

Federal Reserve Board Oral History Project

Interview with

Frederic S. Mishkin

Former Member, Board of Governors of the Federal Reserve System

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Interviewer: David H. Small

Federal Reserve Board Oral History Project

In connection with the centennial anniversary of the Federal Reserve in 2013, the Board undertook an oral history project to collect personal recollections of a range of former Governors and senior staff members, including their background and education before working at the Board; important economic, monetary policy, and regulatory developments during their careers; and impressions of the institution's culture.

Following the interview, each participant was given the opportunity to edit and revise the transcript. In some cases, the Board staff also removed confidential FOMC and Board material in accordance with records retention and disposition schedules covering FOMC and Board records that were approved by the National Archives and Records Administration.

Note that the views of the participants and interviewers are their own and are not in any way approved or endorsed by the Board of Governors of the Federal Reserve System. Because the conversations are based on personal recollections, they may include misstatements and errors.

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MR. SMALL. Today is Wednesday, August 13, 2008. This interview is part of the Oral History Project of the Board of Governors of the Federal Reserve System. I am David H. Small from the FOMC (Federal Open Market Committee) Secretariat in the Division of Monetary Affairs. I am conducting an interview with Frederic S. Mishkin, a current Governor of the Board. Governor Mishkin will be resigning from the Board at the end of this month. He will have served on the Board from September 5, 2006, to August 31, 2008. This interview is taking place at the Board.

Professional Background

MR. SMALL. Governor Mishkin, you served on the staff of the Federal Reserve Bank of New York from 1994 to 1997. What was your path from being born in New York City to arriving at the Reserve Bank in New York?

MR. MISHKIN. The main reason I became an economist was because I was very interested in macroeconomic policy. I grew up with my father talking about the impact that the Great Depression had on his life. The ability to understand how to prevent economic disasters of that magnitude was something that intrigued me. I thought it was incredibly important. So it naturally led me into macroeconomics.

I went to MIT because it had a good economics department, but I thought I might want to be a physicist. Then I thought about a double major. I took physics courses for five semesters. By the end of my freshman year, I did a research project with somebody, and we couldn't get any answers. I said, "This is the field for me." Macroeconomics, of course, has that aspect. Regarding my path to the Fed, my research has always been focused on policy issues, even though frequently much of it, particularly early in my career, was quite technical.

MR. SMALL. What was your dissertation?

MR. MISHKIN. My dissertation was on household balance sheet effects on aggregate demand. I was trying to understand [the] monetary transmission mechanism and expand the concept of [the] monetary transmission mechanism.

MR. SMALL. I can see future work with someone who studied bank balance sheets in the transmission mechanism.

MR. MISHKIN. Right. That has been the theme of research in my career. That led to the work I did on the Great Depression. That led to a lot of work that I did on financial market history, which has had tremendous benefits in this current environment. People outside of the Board worry about having too academic a Board. But having a Chairman who was intimately involved in research on the Great Depression and people like myself who have done work on financial crises turns out to have very high benefits in order to enable us to move fast and expand our thinking on these issues.

I was always interested in policy. I did a lot of technical work in my career, but it was always focused on an interesting policy problem. And because monetary policy and central banking are so broad, that led me to areas of bank regulation and so forth.

Working at the Federal Reserve Bank of New York

MR. MISHKIN. The reason I went to the New York Fed was a little bit of an accident. At the time, the New York Fed had a weak research operation. I had no interest in interacting with them. I didn't send my students there. I was going through a midlife crisis, but of the good kind—one which does not involve being interested in other women. I love my wife—that wasn't the problem—but I needed something new to get me charged up in my career. I was 43 years old, and my father had just died. That stimulated a lot of thinking. I was not as excited about my research, having done it for a lot of years. It turned out that an opportunity opened up.

The New York Fed contacted Ben S. Bernanke, our current Chairman, to become the research director, and he didn't want to do it. Then I heard about it, called the president of the Reserve Bank, and said I'd be interested. He asked if I could come down the next day, and he offered me the job that day.

In that role, I made a change. A key issue for me was management. The research operation was weak. I started bringing in a bunch of outside academics on a weekly basis. I had to talk to the staff and get them to change; they couldn't understand what the view of outside academics was. I said to a group of these academics, "I think that we're in the bottom third of the [Federal Reserve] System." The comment came back from one of them: "No, we think you're the worst." [Laughter] Then I said, "What about Philadelphia?" It was a very funny discussion.

The challenge was to remake the research department. I really turned it around. And I've been told that it had a big impact on research departments in other central banks throughout the world. The model was to create a place where people would write academic papers that were relevant. For half the people's time—and it took a while to free up that time—they could work on whatever they wanted, but it needed to add value to the institution. That created an exciting environment and a research department that went from the bottom to one of the best in the System. I'm very proud of that.

In fact, it relates to my job here at the Board. One of the things I've cared about here has been improving the quality of the research environment. This institution has a great staff, but it has become overburdened with doing all the work that former Fed Chairman Alan Greenspan wanted, which involved a lot of detail and current analysis. And now having a Board, including the Chairman, that wants more analytic work, that has been added on. And, as a result, staff

members are overworked, and they don't have enough time to step back and think about bigger issues. We need people to think outside of the box. We also have a recruitment issue. The competitive environment is tougher. So I've been working on that.

The Board is a bureaucratic institution. It does not have the corporate structure of the Federal Reserve Banks that allows things to change much more quickly. When I went to talk to the president of the New York Reserve Bank, William J. "Bill" McDonough, I said, "Look, you have a terrible research operation. If you're hiring me, I'm going to break a lot of dishes." And he said, "If you didn't want to break a lot of dishes, I wouldn't hire you." And he gave me *carte blanche* to re-make the research department.

By the time I left the New York Fed, 45 percent of the professional research staff had turned over. It was a transformed institution. That's much harder to do in a bureaucracy. Also, my job here is different. I'm not in the trenches. I'm a Governor. And there is a reason for the separation between Governors and [the] staff. The staff members are the lifers, and the Governors are not—particularly in my case, leaving after two years.

Comparing Reserve Bank and Board Culture

MR. SMALL. Does the difference between governance of the Board and of the New York Reserve Bank, being the corporate model, affect the way that the Fed Chairman or the Reserve Bank president uses the research staff?

MR. MISHKIN. Yes, it does. I think that it's much harder to get the Board's research staff to go to your style. In the Reserve Bank, it was very easy. At the Reserve Bank, within two months I completely changed the way briefings with senior management were done. They had been formal and not very interesting. We loosened them up. There was no reading of presentations. Everything was presented. There was a lot of Q&A. I encouraged different

elements of the staff to do it. It was a different type of supervision. Staff members, not their managers, were completely on their own for a presentation. That energized people. At one point, we had a research assistant do a briefing. I thought he was going to pass out—he was so nervous. But it was great. We allowed people to be accountable and perhaps fail, and, as a result, they would perform much better than they ever would have otherwise. In some cases, people didn't live up to the quality expected; those were some of the people who were encouraged to move on.

MR. SMALL. So, at that time, you had a foot in each of two camps: the Federal Reserve Bank of New York and however that work was presented and you interacted, and then when you sat in on an FOMC meeting. Was that a different culture?

MR. MISHKIN. That was a very different culture. Reforming the research department was one aspect of what I did. The other aspect, the policy work, reinvigorated my whole research program, which surprised me. I was exposed to so many interesting questions. My work on emerging market countries started only because the Mexican crisis occurred. The president of the Bank kept asking me questions, and I didn't have a clue about how to answer them. My weakest group at the time was my international group, which then became one of the strongest. I had a 75 percent turnover rate in that group. I had to think about the president's questions and stimulate my research. It was only a problem because I was exhausted from doing two full-time jobs. I was managing a large staff and writing more papers than I did previously. [Laughter] I have a lot of energy, but by the end of my three years at the New York Fed, I was exhausted.

But going back to your question, yes, there is a tremendous difference. It's a much more formal process here at the Board. I've tried to push the research directors to a less formal

process, but it has not been that successful. We did get a recent innovation, which I pushed only after I had announced my resignation. However, the presentations are still formally read, which may not be the best way to do things. Also, there's too much editing from too many people, which I think uses up a lot of time. But it's not a battle I wanted to fight. A model that I think would be the right one may not be the right model.

But one of the things I did get to change was that the Chairman would ask questions, and then each Governor would ask their questions in turn; I thought that was an inefficient way of doing things. I did not raise changing this to the Chairman until after I resigned. I thought it would be self-serving to say that we should do this differently, because I was the last one to speak, being the last appointee. In the context of the FOMC meetings, the Chairman did allow two-handers and so forth.¹ It was just the culture. Now the Chairman asks questions, and we stay on that topic with Governors just coming in rather than going around the table, the latter being a much less efficient process. I think this is an innovation that will stick. The Chairman asked me why I didn't push this earlier: "Why didn't you do this before?" I told him that then it might look self-serving.

Lame-duck status can be helpful rather than harmful. This was even true, to some extent, at the New York Fed, in that I managed by ideas, and then those ideas are either good or not. If you're only about power, then the lame-duck status is a disaster. I felt that I could make a contribution, because now it would not be seen as self-serving. So there's a bunch of issues that we're dealing with, as I leave, about how the Board might work. I can't go to the first part of my last Board meeting, because it deals with monetary policy issues, but at the Board meeting on August 18, I will talk about the game plan for the research operation for the next couple of years.

¹ By raising two hands, the participant indicates a desire to comment on what has just been said. Raising one hand indicates the participant wants the opportunity to make a new comment.

MR. SMALL. In your preparation for FOMC meetings—comparing the New York Fed position and here—where did the brainstorming take place, as far as preparing? How does a research director instigate, and what's the pushback he gets on issues versus here at the Board?

MR. MISHKIN. I found there was a real problem in the brainstorming aspect here. The Board does not brainstorm together. This was a surprise and a disappointment to me.

MR. SMALL. The Board members?

MR. MISHKIN. The Board members. One of the things that I'm talking to the Chairman about is more effective use of the Board. Because of the Government in [the] Sunshine Act [of 1976], you have to announce a meeting publicly if more than three Board members discuss an issue. So that makes it much harder to brainstorm on an issue.

There is also the culture. For me, this has been a lonely position, because I don't have much interaction. I've figured out how to deal with this in certain ways. It's very different in a Reserve Bank. The president, who is the policymaker, is continually having private conversations and presentations that are made before the FOMC meeting, which are much more give-and-take. You're going in all the time and talking about what's going on in the economy and how to think about it. And you'll have several staff. In particular, at the New York Fed, the president, Bill McDonough, Peter R. Fisher [executive vice president], and I would meet frequently and debate ideas like where the economy was, what should be our strategy in the FOMC meeting, and so forth. That has not happened here at the Board, and I miss that. I stated the reasons why it is that way.

Here nobody will come to your office unless they have an appointment. I like to debate ideas. There's a separation between the staff and the Board that has benefits, but it also has a downside. Again, the staffers are the lifers; they preserve the institutional memory more than the

Board members do. So there's a positive to them being independent. There's a positive to them having a different view and being willing to express it. That's good. The negative side of it is that the staff wants to give the party line to you as a Governor. It often has the element of it as, "You're the poor, dumb Governor" kind of thing. Part of it is for efficiency purposes. Also, there are different kinds of Governors. It's ingrained as part of the culture, and I found that my briefings and interactions with the staff were not what I wanted.

I solved this in two ways that worked out quite well. Generally, I write my own speeches, but I do not write the speeches on [the] outlook, because there's a lot of Fed speak. However, I did only two speeches a year on [the] outlook. My attitude was that the staff knows how to do the Fed speak, and this was critical for those speeches.

For the rest of my speeches, I would take an entirely different approach, because I wanted to write them primarily myself. Before starting on the speech, I would talk to [the] staff about what I was thinking about and then I could get them to tell me what they thought. I'd say, "I want to read 30 papers on this topic." We'd sit down, and I'd have staff people debating each other, which is exactly what you need to have—debate. For example, two people would have very different views on certain aspects of how you view the NAIRU and DSGE models. And they would be yelling at each other, but in a positive way—in an academic, very vigorous debate. That meant that I got to hear what people were actually thinking about. I could create this environment, the back-and-forth, and get rid of the formality. It's one of the reasons I ended up writing so many speeches—because that was the way I interacted with [the] staff in a desirable manner.

Also, I felt isolated in discussing strategies and so forth. I would talk periodically with the Chairman, but it was always one-on-one, and we rarely had groups of Governors talking

where someone would say, “Oh, I didn’t think about that.” The one exception, which I found very valuable—but again, it was a limited number of people—was the pre-FOMC briefings for Vice Chairman Donald L. Kohn, Randall S. “Randy” Kroszner, and me. We were the members of the Economic Affairs Committee. We’d openly discuss the forecast and the Bluebook, but we wouldn’t discuss strategy as much. To deal with this problem, I formed a group of staff who would meet with me before the FOMC meetings to discuss what had gone on in the last FOMC meeting—what my thinking was, what their thinking was, what strategy should I play in the meeting. I used them as a kitchen cabinet. That had two benefits. It was less isolating, because I could actually bounce ideas off of somebody. And these staff people are the up-and-coming young guys, but they weren’t able to go to FOMC meetings.

There was an issue about expanding who goes to the FOMC meeting. The problem with expanding the attendance of Board staff meant that the Reserve Banks would then feel that they wanted to bring more people. So it was a political mess. As a result, it was a career development issue for this set of people that would meet with me before every FOMC meeting. I found it very useful, because they would tell me what they think, and I could then start talking to them about the bigger picture. It’s not just about what you think is going on in the economy and objectives, it’s also how you manage the information in the Committee and get to a right decision. So it’s career development as well, and I hope these guys will be future leaders in the Federal Reserve System.

Being a Federal Reserve Board Governor

MR. SMALL. The Greenbook is the staff forecast that has a particular view or framework of how the economy and inflation develop. Is the Greenbook framework too dominant among the staff? Is it too hard to get advice outside that or fresh ideas?

MR. MISHKIN. There is control of information. I started a project that will come to fruition, although it has been taking forever. This is my frustration with bureaucracy. There's a plan to completely redo the FOMC documents and no longer have a Greenbook and Bluebook. It's a great proposal. David Stockton, director of the Board's Division of Research and Statistics, had this proposal in his mind for two years. We've talked about it, and it still hasn't been done yet. [Laughter] This organization is a great bureaucracy. It's not a power-driven bureaucracy; the people are professional. However, the pursuit of perfection is the enemy of the good here. It increases the workload in crazy ways and frequently kills creativity. That worries me. The new plan will help.

There's still an issue that it's hard sometimes to get information that I'd like to have, because the staff controls information. It's partially an efficiency issue. We're trying to minimize the staff's workload in dealing with Governors. There's sometimes a control issue as well. That's been a frustration for me, and I just decided not to fight that war. Part of the reason I didn't fight it was because I felt I had enough information to make the decision that I needed to make. And I wanted to keep the research [division] directors on board to make as much progress as possible in reforms. So it was not a battle I wanted to fight. For example, I've said, "I would like to know how our forecasts compare to outside forecasters." I've asked several times, and I've never gotten that information. I know that staff members produce it internally, because they'd have to think about this issue, but I've never gotten it. That's the kind of frustration I'm talking about.

One of the priorities in my job here has been to improve the research environment. In order to do that, I have to have the research [division] directors on board. We appointed two research directors. I think Dave Stockton is great, and I told him, "I'm giving you veto power.

I'm not going to push anything that you don't want." I felt that Dave's heart is in the right place. And I thought that if Dave got pissed off and left, then we are really screwed.

Because of my personal situation, I did not expect to be here long. Originally, I was going to be here two years, but my wife told me I could stay for three years. We got into a much more complicated environment, and I also wanted to stay close to the end of the Chairman's term. But then the Office of Government Ethics wrote a very bad rule about books. That office was upset about, I think, Colin Powell signing a book contract when he was in the government. They made a rule that you couldn't have anything to do with any book that you have under contract. I was willing to do that if I could stay two years, because I could then revise my textbook after. I figured that was the endpoint.

But then, because of what's happened in the financial situation and also the fact that I think I've been very helpful to the Chairman in the FOMC, my wife said, "I don't like it, but I'll let you stay a third year." I said, "Well, I'll delay the publication of the book until after I leave the Board so there can't be any conflict of interest." There's not a gain to me for doing this. But the Office of Government Ethics still said that I can't work on it. So I decided that I would have to leave, because this is an important part of my life. I love to teach, and the book allows me to do so to a very wide audience. I have about 70 percent market share. I've taught over a million students this way. A million students have already used my book, and I'm not willing to give that up, because it's important. Ideas are important, and disseminating them is also important. But if I had had a longer-term horizon, maybe I would have thought about pushing a little harder on these issues.

In order to get as much done in moving the research operation, I really wanted the cooperation of the research [division] directors. My view was: Don't fight a battle that's not

that important. You have to decide tactically which battles you want to fight to win the war. We have made a lot of progress in the research environment. However, it still has driven me crazy, because it's so much slower than I would like to have seen. I'm an extremely high-energy person, and I get things done very fast. People are always amazed how much I get done. I'm not a workaholic, but I'm very decisive. I make decisions and go with it. If it's a mistake, you just rescind it. That's not the culture here, by the way. [Laughter] So is there a lot of information that I'm not getting that I should get? Absolutely. But it was not battles that I felt I needed to fight.

The problem may be less here than in many organizations, but there are still people who have gone around me even though it was about issues that I didn't even care about. By the way, the current research [division] directors are terrific. But I do worry that there are some layers under them that are very schooled in the old, control-information-type view that is prevalent here. It was much more prevalent when I was in the FOMC meetings in the mid-1990s.

MR. SMALL. Is there an intellectual inertia through, say, the Greenbook? In other words, we think of the inflation process and there being a NAIRU (non-accelerating rate of unemployment).

MR. MISHKIN. I don't think that. I feel that the staff's forecasts are extremely well done. Some of my nervousness about changing things is that, unless you're in the trenches, if you change things, the unintended consequence is that you weaken the forecast process, [and] that would have been very bad. If you're down there in the trenches with the research staff and you do something which results in an unintended consequence that's negative, you pick it up. I dealt with this all the time at the New York Fed where I thought something was a good idea, and then it had some other consequence I did not like. Either I tweaked it or I just got rid of it. Here,

if the Governor says something on high and [the] staff tries to do it, it could have very negative consequences. I feel that the forecast operation here is really superb. I trusted the staff here more than the outside guys, but sometimes I wanted to know why they're differing, and I never could get the information.

This is the nature of bureaucracies. But, as I say, this bureaucracy is better than almost any other one in Washington that I've experienced. To be very frank, I'm not a big fan of Washington. It's not my kind of city, because it's so driven by power, and that's just not where I am. It's not the way I operate. I don't like people who operate that way. This organization is much less that way than almost any other organization in Washington, but it still has some. That's the nature of bureaucracy.

Probably the best part of my job has been interacting with the staff. But there was frustration, and it took me a year until I really figured this place out.

MR. SMALL. As an academic economist joining the Board, you brought some of that research initiative and discipline. For the several years you have been here, you've been exposed to financial crises and operational issues. If you go back to academia and talk to the economics department at-large, on what issues or in what areas would you say to them, "Look, you guys aren't looking at this issue." It might be payment risk or clearing mechanism.

MR. MISHKIN. Well, I think there is. In academia, what people are calling "macroeconomics" is completely unrelated to the kind of issues that we deal with here. There's a focus on elegance. Part of the problem with the Great Moderation is that it's not as exciting, and, therefore, people are focusing on issues that have little to do with what we would call "macroeconomic policy," either fiscal or monetary. It is harder and harder to find people to hire at Columbia University's Business School to teach the macroeconomics course, because they're

doing growth or something and sometimes an esoteric part of it, not focusing on macro policy issues. That's a big challenge for this institution, because we need people who are really very applied and policy oriented. Columbia, between its Economics Department and the Business School, now probably has one of the best groups in the country in that area. But, as a result, we can't find people to hire as easily.

I think that there are a tremendous number of issues that we have to focus on as policymakers that really are not receiving that much attention in academia, and that's a loss. If you think about what happened in the period from the 1950s to the 1970s, academia has played a tremendous role in changing thinking about how monetary policy is done, with tremendous benefits. The quality of monetary policy is so much higher than it was when I started in this business. And we've had huge success for it. Ideas really matter. I believe firmly in that. And when I viewed my role here at the Board on management issues, it was research, but that's because ideas really matter.

In addition, the role I would play would be to focus on analytic frameworks, to think about the problems that we have to deal with. For example, one of the key issues is how to deal with nonlinearities. I coined the term "adverse feedback loops" in my speeches, which has now sort of become a vernacular here. One of the problems is that the academic research on optimal policy tends to be done by older people. The younger generation is not doing this. But there's a group of people who are just fantastic, like Mike Woodford and Lars Svensson and Mark Gertler, among others. But it's all done in the linear quadratic framework. And it just doesn't allow us to think about risk-management issues. A big issue for me involving a research project that I'm going to be doing with some people here after I leave is to think about a systematic way to think about risk management. Under former Chairman Greenspan, risk management was

another word for discretion. But you have to think about how you're managing expectations and so forth. I laid out a framework in a speech that I gave in January.² But we need to see if my intuition is correct by doing some modeling. So that's a new area that I think is extremely, extremely important.

The whole area of building financial stress issues into macroeconomic models is really critical. The way the staff handles it has been very good, but they've done it in an ad-hoc fashion. It's not ad hoc and nonscientific, it is ad hoc and scientific. But we need to have more research done on those issues.

One of the nice things about being an academic is that I can stay at the same place. My career's been changing every five years to completely different things.

Communication issues are central to the success of monetary policy. And the political economy element of that is key. In 1992, the Chairman and I wrote a paper that we gave at the [NBER] Macro Annual. It's probably the worst discussion I've ever had of a paper in my entire life. It was a case study, and people said, "We don't like case studies." One of the nice things about having strong views of the world and being tenured is you can say, "Screw them, I'm going to do what I want."

When I was at the New York Fed, I really wanted to think hard about monetary policy strategy and communications strategy. I got up in front of my staff and said, "I'm going to start a project on inflation targeting, and if there are staff that are interested in that, let me know." Adam Posen came to my office the next day and said, "This is what I want to do." I said, "Adam, you're in." Then Ben, the current Chairman, was visiting at the New York Fed, and I said, "I want to do this big project on inflation targeting, very much along the lines of what we

² Editor's Note: Frederic S. Mishkin (2008), "Monetary Policy Flexibility, Risk Management, and Financial Disruptions," speech delivered at the Federal Reserve Bank of New York, New York, January 11.

did on monetary targeting in our 1992 paper.” Ben said, “Great, I’d love to be in. I have this student, Tom Laubach. Can I bring him in?” I said, “Great.” Tom later came to the Board and has gone to a professorship in Germany.

I organized this project. It was one of the key things I did with the New York Fed. It’s one of the things that I’m proudest of. The book had a lot of impact in central banking circles. One central banker who was putting into place an inflation-targeting regime came up to me at the Jackson Hole conference and said, “When I was doing this, your book was on my nightstand. I was reading it every night while we were doing this.” Part of the reason I’m here at the Board is that I worked so closely with the Chairman on this project. We have an intellectual relationship. It’s not that we spend a lot of time drinking together, but we have a close intellectual relationship, and that’s something I think that he wanted to bring to the Board. And, as Chairman, he has less time to do what I’ve been doing and what he did when he was a Board member. It’s important for somebody to articulate analytic ideas clearly in thinking inside about policy deliberations and analytics, which is not necessarily academic. It’s not modeling of an academic sort, because frequently you don’t have a model. You still have to think analytically. It requires also a real practical element.

A key element of this is the political economy. If you get something perfect, and, in fact, you lose the political support for the central bank doing the perfect thing, you’ve created a disaster. For example, the academic literature talks about having full transparency, what I called in one of my papers, I think, “the Full Monty.” [Laughter] The Full Monty is not the right way to conduct communications. Transparency is very valuable. We need to go further in the direction of transparency. We’re not near what I think is best practice, and I’ve argued in the last speech, the valedictory speech, that we’re not where we need to be. We have to go much further.

You may get something that looks perfect, because, from the modeling viewpoint, full information actually gets better outcomes. On the other hand, full information can confuse and weaken this political support if it's not done properly. If you get a perfect system, and the politicians then say that they are going to hinder your independence, you're dead. The support for the central bank to promote price stability in the long run is critical. Anything that gets what looks like a better system but weakens that support is not a good way to go.

There are interesting issues on the political economy out front. I've written a lot on that stuff. The work that I did on inflation targeting—some of which is technical, but most of which is case study—like—I feel is [as] important as any econometric work that I've done. The details really matter.

Frequently, academics go into policymaking and are terrible at it. Then there are cases where academics are very successful at it. The key is that you can't be arrogant—that you're smarter than everybody else just because you can model better than anybody else. There are a lot of other elements to getting things right than just having a pure analytic framework. You also have to think analytically in the ways lawyers think. You've got to think analytically [about] how the politics are going to play out. So there's a practical aspect here that's very important. I should say that the experience at the Federal Reserve Bank of New York is what taught me all of that. When I walked into the Federal Reserve, I needed a change. I was a standard Ivory Tower academic with one big advantage—I came from a business background. I was a good manager because I worked at my father's factory for years, seeing how he ran his business, but I never wanted to be in his small business. You learn a lot through osmosis. Every night he'd come home for dinner and we'd talk.

MR. SMALL. What was the business?

MR. MISHKIN. It was the schmatte trade—a classic Jewish business. [Laughter] My father had a business that made the inside of the belts for women's belts. It was called belt-backing. He then had a sewing notions part of the business and so forth. Then my father and my Uncle Archie ended up taking over a public company—a cigar company. My father didn't run that company. He was the chairman of the board, and my uncle was the president of the company that made cigars—Phillies, Garcia Vega, and some other fairly famous brands.

The idea that you have an advantage as an academic of thinking much more broadly and analytically is powerful. But then you also have to realize that you're a lot less smart than a lot of other guys in the room on a lot of issues. If you get the details wrong, even if you have the right basic idea, it's a disaster. I learned that practical element at the New York Fed, where I went in and watched a savvy player who was the president of the Reserve Bank, Bill McDonough. It wasn't enough to have the analytics. How did you get it across? How did you persuade people? What issues did you have to worry about in the way people interpret what you were doing? Communication is extremely important. It's very subtle. We don't have any models that can tell us how to communicate effectively.

So that was almost a training ground for this job. It changed my research career because I came back after that doing more practical research that was still scholarly, but it was having a lot of impact and being widely read by policymakers throughout the world. And then, of course, I get the chance to be a policymaker. It doesn't get any better than this.

MR. SMALL. So either at the New York Fed or at the Board, you went in with a self-perception of what your strengths and weaknesses are. Were there any particular people that you saw operating as policymakers along the way that had dimensions that you envied?

MR. MISHKIN. Yes, absolutely. Bill McDonough is an interesting personality, a complicated personality. In many ways, he was a stressful person to work for. But he was a master diplomat. He didn't have the analytic skills, but he had tremendous skills for knowing when to play your cards and when not to play your cards. I'd watch this in FOMC meetings. I'd give him information and could see when he would play his cards and when he wouldn't play them. I learned a lot from him.

Peter Fisher at the New York Fed is an incredibly smart guy. He was trained as a lawyer. He is analytic and extremely smart. He understood economics well but was analytic more in the legal sense. He got me to appreciate how market interactions work and how important that is. Peter and I were close allies at the New York Fed. I would tease him and say, "Anything under 48 hours, that's your job. Anything over 48 hours is my job." There's a value in that.

The Chairman's analytic capabilities are prodigious. He thinks so clearly about a lot of issues.

You have to understand your weakness. And even if it's not a weakness, you may not have the credibility. I have not been particularly happy with the political operation here. I think we make mistakes. I think we've been pushed around by the Congress in ways that can be dangerous for us in the future. I have some savviness about thinking about politics because my wife has trained me to be cynical, and that's a key element in this. But I have no credibility because I'm not somebody who can do politics. My personality is extremely transparent. What you see is what you get. Whenever I play poker, people know exactly what cards I have under the table. [Laughter] So my credibility is not high there. And my ability to get things to move in a direction that I think would have been better for us politically is not that strong. That's something that happens all the time. You've got to play to what your strengths are, and you've

got to play to where you're able to get some action. In this context, I very much played things that way. If you try to get involved in some case, you may just piss some people off, and it's just not going to serve your ultimate goals.

My view always is that you don't beat your head against the wall. You figure out where your skills are and where your weaknesses are. If you have strength in an area but you're not getting anywhere, then you move to an area where you have strength and are able to get somewhere. So I played strategically. People sometimes underestimate me because my style is very loose, relaxed, and colorful. I don't know if you heard the Chairman's speech the other day, but those were all real quotes from me. I'm calculating. I'm controlled in situations where it calls for it. I always think about where I want to get to. What's the best path? What's the path of least resistance? Where can I play my strengths and get the most value added out of it? That's a role I think you have to play whenever you get to any high-level position. And be aware that, if you have a personality that is transparent, you're not going to be the person who's able to deal with politicians themselves. And then people may not realize that you may have some ideas on how to do it, but you can't execute.

So these are all considerations we have to make in how you can be most effective in doing your job well. For me, this job is simple. Most people in Washington are always looking to what the next job is going to be and how much power they are going to have. Power is not something that I find particularly attractive. One of the things that has bothered me here is that it's hard to get the information I want, because [the] staff sees you as sort of the "Gods in Valhalla" kind of thing in this corridor, and that creates barriers. I don't like those barriers. I want to sit down, be one of the children. When I was at the New York Fed, I always told the

staff, “My job is that you’re the children and I’m the head child.” That’s the way you manage a research operation well.

I’m not interested in working on Wall Street. I’m going back to being a professor. It’s a calling. Ideas are what I’ve always valued in my life. Policy has been exciting, particularly if you can put your ideas into play. But I think many policymakers think they’re more important than they are. I’m not talking at all about the Chairman. As Governors, we’re one of the cogs in the machine here. What may be more important are the basic ideas that I’ve put into play that hopefully will live past when I’m here. I think some of the things I’ve done as an academic had important impacts on policymaking.

MR. SMALL. You mentioned earlier how the corporate model at New York differed from the Board model here. Maybe you could discuss the Board model: how the Board works, and how it feels to be in that decisionmaking environment. Some people say the Board model could be used for national health-care or whatever.

MR. MISHKIN. Part of the structure here has some elements of a British comedy. Have you seen the show “Yes Minister”?

MR. SMALL. No.

MR. MISHKIN. “Yes Minister” was this British comedy show where the minister was a political appointee. The nonpolitical appointees ran everything and basically treated the Minister like he was an idiot. There’s some element of that in this organization because of the way our Board structure is set up. People don’t report to the Board or even to the Chairman. The Chairman is limited in his control of the way the organization works. That has advantages and disadvantages. Governors are political appointees. You need people who are lifers who are not completely controlled by the political appointees, because political appointees may not have the

interest of the organization at heart in the long run. I'm a little unusual in this regard in that I knew I was only going to be here a short time, and I love the Federal Reserve System. Once I went to the New York Fed, I always felt strongly that this is a great institution. After I left, I became one of the academic visitors. I said that I demoted myself from head child to child. After I leave here, I'm hoping to be helpful to the Federal Reserve from the outside.

The FOMC Structure

MR. SMALL. What about the structure of the FOMC?

MR. MISHKIN. The FOMC has complicated governance aspects, a lot of which drive me absolutely crazy. And yet I'm going to argue that we need this governance aspect.

The United States has never been a country that's keen on central banks, and it's reflected in many ways. The only other central bank I know that is as Spartan as we are—in salaries, perks, and everything else—is the Bank of Canada. It's not accidental that it was set up later than we were. European central banks are another world when it comes to salaries and perks. You can have lunch in the governor's dining room at the Bank of Spain: You have a fabulous two-hour lunch, and at the end, you're getting port and cigars, and you're surrounded by 20 Goyas. [Laughter] It doesn't get any better than this.

That's not tolerable in the United States because of this resistance to having a central bank. And I'm not arguing that it should be. We had two experiments with central banks that were killed by the Congress. There's always been a reluctance about it. What it requires, then, is a central bank that's a little more decentralized. That's why I think there was political genius in the founders of the Fed. They created a central bank that had all these regional Banks. That keeps it more in touch with these disparate regions and provides much stronger political support for our institution, where it's not natural to support it the way it is in European countries.

The other advantage is that it's a combination of both a private-sector and public-sector institution. At the Board, we are all government employees. On the other hand, the Reserve Banks are not. The legal structure of the Banks is a corporate legal structure; the Board has a civil service legal structure. I'm probably not technically getting it right, but you understand the sentiment. That has the following advantage: Through the board of directors there's a strong involvement of the Banks with the private sector and with their constituents. That is valuable in the System in two ways. It provides information from the private sector that is helping us to think about policy. It also means that we stay more real in being in touch with what people outside of Washington and New York think. There are two cities in the United States that people tend to hate—Washington and New York. Luckily, as a New Yorker, people have been much more positive about New York recently, but they still hate Washington. [Laughter]

I think that our System serves us well politically. It is a nightmare from the point of view of many issues. And I can just talk about the FOMC. We have 19 people sitting in a committee meeting. No committee makes any sense that's much larger than seven to nine people. To give you an idea, one of my tremendous frustrations here has been how slowly we've moved on communication policy. I've been careful not to get ahead of the Chairman and the rest of the Committee members. It was over a year and a half before I made speeches indicating what I really thought about where we should be heading.³ I would only have given my final speech after I resigned, where I say this is where we need to head and our policy right now just doesn't make sense. It's untenable in a logical sense, and we have to move on from it.

My interaction with the Chairman is one where I give him my views. They're unexpurgated. I tell him what I think of the economics. He has to make the decisions. I told

³ Editor's Note: Frederic S. Mishkin (2008), "Whither Federal Reserve Communications," speech delivered at the Peterson Institute for International Economics, Washington, July 28.

him that I will always back him up because I'm a team player. I wouldn't do that if I didn't trust his motives and his judgment. That's the right way to be effective in any organization. You're not a yes man. I felt very strongly in December that we needed to be more aggressive in easing. I ended up being right, and I talked to the Chairman about dissenting because I felt that strongly. But, after we talked about it, I decided that if I dissented it would create a lot of problems for him and for the institution. My view in that context was that you provide your views, but you're part of a team.

There's a real problem with the way the FOMC works because of very different positions. The Board works much more as a team, but not as well as I would like. I talked about this earlier from the point of view of information. There are two aspects of this. One is that you're in the same location. The other thing is that information will get to you through some form or another when you're doing something that people don't consider to be desirable. Let me tell you a story. It was mentioned by the Chairman at this final speech—the remarks he made the other day. In one of my early meetings, we'd been discussing communications, and I was talking about the *Monetary Policy Report*. I said, "This is like sex made boring. It's very dull." It was not meant to be a criticism of the staff, because that's the way Greenspan wanted it. One of the things I'd like us to advance further in is to get documents that we can make public that advance the public debate and explain things. There are countries that have much, much better documents than we have. There have been improvements in the *Monetary Policy Report*, but it's still not there.

Don spoke to me a couple of days later and said, "The staff was upset because they thought you were criticizing them." I said, "I'm so glad you told me." I called the research [division] directors in and talked to them. I told them that I wasn't in any way criticizing the

staff. I said, "Is the document boring?" They said, "Absolutely." I said, "That's what Greenspan wanted. You've been doing a good job." It was not criticism. The fact that I'm getting that information, which to me is the way I always manage, was a good thing. It's hard for executives to get the bad news from people quick enough not to make mistakes. That was something that I encouraged when I was at the New York Fed. So this was great, because then I nipped a problem in the bud. But that kind of thing will happen at the Board, because there are so many diffuse centers of power that will come up.

When you're a Bank president, and particularly if you're not a strong one, if your staff comes to you and tells you that you screwed up, they could lose their jobs. And I know about this. Two people that I had incredible respect for were frustrated by what one Bank president was doing on certain levels, but they could never say anything to that person because their position would have been put in jeopardy. That's one difficulty.

The second difficulty is that the board of directors is not really part of the System. They like to see their Reserve Bank president get a lot of attention.

And there's a third incentive problem. Some of the Bank presidents care more about getting their name in newspapers than the System. As a result, our communication issues have been very screwed up. I talked about this in my last FOMC meeting. I could only do it because I was leaving. I said, "Look, you guys are all talking in public about where to set interest rates. It's making us look very bad. It's weakening our credibility in the financial world. That can hurt us in doing policy." I talked to a prominent central banker who called me and said, "What the hell are you guys doing? You look like the gang that can't shoot straight." I said, "This is very costly to us." Incentives for them are different than the Board. And, in this case, Greenspan controlled it much more, because Greenspan would embarrass people in FOMC meetings. I saw

him do that. He literally sliced up somebody. All the pieces fell down. [Laughter] It was like watching a “Kill Bill” movie. Our current Chairman is not willing to do that. And it has raised serious problems for us.

The other problem is that, with a committee of 19, it makes it hard sometimes to make decisions, and it can create inertia. We spent 18 months getting to something that was okay if we did it in 6 months. But it took 18 months to get there, and it drove me crazy. After the meeting, I said to Don Kohn, the Vice Chairman, “This is worse than a faculty meeting.” Don said, “Yes, but it matters.” [Laughter] On the other hand, because I’m a team player, I knew that I could not get ahead of the Committee members. The Chairman knew I was frustrated by this process. At some point I had to talk about this stuff, because he knew I was not happy. But I waited a year and a half before I did it and then didn’t say what I thought until it would no longer be interpreted as the Chairman’s views. The Chairman’s very careful. You don’t want to look like you’re trying to beat the Committee members over the head. You don’t want people who might move in your direction to get their backs up.

But the frustration was there about how slow it is to get change to occur. I understand better now that incremental steps make a lot of sense, but if each one takes two years, it’s too slow. Both are serious governance issues that do worry me. The current one is more serious—this cacophony of voices that is hurting our reputation. I am worried about what could happen to the independence of the Fed. I warned the Bank presidents about this at my last FOMC meeting. I said that if we weaken our credibility out there with the political process, they could come after us. There has been talk about taking away the Bank presidents’ votes or making them presidential appointees. That would hurt this positive private sector interaction with us. So I do worry about this. There’s possibly going to be a relook at the Federal Reserve Act simply

because the whole regulatory structure has to change as a result of what's gone on. I think we could be in a vulnerable position.

More on Being a Board Governor

MR. SMALL. As a policymaker, the push of current events places you in a situation that is not where your strengths lie.

MR. MISHKIN. I don't agree. I have done a lot of thinking about financial crises in my career and lender of last resort. But there was a problem in terms of my effectiveness. Let me give you an example. Because of our Government in [the] Sunshine law, more than three Governors can't be involved in discussing this at any time [unless in a publicly announced meeting]. So when things started to get hairy starting in August, I could not go to the calls, because we had the three people involved: the Chairman, the Vice Chairman, and Kevin Warsh. This was frustrating, because when things happened, I didn't have the information to really help. Even if I would be right on some principles or thoughtful about the principles, if I don't have the details, I'm not going to be able to help. So I feel that I've operated here at 50 percent capacity. There are whole areas in which I could have been much more effective. My expertise could have been valuable, but there was no way to get in. You have to accept that. Some of it was politics.

As the chairman of the Economic Affairs Committee, I have taken an active role. I interviewed maybe 100 people here in the institution and wrote a report on the research activities and where the weaknesses are, where they need to be strengthened, and so forth. Implementation has been slow. I'm a little frustrated about this, because there's no payoff in the outside world to care about research. It's going to be unusual to get somebody who cares as much as I have cared about it. That hasn't happened before. Also, I have immense energy [laughter] and so the

combination's going to be rare for anybody coming in. You may have somebody who cares, but he or she won't have the energy.

I do not feel I've gotten the information that I needed to be as helpful as possible. Can we use the Board meetings more effectively to keep people better informed so they can be more helpful when things are happening fast? I don't mean when the exact crisis is occurring, because that's so fast. Bear Stearns started on a Thursday, and we were dealing with it on Sunday. But if you get more information after it happens, then when the next one comes up, you want to think of what lessons were learned and so forth.

MR. SMALL. What are those Thursday-to-Sunday episodes like, where you might have too much information coming from all sources or not enough, and you might not have an analytic framework?

MR. MISHKIN. It was such a small circle of people that I didn't have the information where I could even bring to bear my analytic framework. It made us more dependent on the New York Fed—not that we shouldn't depend on the New York Fed, but in this sense, the Board did not have as much independent information, because we couldn't work together as a Board on this. The New York Fed had no problem doing that. They could have a task force of several people, and they could be sitting and schmoozing about it. That's maybe a little bit uncomfortable, because the New York Fed naturally is close to Wall Street, and maybe too close. It's just the nature of the business. A lot of people associated with institutions that we've been closely involved with are all sitting on the board of directors at the New York Fed.

So I think there would have been an advantage to us having this information, but that happened so fast. When this was happening, I said to Don Kohn, "I know I can't be involved in the day-to-day, because I don't want to slow things down. On the other hand, we've got to have

a way of getting the information to the other Board members.” And that never really worked as well as it should have.

MR. SMALL. The view in an article that looked back on Bear Stearns was that when you’re the policymaker and you’re there, a strong emotional tendency would be that this isn’t going to all collapse “on my watch.” That’s an emotional issue that’s hard to step back from and that distorts the decisions.

MR. MISHKIN. Right. You had to be careful about discretion. You can’t just think about what you do. You have to think about what kind of expectations it is going to create about the future that creates problems for you. [Timothy F.] Tim Geithner comes from a model of crisis management. You use discretion to solve the problem. But what about the impact of that? This is the exact time inconsistency issue that we know about well in economics. And this is the reason for frustration. I wasn’t able to be a little bit more involved, because, naturally, I could step back a little bit from that and say, “How do we think about this other implication?” so we can be aware of it.

I am unhappy about the way we were brought in on the GSE (government-sponsored enterprises) issue—not about the financing, that we were the backstop. I thought that was what we had to do. I felt strongly that we should not be involved in the regulation of the GSEs. They’re political animals. They’re strong and powerful organizations. It could politicize the Fed. I said, “That’s the Treasury’s job, not our job.” We’ve been brought in on this so-called consultative basis, which I think is going to play badly in that people are saying the Fed’s grabbing for more power and so forth. This is what I talked about earlier. Because I’m not seen as political, it’s hard to have as much credibility, but I think that it could create some severe problems for us.

Treasury clearly wanted us in to help protect them. I think Henry M. “Hank” Paulson is a great guy, but he’s operating in the interest of the Treasury and the Administration. We’ve got to think about the long-run independence of this institution. Pure discretion says, yes, let’s do it. Get in there. The Treasury wants it, bingo. But what is that going to mean for what’s going to happen two years from now, when the Congress is relooking at what the role of the Federal Reserve should be? These are important issues.

As somebody who thinks from a more analytic perspective, I can step back a little bit. I would like to have been much more active, but I never had the opportunity. It’s one of the tremendous frustrations I’ve had. There are issues that I still don’t understand about Bear Stearns. Do I think we had to do what we did? Absolutely. Do I think we have to provide the backstop for the Treasury in terms of GSEs? Absolutely. I have no problem with the decision. But I am not comfortable with the details.

I know that I’m not the person to manage the crisis, so that’s why I didn’t want to say to Don, “I need to get in,” which you can do and cause a discomfort. Why can’t I be involved in the morning calls some of the time? Or when you’re discussing this stuff, why can’t I be involved? My attitude was, that would gum up the works. On the other hand, because of these aspects—some of it because of the way things work and also some of it just because of unintended consequences of a law like the Government in [the] Sunshine Act—I basically felt I could not be as effective as I would have otherwise been, not to be the main person. But I think that there are a lot of things that we’ve done in the passion of the moment. I think that if we had some people who could step back and say, “I’ve thought about these issues—lender of last resort,” it would have helped. And then there are moral hazard issues. How do you manage that? I think those can be overemphasized, the moral hazard. I call the people who overstress

moral hazard the “moral hazard Nazis.” There’s always moral hazard—the issue is the tradeoff. You do have to think clearly about what are the implications for what you’ve done going forward and then factor that into your decision process.

MR. SMALL. You are being a policymaker and trying to step back and use your analytics. But what about the emotional angst—I know what I need to do or I don’t?

MR. MISHKIN. You see, I actually feel that. I’ve been very pleased on this basis, the way this Board has operated. Through this whole crisis, everybody’s been extremely calm and collected. You don’t want to react emotionally. You want to think things through. You don’t want to be panicked because you could do too much too quickly, or you could be the deer in the headlights. That’s extremely common entering crises. You see this all the time. This Board has not operated that way. The Chairman, in particular, stays cool and calm. He feels everything. He cares a tremendous amount about doing a good job, and it’s very stressful. But he doesn’t get excited. He sits there and thinks it through. We do the best we can.

I think you have to take that attitude. You’re there to do a job. You’re not a magician. You’re not the Wizard of Oz. People think you can do everything, but there’s only a limited amount of stuff you can do. You want to stay calm and think through clearly what the implications are. But you don’t want to sit there like you do when you work with academics and say, “I’m going to take six months to think about it.” You say, “I’ve got X amount of time to think about it. Then I have to make a g*ddamn decision and go with it.” But you want to stay cool and calm during that period. That’s exactly the way this Board has operated.

I’ve not sensed any panic in this institution. Has it been stressful? Absolutely. I’m currently still worried about what could happen. We are not out of the woods yet. Some things could happen that could scare the sh*t out of me. But my view is that the Board’s

decisionmaking process has been very good on that basis. As I said, I think the weakness is that we have not been able to function as a team as well as we could because of some regulations that are hindering it and the culture.

MR. SMALL. You certainly had some real problems to deal with. But you haven't engaged in a lot of tightening of monetary policy and just knowing the unemployment rate is high.

MR. MISHKIN. I've been blessed. And I say this as a scholar—it doesn't get any better than this. It's been so g*ddamn interesting. It's been very stressful, but monetary policy was really boring for the first six months I was here. I've been in an environment where it was more interesting, because we were raising when I was at the New York Fed. Until February 1995, we were raising rates.

Bob Lucas, this famous economist, once said, "Macroeconomics is a game anybody can play." Well, monetary policy is a game anybody can play. Everybody's got an opinion. I was talking to Stan Fischer, and he said, "But in Israel it's even worse, because everybody has an opinion on everything." [Laughter] If you notice, on the Seinfeld episode where two guys try to pull into a parking spot, there are 50 people standing around saying who had the right to do it—classic. So I feel that the time when you're raising rates is not any worse than if you're in this kind of crisis. What's really stressful here is that there is a potential for things going south in a very nonlinear way that can mean things are getting out of control.

Today's environment is much scarier than being in a normal policy environment where you may raise rates. I think the issue always is: Am I setting rates properly? That's what's stressful. But we're in a situation with financial crises, which is a whole other level of stress. I don't think it compares at all.

MR. SMALL. Thank you very much.

MR. MISHKIN. You're very welcome.