Speeches by Bob McTeer

The Prodigal Son as Central Banker
H. Parker Willis Lecture in Economic Policy
Washington and Lee University
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I'm honored to be invited to give the second annual H. Parker Willis lecture. Especially since the first lecture was given by Al's and my colleague Roger Ferguson, vice chairman of the Federal Reserve Board. I probably should explain for the benefit of the students that "vice chairman" at the Fed does not mean the chairman in charge of vice.

My invitation came from the chairman of the economics department, Art Goldsmith. I was flattered, but I can't help wondering why he left the country shortly before my appearance. He turned me over to the acting department chair, Carl Kaiser, who then turned me over to associate professor Linda Hooks. I was beginning to feel like a hot potato, but Linda didn't drop me—maybe because she used to be an economist at the Dallas Fed. The Lord truly works in mysterious ways.

I hope you aren't expecting a talk similar to the vice chairman's last year. I know Roger Ferguson. Roger Ferguson is a friend of mine. And I'm no Roger Ferguson. The main difference between Roger and me is that Roger is a Harvard man. You know what they say: "You can always tell a Harvard man, but you can't tell him much." Roger has a bachelor's degree in economics from Harvard, a Ph.D. in economics from Harvard and a law degree from Harvard. He later worked for McKinsey, for heaven's sake. Where I come from, they call that piling on.

Where I came from is the University of Georgia, where I wouldn't be accepted under today's standards, but back then Georgia was a football school. I'm told that Harvard has had several well-known, distinguished alumni over the years in addition to Roger. I'm not sure about Georgia. The most famous Georgia graduate I know of is the late Lewis Grizzard, newspaper columnist and author of great books. His books include *Kathy Sue Loudermilk, I Love You; Don't Sit Under the Grits Tree with Anyone Else but Me; Won't You Come Home Billy Bob Bailey?* and *Elvis Is Dead and I Don't Feel So Good Myself.* I'm not sure why I feel compelled to share these book titles with you, except that my taste in literature may shed some light on what led me eventually to the status of prodigal son.

I left Georgia in 1968 to move to Virginia, the home of two distinguished Virginia gentlemen of different times: H. Parker Willis and J. Alfred Broaddus. H. Parker Willis was one of the first academics to have significantly influenced the creation and direction of a governmental institution—in his case, the Federal Reserve System. He was a forerunner of today's influential academic and think tank economists. J. Alfred Broaddus, on the other hand, is one of the Fed's most respected contemporary practitioners of the art of central banking. If H. Parker and J. Alfred had been contemporaries, they no doubt would have been good friends—sitting around a faculty lounge somewhere in overstuffed leather chairs, sipping Virginia Gentleman, smoking dark cigars, blowing smoke rings and opining on essential first principles of central banking.

H. Parker might have said, "The important thing for the new central bank is to avoid the overissue of currency, which it will succeed in doing if it limits its discounts to real bills: that is, short-term, self-liquidating commercial or agricultural paper that comes into being as goods are created and gets paid off as the goods are consumed. Thus, money and goods will rise together and fall together."

J. Alfred might well have replied: "Yes, yes indeed. Avoiding overissue is most important. But the central bank should not only not overissue; it should be seen to be not overissuing, because the most important thing for a central bank is its credibility. And transparency is essential to credibility. Most important of all, the successful central banker must watch inflation like a hawk."

As the economics faculty here certainly knows, for years Al has had the reputation for being an inflation hawk. Lately, he's becoming a hawk on deflation as well. He doesn't like inflation. He doesn't like deflation. I don't think he even likes *flation*. One thing's for certain: J. Alfred Broaddus will go to central banker heaven. Only hawks need apply. And he is a hawk in both directions. A symmetrical hawk.

Unfortunately, I got branded as a dove a few years ago. What happened was I dissented against the tightening of monetary policy in June and August 1999. Not long after that, the press began using the dreaded "D" word to describe me. I didn't think it was accurate then and still don't. I never thought of myself as a dove, just a kinder and gentler hawk. But before I could correct the spin on that ball, *Business Week* called me the “Lone Star Loner.” Before long people started putting two and two together and came up with “the Lonesome Dove.” While I didn't like "dove" much, I kind of liked the Lonesome Dove. I figured if the Lonesome Dove was good enough for Larry McMurtry, it was good enough for me. I had me a persona, a Texas persona. A cowboy persona. More recently, after learning that I grew up in Ranger, Georgia, one writer put me on a horse and called me “the Lone Ranger.” He forgot an important rule of the West: "Never call him a cowboy 'til you've seen him ride."

I thought this was harmless fun, but soon I learned why Willie Nelson advises mamas not to let their babies grow up to be cowboys. People take potshots at cowboys. This particular cowboy was ambushed on Wednesday, May 2, 2001, by Paul Kasriel, a friend of mine, economic research director of Northern Trust Corp., in his daily economic commentary. In writing. I quote verbatim:

Is 'Cowboy' Bob McTeer Becoming an Embarrassment to the Fed?

Dallas Fed President Bob McTeer is fond of dressing up like a cowboy, boots and all. Not only does he look like a cowboy, but he is beginning to act like one, too. That is, he's starting to shoot from the hip, or perhaps more accurately, shoot from the lip. Today, the BridgeNews service quoted Cowboy Bob as saying that the Fed was doing a 'good job' keeping U.S. inflation under control. Is that so. [sic] Looking at the three charts below, which show variations on the theme of consumer inflation, it looks to this old cowpoke (yes, on casual Fridays, I've been known to put on boots and bolo tie, too) as though that steer, inflation, has slipped Cowboy Bob's rope, as it were. Robert Black, the former president of the Richmond Fed under whom Bob McTeer served before he became a Cowboy, was an inflation hawk if there ever was one. In his retirement, President Black must be wondering where he went wrong in mentoring McTeer. Another one of Black's protégés was Al Broaddus, the current Richmond Fed president. Well, President Black, don't feel too down. "One out of two ain't bad."

End quote. (How do you spell ad hominem?)

Well, there you have it. Cowboy Bob is an embarrassment to the Fed for thinking the Fed was doing a good job keeping inflation under control.

If Cowboy Bob weren't such a kind and gentle cowboy, he would call attention to the press release following last week's meeting of the FOMC, which reads in part: "The probability of an unwelcome substantial fall in inflation, though minor, exceeds that of a pickup in inflation from its already low level."

Yes, you heard that right: "an unwelcome substantial fall in inflation."

I don't expect you students to get too excited over that statement, but the economics faculty will no doubt recognize its historic meaning. Inflation has been beaten down so low, the FOMC would consider a further substantial fall in it to be unwelcome.

I guess all that progress against inflation came after May 2, 2001.

Those of us who favor price stability, like Al and like me, are not being inconsistent in wanting to prevent deflation. If you are for price stability, you want neither inflation nor deflation. We are all together on that.

Yet, with the target fed funds rate at 1¼ percent and with the FOMC worrying more about deflation than inflation, I must confess to finding some satisfaction in the fact that the Lonesome Dove is not so lonesome anymore. Maybe the prodigal son can come back home to Virginia some day. (To Billy-Bob Black.)

While I agree that deflation is undesirable—and certainly less desirable than modest inflation—I also agree that the probability of deflation in the United States remains "minor" at this point. People worry that we might go the way of the U.S. during the Depression years or the way of Japan in the 1990s. But the Fed is smarter than it was in the 1930s, and economic theory is clearer now than it was then on what to do. Many of us, including me, like to disparage Keynesian economics as a "general theory" of employment interest and money, but it is still a pretty good road map for fighting deflation and recession. It's not too bad as a "specific theory."

Just as we won't allow the money supply to shrink in a steep recession, as happened in the 1930s, neither will we nickel and dime our response to early signs of stagnation in a postbubble environment, as occurred in Japan in the early 1990s. In fact, with our target short-term interest rate at 1¼ percent and our money supply growing nicely, we have already front-loaded a very stimulative policy, while a Keynesian countercyclical swing in fiscal policy is also already well along. It would be much better, however, in my opinion, to have a supply-side policy stimulus than to have demand-side Keynesian fiscal stimulus. Ideally, pro-growth tax cuts and other incentives could be increased while partially offsetting any negative revenue implications with spending cuts elsewhere.

Perhaps more important, however, in avoiding Japan's deflationary dilemma is that we don't have the banking problems that continue to stifle Japanese growth. We took our medicine early. That's why there are no large banks headquartered in Texas—possibly just as the first president of Texas, Sam Houston, protégé of Andrew Jackson, would have wanted it. Sam's and Andrew's views on money and banking were fairly clear and simple: They were for money and against banking. As for central banking policy, they were for sound money and plenty of it.

(That was a joke. Let's not get the Dove thing going again.)

As I said earlier, I think the chances of slipping into deflation are fairly minor. However, I do think economic growth should be boosted substantially. As far as I'm concerned, pro-growth policies are also antideflation policies. So while I may think deflation is less likely than Al does, I may be a bit more willing to give growth a boost. So the difference is only in the rhetoric and not in the policy prescriptions. I will continue to be a cowboy while he remains the quintessential Virginia gentleman.

Actually, economic growth has not been all that weak by historical standards—only by the higher standards of the late 1990s, the New Economy period. Over the past six quarters, real GDP growth has averaged over 2 ½ percent—but only 1 ½ percent over the last two quarters. The problem is that productivity growth has produced that output and income growth without the need for more employment. This recovery has not only been a jobless recovery; jobs have actually declined substantially. Aggregate demand needs to be large enough to produce employment growth as well as productivity growth. And given the degree of slack in the economy, my preferred growth number would be well north of 4 percent until full employment is restored. I don't think growth that high would cause higher inflation, but it might help keep disinflation from morphing into deflation.

We not only need to grow fast enough to reemploy unemployed workers; we need to employ new workers coming into the labor force, like, for example, the graduating class of Washington and Lee University. Jobs may be a bit harder to find this May than they will be next May. If you are at the tipping point in deciding to go on to graduate or professional school, you might tip in favor of doing that. But if not, things will be all right.

I'm scheduled to give a commencement address next week to the economics graduates of the University of Texas, over 300, I understand. So I've been thinking what advice to give on finding a job and succeeding in a career. Rather than tip my hand here, let me mention something I often say to training classes at the Dallas Fed. It has to do with the importance of the "likability" factor in your career. But first let me give you some other "cowboy advice." If you go into management, do like the cowboy does and look back occasionally to see if the herd is still there. And of course always drink upstream from the herd. And whether you go into management or whatever, remember never, never squat with your spurs on.

Now to the likability factor: No matter how skilled or educated you are or how hard you work, you won't go very far up the ladder if you aren't pleasant to be around. I tell our trainees about the test for likability I had when I worked in Baltimore and had to drive to Richmond once a month for board meetings. It was about a three-hour drive, as I recall. Not very pleasant. The question was, Would I prefer to make that drive by myself and have a three-hour conversation with myself? Or would I rather take someone along to keep me company?

There were several people who met my three-hour test handily. People who were fun and interesting to be around. Not boring. Not too talkative, but talkative enough. While several met that test, it was a pretty hard test to meet, and some of my colleagues didn't meet it. Those, I tried to avoid carpooling with. Which of these groups of people do you think are having more career success today? Think about it.

I didn't know how to get from Texas to Lexington, Virginia, so I asked people here, the dean who left the country and others. I was told I could fly via Richmond to Roanoke or Charlottesville and rent a car. Or I could get off the plane in Richmond and ride over with Al Broaddus. About a three-hour drive, I was told. I caught a ride with Al.

I've teased J. Alfred Broaddus a lot tonight. And I didn't warn him that I was going to do that. But I knew it would be OK, because Al is not only a valued colleague at the Fed but a true friend of more than 30 years. I would take a three-hour ride with him almost any day. But probably not four. No sense pushing it.

But even nicer from my viewpoint was not that I accepted a ride from Al, but that Al offered. It appears that I'm car-worthy too!

Like me, Washington and Lee is lucky to have Al Broaddus as a friend. I'm glad he brought us together. We'll be driving back to Richmond in the morning, the Virginia gentleman and the prodigal son.