicate with "everyman." Without knowing about this particular controversy, the Dallas Fed has been trying to do this in its economic education programs. I think of economic education as making the world safe for sounder policy.

I was in London a couple of weeks ago visiting the Bank of England and speaking at the Institute of Economic Affairs. I spent 10 pounds of my own money for an IEA publication on just this subject titled: *A Plea to Economists Who Favour Liberty: Assist the Everyman.* (This booklet was the source of the Summers quote.)

The IEA, as you probably know, is a libertarian think tank closely associated with Margaret Thatcher before and during her prime ministership, with a lineage that goes back to Hayek. Note that they want only economists who favor liberty to assist the everyman. If you don't favor liberty, they don't want you messing around with everyman's head.

A small digression: My favorite dead economist is Frédéric Bastiat, whom libertarians have adopted as their own. I spoke on "Why Bastiat Is My Hero" at his 200th birthday party last year in France. You can find that speech and lots of other good stuff at www.dallasfed.org. Anyway, the Bastiat conference attracted lots of libertarians from all over the world. I found them to be good communicators. Written on the bathroom wall the first morning was the admonition, "Defy authority." The next day, written just under "Defy authority" was "Who the hell are you to tell me what to do?"

As I've indicated, my academic life began in Dr. Waller's Money and Banking class. I learned from him that the world of economics in the 1960s was dominated by Harvard on the left and Chicago on the right. It was early in the Kennedy administration, and on the first day of class, Dr. Waller asked if we knew the way to the New Frontier. We didn't. He said you go to Harvard and turn left.

Then he questioned the already-famous and popular line from President Kennedy, "Ask not what your country can do for you. Ask what you can do for your country." He said Kennedy had it backwards. In a free country, individuals are not supposed to subordinate themselves to the state. That was the first time I recall a professor challenging a truth that I had simply taken for granted. Of course, that quote is as popular as ever, and I'm still not sure how I feel about it.

In the great divide between Harvard and Chicago, Georgia professors were mostly in the Chicago camp. Milton Friedman was god in that universe. Richard Timberlake, one of my professors who studied under him at Chicago, called Friedman the fastest gun in the West. The infidels on the other side weren't personified by a single person. The Huns had no living Attila. They were Keynesians, but Keynes was already dead, as he had said we all would be in the long run. Keynesians were too easy on government and government spending, budget deficits, the minimum wage and other things.

David McCord Wright was Georgia's most accomplished professor—meaning he had the most journal articles. He thought Keynes had a few good points, if interpreted correctly, and he was there to interpret him correctly. He was hard to argue with because he had personal letters from Keynes in his coat pocket. My tribute to David McCord Wright is on our web site.

The Friedman I heard about first in Money and Banking class was Friedman the monetarist. Abolish the Fed and have a computer increase the money supply 3 or 4 percent per year, per quarter, per month, per week, per day, etc. Almost as prominent was his advocacy of flexible exchange rates. His *Capitalism and Freedom* became the economic agenda for the coming decades. By the way, the Dallas Fed hopes to have a conference on the 25th anniversary of *Free to Choose*. We are all Friedmanites now, aren't we? With Friedman's important contributions in many areas of economics, I've never quite understood why his Nobel Prize—which, I'm proud to say, I've seen on his living-room wall—was based on his permanent income hypothesis. Go figure.

Looking back on all the time spent on Keynesian vs. classical economics, it's hard for me to see what all the fuss was about. Can't we just declare that Keynes is somewhat useful in recessions, while his classical predecessors had most of the other bases covered? The most trivial thing to me was the search for a logical classical escape hatch from the liquidity trap where monetary policy is spinning its wheels. They conjured up Pigou's real-balances effect, or the Pigou–Patinkin effect. Even though you can't push interest rates lower, you can pump out money until the value of *M* over *P* drives you to the mall. Was Patinkin's book ever translated into Japanese?

Surely nobody thinks the United States of America would ever get into a liquidity trap or a deflationary pickle. Surely nobody worries about interest rates too low to fall further. Or the Fed running out of ammunition. Surely no one takes a liquidity trap seriously, or the paradox of thrift.

Ah, the paradox of thrift. We've been through an investment-led slowdown and recession and, presumably, are now in a sluggish, jobless recovery. Through it all the consumer has continued spending while high-tech investment has collapsed. With the consumer's saving rate close to zero, with her debt levels high and confidence low, and with virtually every family in America needing to save more, surely worry about the unintended consequences of trying to save more is misplaced.

Given my monetarist indoctrination, when I joined the Richmond Fed I became the first to write the money supply into our president's notes for FOMC meetings. At least I believe I was first. That's my story. My first economic review article was on flexible exchange rates. The second was a postwar history of our balance of payments. My speeches back then were deadly. (Be nice now.) Do bankers really care that the factors behind the demand for foreign exchange are debit items in the balance of payments?

My timing as the Richmond Fed's new "international" economist was perfect. I arrived in late 1968, and through the early '70s, the Bretton Woods fixed exchange-rate system was in a death spiral. I had numerous opportunities to explain to our boards of directors the meaning and significance of the latest currency devaluation, revaluation, outflow of gold, exchange controls, the voluntary foreign credit restraint program and Operation Twist, and so on. Operation Twist, you may recall, was an effort to keep long-term interest rates low to stimulate the domestic economy and short-term rates high to stem the dollar outflow. Operation Twist had nothing whatsoever to do with what Chubby Checker did last summer. International monetary economics was complicated, and it was a mess, but McTeer, thankfully, was there to explain it all.

Milton Friedman had promised that under flexible exchange rates such crises would go away. He was right. Once we floated the dollar, I had to find other things to do. I couldn't find honest work, so I went into management. Those who can, teach. Those who can't teach, manage. I'm now up to about 1973. I hope your seats are comfortable.

From 1973 to 1980, I worked as an assistant to the president of the Richmond Fed. I could write his memos and speeches because I could read his mind. His Ph.D. was from the University of Virginia. Like Georgia, only more so, Virginia was Chicago lite. Bob Black didn't have to tell me what to say in his speeches because I already knew what he knew and believed what he believed. Any differences we may have had, I kept to myself.

Well, maybe he found out about some of them because in 1980 he put me in charge of the Richmond Fed's Baltimore Branch, where I was further removed from economics. I became even more "erstwhile." I would later say that I started out as an economist, but eventually got over it. I continued to read the editorial page of the *Wall Street Journal* in the 1980s, however, and soaked up some supply-side economics without realizing it. I'm still hooked.

I didn't accumulate much new economic capital in the 1980s, but I honed what I had learned by teaching night school at Johns Hopkins. Money and Banking, of course, and the Economic Environment, a principles course with more lipstick.

I went to the Dallas Fed in 1991 and onto the FOMC, which included the fringe benefit of a research department. I went from being one teacher with 30 students per class to being the only student in a class with about 15 teachers. I had a lot of catching up to do, and I haven't caught up yet. I get to ask stupid questions, and they are supposed to answer them without calling them stupid, although I do detect an eye roll every now and then.

I came to the Dallas Fed at a good time for a fan of Frédéric Bastiat, especially his "Petition on Behalf of the Candlemakers." The NAFTA debate was just starting, and I weighed in as a Southern-fried imitator of a French satirist.

Espousing free trade is as close to God's work as an economist gets. It's a worthy goal in itself, and it gives an opportunity to espouse markets in general. In the process of doing so, the Dallas Fed became known in some quarters as the "free enterprise Fed," which embarrassed me at first, but I learned to love it.

More recently we've been called the "New Economy Fed" as a result of my cheerleading for the new paradigm. The stock market correction and the collapse of high-tech investment spending have reduced the value of that brand, at least temporarily.

Behavioral economics is new to me, but it sounds like fun. I recently read in the *New Yorker* that one principle of behavioral economics is that when we look back on an experience we focus on two things: how it felt at the peak of the experience and how it felt at the end. (Our mothers had that one covered with "All's well that ends well.") Another principle is that we hate losing more than we love winning. Both these principles help explain the bad feelings many people now have toward the New Economy period in the late 1990s.

Productivity growth, or growth in output per hour worked, doubled in the late 1990s from the anemic pace of the previous two decades. The increase, from about 1.4 percent per year to about 2.8 percent per year, enabled noninflationary output growth to rise to almost 4 percent and the noninflationary unemployment rate to decline to 4 percent. The Fed under Alan Greenspan didn't try to enforce the old speed limits during the early part of this period, which would have choked off this extraordinary performance and prevented our knowing it was even possible.

Econometric models, based on historical relationships, said inflation is coming. But two of my favorite economists said hold on a minute. Yogi Berra said, "You can observe a lot just by watching." And Richard Pryor said, "Who are you going to believe? Me or your own lying eyes?" We waited, observed and believed our eyes. Besides, as Mae West said, "Too much of a good thing is just about right."

I was certainly in the wait-and-see camp during the New Economy period. If I'd been a better economist—a more "quantitative" economist—I likely would have been on the wrong side of that debate. Fortunately, you don't have to be smart to be right in this business.

Of course, given the stock market correction and recession, many would say I *was* on the wrong side of the New Economy debate. Maybe. Maybe not. I just can't imagine the FOMC issuing a press release that says (listen carefully now):

Even though inflation is tame and falling, the unemployment rate is too low and stock prices are too high, so we are tightening monetary policy today to raise unemployment and bring stock prices down.

I don't think so.

Recent data revisions suggest that the late 1990s were not quite as wonderful as we thought at the time. A Texan might say there was more foam and less beer than we realized. True. But there still was a lot more beer than we'd seen in a long time. There ought to be a law against data revisions. Or at least a statute of limitations.

Remarkably, productivity continued to increase during the recent soft spot. We just posted the biggest full-year productivity increase in decades, 5.4 percent. That hurts job growth in the near term, but it augurs well for future growth. September 11 showed us once again just how resilient the U.S. economy is.

Some of the hot topics of the 1960s have not figured prominently in recent economic history, but some have. Milton Friedman was supposed to have killed the Phillips curve in his AEA presidential address in 1968, but the Phillips curve keeps raising its ugly head like a whack-a-mole on a beach boardwalk. When you knock it down, it pops up somewhere else.

Wage- or cost-push inflation was a big topic in the 1960s. I remember Professor Waller coaching me on how to grade his tests on it. If a strong labor union or government pushes wages up by more than is justified by productivity increases, unemployment will rise if the increase is not validated by monetary expansion. If it is validated by monetary expansion, inflation will rise. He even had a little poem for it:

Economists all or most of us consent
If wage rates rise by ten percent
It puts the choice before the nation
Of unemployment or inflation.

I never hear the terms *wage push* or *cost push* anymore, but they still play an implicit role in some people's thinking about the inflation process. And they don't always remember Professor Waller's caveat about the role of money in the process.

Looking back, monetarism gained ground and peaked on a Saturday in October 1979, when the FOMC decided to influence money growth directly and not through an interest rate target. It worked for a time, perhaps too well. But financial innovation eventually destabilized the demand for money and velocity. We are back to targeting interest rates, but we are acutely aware of its hazards. Between you and me, I still feel better when money growth is consistent with what we're trying to do, even if it isn't the primary focus. Direct money targeting shall return, in my opinion.

The adverse implications of downward price and wage inflexibility got a lot of attention way back when. If wages won't fall, output and employment will. You don't hear much about that anymore. My guess is that floating exchange rates helped by making real wages flexible in foreign currencies. The breaking of the air traffic controllers' strike in the U.S. and the coal miners' strike in the U.K. also contributed to labor market flexibility in those countries. The U.S. and U.K. have lower unemployment rates because of more flexible labor markets than do the countries of the euro zone. As I said so eloquently in my epic poem, *Give Growth a Chance*:

Laws against firing
Discourage hiring.
And too high a safety net
Is sure to aid and abet
Those dead set
On avoiding sweat.

(You really do need to check out our web site.)

Another stupid question I asked when I got to the Dallas Fed was why economists stopped talking about profit maximization and started emphasizing stock price maximization. I know it's a stretch, but I suspect that change shortened time horizons and contributed in some small way to recent corporate indiscretions. I imagine moral hazard was involved some way, a term that I didn't hear in the 1960s.

Looking back on the 1960s with the advantage of hindsight, several things stand out. One is that I never realized how well the economy was doing then. We learned that only when we had the 1970s for comparison. We could talk about inflation and unemployment in the context of the Phillips curve, but in retrospect, both were low in the 1960s and both rose together in the stagflation period of the 1970s, not Phillips curve-like at all.

All the talk back then about the evils of budget deficits seems quaint now that we know how big budget deficits really can get, and without making the sky fall. Of course, once we got used to the deficits being so large and always growing, it came as something of a shock to see how rapidly they turned into surpluses in the 1990s. They certainly were sensitive to economic conditions.

We also just learned how fast surpluses as far as the eye can see can disappear. But that's largely a function of the response to 9/11, and as Keynes might say (forgive me Professor Waller), that's what surpluses are for: to turn into deficits.

Probably the most important thing on the economic scene nowadays is productivity—something I never heard discussed directly in school. It was discussed indirectly in the context of whether higher wages were inflationary, with the answer depending on how much productivity growth shifted the demand curve for labor to the right. But it wasn't discussed in the present context of how fast our standard of living can rise and how productivity growth makes most other good things—like rapid growth, low unemployment and low inflation—easier to attain. And rapid productivity growth certainly makes monetary policy easier and more fun. The problem is that it's the second derivative that has to keep increasing to facilitate monetary policy. If the growth rate flattens out even at a high level, the magic disappears. I almost got quantitative there, didn't I?

Progress on inflation has been remarkable recently compared with the gloomy expectations that were generated in the 1970s. Who would have thought even five years ago that serious people would be seriously worried about possible deflation in the near term. I'm not there yet; I'm obviously not a serious person. But I am an ally of those who do worry about deflation, since the monetary policy needed to combat deflation is essentially the same as the policy needed to stimulate faster growth, and I do believe we need to do that. Maybe we can kill two birds with one stone.

Since central bankers who want to go to central banker heaven are worrywarts, some of them worry that we've been so successful in bringing inflation down that we might have a problem getting real interest rates low enough to counter a serious recession because the downward limit on nominal interest rates is presumably zero. That's called the zero-bound problem.

Since I've already lost my shot at central banker heaven, I refuse to be seriously worried about the zero-bound problem. To me, it's like the concern not long ago that budget surpluses as far as the eye can see would retire all government securities and we wouldn't have anything to buy or sell in open market operations. That problem seems to have taken care of itself. I suspect the zero-bound problem will also go with the wind. Or, at least, like Scarlett O'Hara, I'll worry about it tomorrow. If that makes you nervous, relax. There are plenty of serious Dallas Fed economists who do worry about such matters, and they've promised to wake me up when the time comes.

Let me conclude by saying, seriously, what an honor it is to be invited to give the distinguished lecture here today. I haven't attended a Southern meeting since the 1960s, largely because I didn't think I would understand the technical presentations—not being quantitative and all. That your president would take a chance on inviting me here, and that his doing so didn't trigger a coup within the leadership of this fine organization, is, indeed, quite an honor for me.

I mentioned Professor James Waller several times early in these remarks. I really did love that man. He, of course, is no longer with us. A few years ago I attended a Mont Pelerin Society meeting in large part because that was his big trip every year. He lived a hermit's life, except for his annual Mont Pelerin meetings somewhere in the world. That's where most of his close friends came from. The main exception was the Southerns, which he also attended regularly, and loved. I doubt that he attended many of the sessions. He, too, was nonquantitative. I'm sure he drank a lot of scotch with his friends though. While he was nonquantitative, he had a great b.s. detector. He could separate the wheat from the chaff and teach the wheat.

Two members of the Georgia faculty—Nick Beadles and Aubrey Drewry of Harvard and Virginia, respectively—edited a book of essays in his honor, with the foreword written by another colleague, Bob Dince. The title of the book is *Money, the Market, and the State*. My great honor was being the only student asked to contribute an essay to that book. One student in there with the likes of Leland Yeager, Henry Hazlitt, Clarence Philbrook, David McCord Wright, Warren Nutter and other bright lights who attended the Southerns in those days.

Of course, like this talk today, my essay was invited rather than accepted; so my pride is based not on the quality of my contribution but on the faith of my friends. So unless these personal recollections get an embarrassing review, I'd like to dedicate them to James Muir Waller. Thank you very much. And thanks for inviting me.