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Interview with Ted Balbach

Conducted by Robert L. Hetzel

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Robert L. Hetzel: —where you went to school?

Ted Balbach: I did talk to you once before. Did you record that or not?

Robert L. Hetzel: Would you be willing to tell me a little bit about your background before you got to the St. Louis Fed? I admit I know nothing.

Ted Balbach: I was teaching at California State University of Northridge.

Robert L. Hetzel: Where did you get your degree?

Ted Balbach: UCLA.

Robert L. Hetzel: And so at UCLA, then you had contact with Brunner [phonetic 00:00:39], and that was the nexus ultimately with St. Louis?

Ted Balbach: Yes. Actually, not—no, that was not the case, indirectly. The contact was with Jerry Jordan, who was my student. And when Jerry Jordan got to St. Louis, he invited me to come once for a year as a visitor, and then I got an offer from them [unintelligible 00:01:06].

Robert L. Hetzel: So what year did you get your PhD from UCLA?

Ted Balbach: '61.

Robert L. Hetzel: And what was your thesis topic?

Ted Balbach: Ha, ha. Clark Warburton's hypothesis reconsidered.

Robert L. Hetzel: Say that again. What was the first thing?

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Ted Balbach: Clark Warburton's hypothesis reconsidered. There was an economist by the name of Clark Warburton.

Robert L. Hetzel: Oh, Clark Warburton.

Ted Balbach: Yeah.

Robert L. Hetzel: Sure. So his hypothesis had to do with the cause of the Great Depression, the money—

Ted Balbach: [Unintelligible 00:01:48] money, but the things of my interest was the money. And he had a hypothesis that money had more of an influence than people at that time believed. And he was kind of an outcast and was not listened to. But what I did is simply subject some of his hypotheses to some more rigorous statistical testing, and it turned out he was right.

Robert L. Hetzel: Why do you think he had so little influence?

Ted Balbach: Because he was a nasty fellow.

Robert L. Hetzel: Oh, that's interesting. I did meet him once and, you know, it was a privilege to meet him. I had the feeling that one of the factors was that he didn't make an effort to sell his ideas and to use the language of the time, whereas Friedman directly challenged Keynesianism. Warburton just did his own thing and was very easy to ignore, because he wasn't confrontational the way Friedman was.

Ted Balbach: Well, I think he was quite confrontational. The problem is that he did not package his things nicely, nor was he able to debate things as well as Friedman did. But his ideas were all solid, or at least turned out to be solid in those days of testing.

Robert L. Hetzel: Hm-hmm. He wrote a lot, and his writing style is very dense. I've read a lot of what he wrote, and it's very useful. But it is hard to read. You have to read for the insights, and it helps if you know about the Fed and you know about policy. Oh, that's interesting. So then did you work on money? Were you involved at all in contributing to the Friedman-Meiselman debate? Because, you know, Andersen's already looked at it.

Ted Balbach: No, I was teaching at that time, most of the time, and a lot of classes, and did very little research.

Robert L. Hetzel: What was the year you spent visiting St. Louis?

Ted Balbach: '71, '72.

Robert L. Hetzel: Oh, so that was an interesting time to be there.

Ted Balbach: Right.

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Robert L. Hetzel: Was Homer Jones a convinced quantity theorist, or was he just willing to—

Ted Balbach: Oh, no, he was a convinced quantity theorist. By the way, let me mention something, a sideline about Warburton.

Robert L. Hetzel: Yes?

Ted Balbach: When I finished my dissertation and dissertation was deposited in Michigan, University of Michigan Depository of Dissertations, suddenly my department chairman and Brunner got letters, very indignant letters, from Warburton saying how dare they approve a dissertation of a living economist, blah, blah, blah, even though the dissertation supported his views. And there was a very unpleasant exchange between Brunner and Warburton and then between the department chairman and Warburton.

Robert L. Hetzel: (00:05:17) What did Warburton want you to do? He wanted to be—

Ted Balbach: That I don't know.

Robert L. Hetzel: He wanted to be on the committee somehow or—

Ted Balbach: Nobody knows. Nobody knows. Nobody knows.

Robert L. Hetzel: Hmm, that's strange.

Ted Balbach: Anyway, that's a vignette.

Robert L. Hetzel: No. But it is interesting to try to understand why Warburton's ideas had so little influence.

Ted Balbach: Yeah, I think he was kind of a bitter old man.

Robert L. Hetzel: Well, he was bitter about Friedman. On the basis of my conversation with him, the fact that Friedman would get publicity and he, Warburton, didn't. And yet Friedman was much better at packaging his ideas and selling them and…

Ted Balbach: Sure.

Robert L. Hetzel: Hmm. So when you were in St. Louis, '71, '72, what were you working on?

Ted Balbach: Mostly international trade at that time. I was hired as an international trade economist. And, as usual, just questions of, you know, does money supply influence exchange rates, and how does it divert them. And also at that time, I was quite interested and was doing some of these sort of questions of relationships between monetary base and money

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supply, which at that time sort of was still in sort of a [unintelligible 00:06:41]. And Berger [phonetic 00:06:42] and I did some work on it.

Robert L. Hetzel: Hm-hmm. What was the pre-FOMC process like then? Was it a general staff discussion so you could be involved in it? Or was it a small group of—

Ted Balbach: No, a general staff discussion.

Robert L. Hetzel: So it wasn't just Homer Jones and Jerry Jordan talking to [unintelligible 00:07:01]?

Ted Balbach: Oh, by the way, when I arrived here in '71, Homer Jones left. He hired me, but when I came in, he left that same day, retired.

Robert L. Hetzel: Oh, I see. So who is—this is the year you were visiting, '71, '72?

Ted Balbach: Right. Right. Andersen became the research director.

Robert L. Hetzel: How long was he director of research?

Ted Balbach: For one year, I believe.

Robert L. Hetzel: And his background—

Ted Balbach: He was University of—I think undergraduate was from Minnesota, not University of Minnesota, St. Olaf's College. And then his degree was from University of Illinois.

Robert L. Hetzel: Did he have the same kind of leadership qualities as Homer Jones? Was he good at carrying the torch? I remember reading his things, and—

Ted Balbach: Ah, not really, for one reason—that he did not want to kind of sit and teach the president and spend time with the president. That's why he did not last long and Jerry Jordan became a research director in about one year or two years.

Robert L. Hetzel: So Andersen went to Florida State after that? Was that—

Ted Balbach: Ah, yes. Florida or Florida State. It was in Gainesville.

Robert L. Hetzel: Hm-hmm. He was the one who was involved in the flap over the *Fortune* article and the Pete Rose stuff and—

Ted Balbach: Yes. Yes. He was not involved. Somebody involved him. And then of course, as you know, what's his name admitted to being the blabbermouth. Who was their head of research at that time at the Board who is now at Berkeley?

Robert L. Hetzel: Jim Pierce?

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Ted Balbach: Jim Pierce, yeah.

Robert L. Hetzel: I didn't—I had never heard that story. In fact, I've talked to Jim Pierce a number of times, and he never brought that up. My understanding was always that the Board assumed it was Leonall Andersen. I never heard the story that Pierce had talked to—

Ted Balbach: That just showed up not too long ago. It might be 10 years ago.

Robert L. Hetzel: Hmm. That's interesting. So with Darryl Francis—I met him once also. He seemed like an unlikely instrument for leading a challenge to Arthur Burns and the Board of Governors. But he was willing to read the statements that Jordan and Andersen wrote for him. Was he, beneath the pleasant exterior, was he a combative individual? What was it that—

Ted Balbach: (00:10:20) Ah, yes, he was a combative individual. And he'd already had for some reason somehow a pretty strong conviction that money matters, that money supply matters, and that one should look at the growth of money supply. Well, and that occurred because—in all probability, it occurred because of Homer Jones. By the way, there is a previous president whose name I don't remember now, Deming or something like that.

Robert L. Hetzel: Johns? No, that's—

Ted Balbach: Oh, Johns.

Robert L. Hetzel: Delos Johns.

Ted Balbach: Yeah—who also already believed that money supply matters and became a sort of a burr in the saddle of the Board. So somehow this whole feeling about money matters was there for quite a while before I came.

Robert L. Hetzel: Well, Johns brought Homer Jones in.

Ted Balbach: Yeah.

Robert L. Hetzel: And Johns's personality was such that he was willing to challenge the Board. So I think it was a combination of his personality and Homer Jones's interest in money.

Ted Balbach: Yes. And so Darryl Francis was pretty convinced of that, and he pushed the issue. And it was not just that he read something that Homer Jones or somebody else wrote for him. He was pretty convinced. He was pretty knowledgeable. Now he could not sit and argue with economists about that. But he felt strongly, and he expressed his own opinions. But, of course, every time we had a meeting, then somebody wrote down some notes for him to do, and then he probably wrote them out himself in longhand about what he's going to say precisely. I don't remember ever printing out something for him to speak from.

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Robert L. Hetzel: Hmm. Well, his statements in the minutes are very carefully crafted.

Ted Balbach: Well, that's probably because he himself decided to do some.

Robert L. Hetzel: Oh, that's interesting. I just assumed that, because they were so well-written, that he went up there with statements that he read, statements written by the staff. But that's not the case.

Ted Balbach: I think—please remember that the statements that appear now were edited afterwards. And so perhaps during the editing process they became kind of cleaned up.

Robert L. Hetzel: Oh, I see. They go back, and then the presidents and their staff can—

Ted Balbach: And if you remember, the Board used to send their statements back and say, you know, "Make corrections." And so corrections were made.

Robert L. Hetzel: I see. Kind of more generally, this was an absolutely extraordinary time. And with the benefit of perspective, it seems even more unusual. The only example in the history of the Fed where a regional bank has been willing to use an analytical framework to challenge policy and to associate itself with a theoretical framework was the St. Louis Fed in the late '60s and in the 1970s.

And that occurred in the context of a change, a realization that the price system was not tied down in a regime of fiat money creation the way it is tied down in the commodity stabilization standard and also with the realization that the Central Bank is the determinant of inflation, not other factors. And so it was really quite extraordinary what St. Louis did. And in this process, St. Louis exposed itself to a fierce amount of criticism and debate. And I'm interested if you remember when Arthur Burns began to take notice of the St. Louis Fed and began to respond to its challenge. Burns was not one who liked dissent and liked debate for debate's sake.

Ted Balbach: (00:15:22)I would say the year when I came here in '71, when I came to the bank, I think that is when Arthur Burns took over.

Robert L. Hetzel: He took over in February 1970.

Ted Balbach: '70?

Robert L. Hetzel: Uh-huh (affirmative).

Ted Balbach: So by the time I got there, the gauntlet was already thrown. They're already—Burns and Francis did not get along. So he must have reacted to it much earlier, Burns, because one of the big problems, I think—the issue that I remember was always a

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battle was a question of whether you target interest rates or money supply, period. If you want to summarize very quickly what the issue always was, it was that.

Robert L. Hetzel: Did the directors support—

Ted Balbach: Yes.

Robert L. Hetzel: —Francis? So he was supported. But Burns did badger him. I did talk to Darryl Francis once, and Francis told me that on a Sunday morning he picked up the phone and Burns was on the other end just blistering in his—

Ted Balbach: Yes. Yes. And the reason Francis retired early because he could not take it anymore.

Robert L. Hetzel: Hm-hmm. Francis retired in what—'75, something like that?

Ted Balbach: Ah, '75 or—yeah, '75 or '76. I think '75. You're right.

Robert L. Hetzel: Hm-hmm. Our directors in '71 were very much supportive of the wage controls. In fact, the major political push for controls came from the business community that thought that their profits were being eroded by aggressive, militant wage demands by labor unions. What about the directors at St. Louis? Were you able to educate them about wage controls?

Ted Balbach: Yes. If I remember correctly, the directors did not push for wage controls at the meetings. Maybe in private they did some plays, but at the meetings, that was seldom discussed. Darryl Francis usually kind of ran the thing in terms of what he liked and what he was interested in. And most of the directors that I remember were very much in favor of that approach. You must also realize that Darryl Francis was made president of the bank against the wishes of the Board.

Robert L. Hetzel: No, I hadn't heard that story.

Ted Balbach: Oh, yes. They apparently did not want to make him—he was the first vice president here at the bank, and they didn't want to promote him to president. And apparently, the Arkansas bankers or Arkansas members of the Board went to Wilbur Mills, and Wilbur Mills put some pressure on. So already that probably created a bit of a difficulty between the Board and Federal Reserve Bank of St. Louis.

Robert L. Hetzel: So the Board supported the candidacy of Darryl Francis?

Ted Balbach: The Board didn't.

Robert L. Hetzel: I'm sorry, the Board in St. Louis?

Ted Balbach: That's correct. St. Louis, yes, very much so.

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Robert L. Hetzel: And that would have been '67? '66, '67?

Ted Balbach: That I don't remember. I wasn't here.

Robert L. Hetzel: So that was William McChesney Martin.

Ted Balbach: Yes.

Robert L. Hetzel: Hmm, that's interesting. I wasn't aware that he—I guess Bob Holland was the one who was working with him on appointees.

Ted Balbach: Yes.

Robert L. Hetzel: And I suppose that—well, yeah. Okay. That's interesting. After he retired, the Board did weigh in—Board of Governors weighed in again? But you have a very independent Board and, you know, the St. Louis Board has just always insisted on having its own president?

Ted Balbach: That's basically the case, and they all liked Darryl Francis, and they all fought for him. And, apparently, they had a lot of political pull.

Robert L. Hetzel: There is a story that Paul Volcker flew in and asked the Board to appoint Melzer as president.

Ted Balbach: Yes.

Robert L. Hetzel: That really happened?

Ted Balbach: Yes.

Robert L. Hetzel: And then Melzer turned out to be a very good president, very independent and very analytical. So it sort of didn't make any difference.

Ted Balbach: Oh, he was one of the better educated of all those presidents.

Robert L. Hetzel: Volcker for all his dislike for inflation was not a monetarist and didn't want the—

Ted Balbach: (00:20:34) However, when he wanted to stop inflation, that's what he used.

Robert L. Hetzel: Well, he didn't have any choice about how the world worked. It wasn't his—that wasn't his to choose, so…

Ted Balbach: I think that's the greatest achievement of St. Louis, is precisely that, that Volcker finally bit the bullet and controlled the money supply.

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Robert L. Hetzel: Well, let me ask you about that. The minutes of the FOMC are not yet available for the period when Volcker was President of the New York Fed. So there's no—right now there's no public record of his participation. But I was here from fall of '75 on and was briefed, and I never had the impression that Volcker was an inflation hawk and that was leading a fight for inflation. We knew that when he became Board Chairman that he would be more aggressive than Miller, because priorities had changed. But I think we were surprised by how aggressive he was in bringing down inflation. Did you have—do you feel like he changed between becoming President of the New York Fed and FOMC Chairman?

Ted Balbach: I don't believe that I detected that particular change at that time. I thought there was a change simply when inflation became really rampant. Something had to be done. And that was a while after he already was a chairman. But I think that his basic—you know, he was not a supporter of any kind of economic theory. By no means was he a Keynesian and by no means he was a monetarist.

Robert L. Hetzel: Yeah.

Ted Balbach: But, basically, what he believed very strongly is that somehow—I think—my interpretation is obviously interpretations of one single individual—that he believed that he can guide monetary policy to achieve various goals that he may have, so without any kind of theoretical basis, mostly through manipulation of interest rates. And I remember when he was president of the New York Bank, he was always extremely concerned with international trade. And he was willing, you know, to do lots of things in order to stabilize exchange rates and so on and so on.

Robert L. Hetzel: Well, he was the Undersecretary of the Treasury in much of the '60s. And then he came back in with Nixon. So his job was preservation of the Bretton Woods system. And it's clear from his autobiography that he keenly feels that if the Fed had done what it should have done—raising interest rates when we have balance and payments problems—we'd still have the Bretton Woods system today, and we'd be much better off for it.

Ted Balbach: I believe that's probably—I did not see his autobiography. I didn't even know it was published.

Robert L. Hetzel: Oh, yeah. It's not hard to read. It's very easily written.

Ted Balbach: Oh, boy. I have to find it.

Robert L. Hetzel: It's called *Changing Fortunes*. And it's written with a Japanese person called Gyohten. They write alternate chapters. But Volcker's are the best, and you can read it in an evening, and he writes beautifully, and so it's very easy to read.

Ted Balbach: I have to find it.

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Robert L. Hetzel: Yeah, *Changing Fortunes*. So over this—well, I remember when I came in in '75 and, you know, I was asked to go talk to the directors. And I was just out of graduate school, and I didn't think anything about it. So I'm talking about inflation and money growth and how the Fed causes inflation. And there's this silence. And finally, somebody says, "Well, I can't believe the Fed causes inflation." And then I realized I've jumped to a whole different culture. So the association of the Federal Reserve System with inflation was a major achievement of the '70s. And that's something that happened only gradually, and it was something that St. Louis was the—you know, apart from Chicago was the most important of the voices contributing to public debate.

Ted Balbach: (00:25:38) Yes. And the point I think was that one of the reasons that the Board, I think, and many people in the Federal Reserve System fought this idea of controlling money supply, because that implied that it was their fault that we have inflation.

Robert L. Hetzel: That's right. They create money, and they much prefer to see themselves as one influence on financial markets.

Ted Balbach: Right. And so—

Robert L. Hetzel: Fighting wage push pressures, cost push pressures.

Ted Balbach: It would be admitting that it's our fault, and nobody wants to admit that.

Robert L. Hetzel: It's hard to understand now, or maybe it's not so hard to understand. But whenever you talked about money, there was a lot of emotion in—evolved. There was a hot button for economists, for policymakers. There's a lot of anger in discourse then that today when we just do mathematics, nobody can imagine sort of the personal emotion that gets involved. And I think you put your finger on one of them, that St. Louis and Friedman were saying the Fed's not an inflation fighter, it's an inflation creator.

Ted Balbach: Exactly. Exactly. And that was something that was unacceptable. And by the way, that did not have to be explicitly stated. It was sort of felt under the surface. And for that reason I think these emotions were even stronger.

Robert L. Hetzel: There's no question but what Arthur Burns disliked inflation, and he to the very end, and I assume until the day he died, he saw himself as the paramount inflation fighter in the United States. What was it about his view of the world that could cause him to go so wrong?

Ted Balbach: Oh, look, it's—again, I'm expressing purely personal opinions.

Robert L. Hetzel: Sure.

Ted Balbach: But the point is, I mean, there are always alternatives that you have. If you fight inflation, then you have to suffer other consequences. And so he tried, probably, I

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presume, in his own mind, to somehow move in the middle and not to suffer the consequences of one or the other, and perhaps not believing that there are long lags in effects of money creation or of other things.

Robert L. Hetzel: I think that's a really good insight. This was the era of sacrifice ratios that seemed unbelievable. You'd need—I don't know—five years of unemployment rates about one percent above normal to bring the inflation rate down half a percent or something. And I think it was basically because people saw inflation as cost push, and so as being very—

Ted Balbach: By the way, there is always—in the Federal Reserve System as far as I'm concerned, there is always a great fear or perhaps a dislike of interest rates rising, because the pressure of the financial community becomes very powerful when interest rates begin to rise. And since the Fed has spent all this time trying to convince the world that they can control interest rates, it becomes untenable to suffer a period of high interest rates.

Robert L. Hetzel: Yeah. That's something that's hard to imagine now, because the Fed does move interest rates around, and we have people who save, and old people like high interest rates on their bank CDs. But in the environment of the times, it was an enormous political issue. And FOMC members had this idea that somehow or other it was disruptive to the economy for that particular price to change. And it was not a question of real rates, it was a question of the market rate. And given—it was like the FOMC had things turned upside down. Because inflation was cost push, responsibility for inflation was with wage controls or whatever—moral suasion. But the Fed had responsibility for the economy, and sharp changes in interest rates would be disruptive to—

Ted Balbach: (00:30:15) Right. So I think, if we want to return to Arthur Burns, that he was trying to navigate somehow a neutral path, which was impossible to do, and he just leaned a little bit too much to one side, and the result we all know.

Robert L. Hetzel: Yeah. Yeah. Yeah. He saw himself as a political advisor, and he thought that the society was deeply divided and there were limits to what the Central Bank could do, and he was going to try to walk this limit that you would have enough inflation that you wouldn't have social unrest, but you wouldn't have so much that you would—some lose it and as you save. You know, it was not a line you could walk—

Ted Balbach: By the way, there was another thing that kind of bothered me a little bit. I don't think that there was much consideration by Burns and by others that the rate of inflation build nominal interest rates up, that there was an inflation premium in every interest rate. I think they very seldom talk about that, or at least I never heard anybody say that.

Robert L. Hetzel: Yeah. I think that when Arthur Burns wanted to justify interest rate increases before Congress, he would use that language. But around the FOMC table, it was never—you know, the discussion was not in terms of real rates of interest. It was in terms of the Funds Rate.

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Ted Balbach: That's right.

Robert L. Hetzel: So it never—it is—even today, it's somewhat puzzling that the Fed could go through two, maybe three, major episodes of inflation, and not until the third one after '65 through '68 and then '73 to '74 and then—it wasn't until the third episode, '78, '79, that the Fed kind of realized that it was responsible. But I think that was the intellectual tenor of the times.

Ted Balbach: Precisely. Precisely. Remember that all these years that you are talking about, everybody sort of believed in a very simple-minded Keynesianism. Oh, not everybody, but, you know, a lot of people. And in that structure, money supply did not matter.

Robert L. Hetzel: Well, 99% of the economists were Keynesians.

Ted Balbach: Sure.

Robert L. Hetzel: Basically, if you were an economist you were a Keynesian at that time, unless you went to Chicago or UCLA.

Ted Balbach: Oh, no, no. I was a Keynesian at UCLA until very late in my graduate work. But I sort of began to think about these things and of course was exposed to Brunner. But I was exposed to Brunner even as an undergraduate. And Brunner was a Keynesian, so…

Robert L. Hetzel: Well, can you tell me a little bit about his intellectual development? Because that's interesting for me. How did he become in—I mean, in the '50s I had the feeling that most of his interest was in sort of methodological, almost sociological issues. And he was not involved in sort of the empirical work of macroeconomists.

Ted Balbach: That's right. That's right. He liked theory and he tried to kind of build models and so on and so on. I cannot tell exactly when he became truly a believer that money does affect the rate of inflation. I cannot really specify that particular point. But when he was first my teacher, this is—I'm talking, now about 19 what?

Robert L. Hetzel: '60?

Ted Balbach: '50—1950, '51, '52, something like that. During that period of time in his classes, you know, he taught standard Keynesian models.

Robert L. Hetzel: So you were an undergraduate in 1951, '52 during the Korean War and the Accord?

Ted Balbach: Actually, I got my bachelor's degree in '51, and then I was drafted into the Army and all. Actually, went to graduate school, and then I was drafted into the Army.

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Robert L. Hetzel: And so you don't remember at that time any discussion of the Treasury Fed Accord and the debate over pegging interest rates?

Ted Balbach: Oh, yes. Oh, yes. Oh, yes. I do remember that. But that particular discussion was also a pretty clear-cut situation. If you controlled interest rates, that was bad, because the markets didn't work. I mean, [unintelligible 00:35:11] the markets were always [unintelligible 00:35:13] free markets as the thing that I want to do. But if that was Brunner's inflation or Alchain's, I'm not sure. Could be Alchain's.

Robert L. Hetzel: (00:35:24) That's interesting. Did Alchain have a Chicago connection?

Ted Balbach: No.

Robert L. Hetzel: So he just came to free markets on his own?

Ted Balbach: Yeah.

Robert L. Hetzel: That's interesting.

Ted Balbach: He had a degree from Stanford.

Robert L. Hetzel: Because I think that they sort of ultimately work—you're very much predisposed to being a quantity theorist if you believe in free markets.

Ted Balbach: That's right.

Robert L. Hetzel: Because you don't believe that the price system has failed and that you need all this aggregate demand [unintelligible 00:35:56].

Ted Balbach: And I think that's how Brunner became concerned with money and became a quantity theorist, actually.

Robert L. Hetzel: Was he the one who suggested you look at Warburton?

Ted Balbach: Yes.

Robert L. Hetzel: So that came from him?

Ted Balbach: Yes. Because Warburton at that time was just about the only one of that period in the '30s who wrote about the influence of money on prices.

Robert L. Hetzel: Hmm. This is just sort of anecdotal, but I talked to Phil Cagan, and Cagan went in and talked to Friedman about a thesis. This would have been in, oh, '52 or '53. And Cagan remembers Friedman saying, "Well, you know, everybody thinks this Clark Warburton's a crank, but I think we ought to give his ideas a look at and think about them

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seriously." So that was the word that Friedman used at the time to characterize Warburton. Everybody thought of him as a crank.

Ted Balbach: And, you know, I kind of agree with that. (Laughs.)

Robert L. Hetzel: Cranky is what you've said. Hmm. Okay, so when—did you become Director of Research at the St. Louis Fed?

Ted Balbach: Ah, I came in in '73, and I think I became Research Director when Jerry Jordan left. That was—let's see, if Darryl Francis left in '75, then it must have been in '74, because I was Research Director while Darryl was there still for one year.

Robert L. Hetzel: Hm-hmm. Okay. Let me ask you about something that made a big impression on me in 1974, at least after the fact. Proxmire had hearings, I believe it was in August of 1974, and the regional bank presidents were asked to testify.

Ted Balbach: Right.

Robert L. Hetzel: And the regional bank presidents were asked to send their testimony to Chuck Partee at the Board for review.

Ted Balbach: Right.

Robert L. Hetzel: And I remember somebody crafted the St. Louis statement so that the arrow would go right to Burns. That is, Burns always liked to talk about, you know, everything caused inflation except the Fed. And the longest-running theme was how government deficits caused inflation. And there was a graph in this testimony showing government deficits over time and how the percentage of that deficit had been monetized over time, and that percentage was increasing. And then they had a picture of the money supply growth and then inflation, and it was very striking. It spoke directly to Burns and the Fed. And it was one of the most effective attacks on Fed policy that I've ever read. You must have had a hand in this, in this whole debate?

Ted Balbach: [Unintelligible 00:39:20.]

Robert L. Hetzel: So can you tell me anything of what you recollect of this incident?

Ted Balbach: I recollect very little about what we wrote in there.

Robert L. Hetzel: Well, you should go back and read it. It's great.

Ted Balbach: I probably should. But I recollect that it happened and that there were some arguments from the Board asking for change to the thing, and Darryl Francis refused, and said as a matter of fact that I'm not going to go in front of Congress and lie. It became that strong. And I think this is where the falling apart truly between Darryl Francis and the Board came.

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Robert L. Hetzel: Yeah, and that's probably—

Ted Balbach: [Unintelligible 00:40:01.]

Robert L. Hetzel: And the timing is right in terms of probably when Burns called Francis and then when Francis was—

Ted Balbach: I think Burns called Francis about a speech.

Robert L. Hetzel: Oh, I see. So it wasn't this? It wasn't over the testimony?

Ted Balbach: It could have been. But I think that there were several phone calls like that and very frequently phone calls—not from Burns, but perhaps from some other governor, like—Partee was not a governor at that time—but from some other people, were always over speeches, because we did not send the speeches for their approval. Darryl Francis refused to do that.

Robert L. Hetzel: Yeah. The people working most closely with Burns at the time were Bob Holland, Lyle Gramley, and Chuck Partee.

Ted Balbach: Exactly.

Robert L. Hetzel: But my guess is that, given the personalities of these individuals, it would have been Chuck Partee that Burns would have used. Lyle Gramley and Bob Holland are completely pleasant individuals as far as I can tell. Maybe that's wrong, but—

Ted Balbach: Oh, these people were not unpleasant in a sense, you know. But they're just very persistent arguing that you are wrong, you are wrong, you are wrong, a board that you are causing embarrassment to the Federal Reserve System.

Robert L. Hetzel: Yeah.

Ted Balbach: And those were the arguments, basically.

Robert L. Hetzel: Yeah. Yeah. So when did you begin attending FOMC meetings?

Ted Balbach: I would say—I don't remember exactly, but I would say '74 sometime.

Robert L. Hetzel: Hm-hmm. When you became Director of Research, probably.

Ted Balbach: As a matter of fact, I think I attended once before or once or twice. But it wasn't when [unintelligible 00:41:52].

Robert L. Hetzel: Hm-hmm. At St. Louis at the time, who were the most effective people in terms of helping you craft FOMC statements?

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Ted Balbach: Well, I would say Andersen while he was there, and of course Karnovsky, Dennis Karnovsky.

Robert L. Hetzel: Yeah.

Ted Balbach: And Al Berger [phonetic 00:42:18]. Everybody got involved in those statements. We never—they were still crafted by the department as a whole. Everybody read them and everybody made comments and remarks, and then we presented them to the president, who then made his own comments and remarks.

Robert L. Hetzel: Hmm. What do you recall about the FOMC meetings that you attended in terms of the way Burns ran the meetings? In particular, in the fall of 1974, there was a—division was in the community. At this time I think Burns was very concerned about the behavior of the deficit and didn't want to lower interest rates as long as he thought Congress was going to raise expenditure and increase the deficit to unacceptable levels. So monetary policy turned out very restrictive in fall of '74, and there was a division. And then that lasted into early '75. Money growth falls drastically. Do you remember anything about how Burns handled the divisions within the Committee?

Ted Balbach: Very, very little. I probably could look at my notes, but at the moment I don't have them.

Robert L. Hetzel: Sure.

Ted Balbach: If I remember correctly, when Burns ran things, there was very little argument with him. There were very few people who disagreed.

Robert L. Hetzel: Hm-hmm. Because they were afraid of getting jumped on? Or—

Ted Balbach: Because they were afraid—yeah, getting jumped on intellectually, because he could do that. And the guy who disagreed—if I remember correctly—frequently, for the wrong reasons, in my opinion, was a guy from Boston. What the hell was his name?

Robert L. Hetzel: Frank Morris. Frank Morris. Frank Morris.

Ted Balbach: Frank Morris. But he disagreed for the totally different reasons than Francis. Morris certainly was no monetarist by any means.

Robert L. Hetzel: He was a money markets man, and he was very concerned about unemployment, and he—

Ted Balbach: And interest rates and all that. That's right.

Robert L. Hetzel: He was very effective, but he was on the wrong side.

Ted Balbach: But nobody else, to the best of my knowledge, to the best of my memory, which is getting weaker and weaker.

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Robert L. Hetzel: Well… How long did you attend FOMC meetings and how long were you Director of Research?

Ted Balbach: Well, until I retired in '92.

Robert L. Hetzel: (00:45:02) And what year was it?

Ted Balbach: '92, so I guess 18 years, something like that, 17 or 18 years.

Robert L. Hetzel: What do you remember about the transition from Burns to Miller? All of a sudden you went from having a towering figure in charge of FOMC meetings to a person who really cared more about detail than—

Ted Balbach: And who knew nothing about monetary policy.

Robert L. Hetzel: So who was—was it strong governors like Partee who were running things? Or was it the Board staff like—

Ted Balbach: I think Board staff mostly. And besides, I kind of have a suspicion. I have no proof or anything. I think that Miller took his orders from the political spectrum.

Robert L. Hetzel: Well, the chairman always talks closely with the Treasury and with the head of the CEA. But ordinarily it's consultative, but you can imagine in the event of somebody like Miller, who really comes in completely cold—

Ted Balbach: Yeah, and that's, I think, what was happening from his point of view. I think he was—he was a nothing, so to speak, as a chairman.

Robert L. Hetzel: Yeah.

Ted Balbach: Worried about elevators and escalators and things like that, not much about monetary policy.

Robert L. Hetzel: Yeah, egg timers to limit how long you spoke and whether there was smoking in the boardroom.

Ted Balbach: The smoking, oh God, that is easy to remember.

Robert L. Hetzel: Yeah. So things were just sort of on—not on hold, but sort of there was no leadership to do things in a—

Ted Balbach: I would agree.

Robert L. Hetzel: The Fed was raising interest rates. It's just that in '79 when you got the oil price shock and the Fed thought, "Oh, no, we don't want a recession," and it slowed down the rate of increase, but expectations of inflation took off, the real rate goes to zero, and then things just blow up. But there was no ability to begin to think in a new way,

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because there was nobody who could take 19 people around the table and all—you know, move them all in a new direction.

[00:47:28]

[END TAPE 103, SIDE A]

[START TAPE 103, SIDE B]

[00:47:32]

Robert L. Hetzel: So the term structure was deepening, and we were trying to keep up with the term structure?

Ted Balbach: Sure.

Robert L. Hetzel: Hm-hmm, that could be. And then especially in the fall of 1978, the dollar fell out of debt, and that created diplomatic problems for the United States with our allies. And so, certainly at that time, in the fall of '78, it seems pretty clear to me that it was the Treasury that spearheaded the move toward more restrictive policy. But then the Fed was the one that made us back off after the oil price hikes in December of '78.

Ted Balbach: Yeah. I don't know that. I don't know the intricacies of the Treasury relationship with the Fed. We don't know much of anything about it. All I know is that things were pretty bad by the time Volcker decided to really cut down our money supply growth.

Robert L. Hetzel: Ooh.

Ted Balbach: But he did, of course. He created a substantial slowdown. But at least from that point on, inflation began to decline.

Robert L. Hetzel: Hm-hmm. St. Louis was generally supportive of Volcker, even though, you know, we had these very convoluted operating procedures with non-bar reserve control and lag reserve requirements and—

Ted Balbach: Now I don't—I think St. Louis mostly was critical constantly of everybody who was a chairman, period. And it became a sort of a—not a religion, but sort of a habit. And, clearly, we were much less critical of Volcker than we were of Arthur Burns or of Miller.

Robert L. Hetzel: Did you feel like Volcker was the right man in the right place? He was a natural leader, and he—

Ted Balbach: I think at the beginning I thought that that was the case, yes. But later on—you know, Volcker was not exactly fighting inflation all the time. Volcker was usually one of those people who did not want interest rates to go up, very strongly fought always

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against raising interest rates in any way, manner, or shape, until of course 1980 when the problem really arose. But I think, yes, he was a leader, and I think that he allowed people to speak, and he argued with people. And I thought that during his period, FOMC was sort of a much better institution than it was before.

Robert L. Hetzel: Because Volcker encouraged discussion and—

Ted Balbach: Yes. Yes, or at least did not immediately sit on somebody's head when they said something he didn't like.

Robert L. Hetzel: Well, I can certainly remember the change in intellectual environment before then. I don't want to say there was an environment of fear, but there was always a nervousness about whether Axilrod or somebody was going to be on the phone blistering you over some article for your economic review or whatever. And after that it was like Volcker just didn't care. He didn't want to get involved in that sort of detail. And there was a huge change in the intellectual environment. Everybody relaxed. It was like you could voice your opinions without getting jumped on.

Ted Balbach: (00:51:24) Although I remember one day we wrote a speech for Roos, and we sent it for their approval. And they made some really—but very important changes, and we disagreed with those changes. And I received a call from Mr. Volcker himself, who started dictating and dictated to me a paragraph for that speech.

Robert L. Hetzel: Oh, I'm amazed. (Laughs.)

Ted Balbach: Yeah. So he was perfectly willing to do that too.

Robert L. Hetzel: Was it on something touchy on the international sphere? Or was it just domestic monetary policy and he didn't want the criticism?

Ted Balbach: I think it was just domestic policy. International—we used to be very careful about international, because everybody else had to be careful.

Robert L. Hetzel: Yeah.

Ted Balbach: But it was domestic and somehow touched the wrong nerve and—

Robert L. Hetzel: Hmm. Well, I guess that's in line with the fact that he would fly into St. Louis and make the case for his own man.

Ted Balbach: Now, as a matter of fact, the rumor had it, and I believe it's true, that they—that the Board of Directors at that time, that the St. Louis Board of Directors—now let's see, who did they choose? Oh. They chose Lee Hoskins.

Robert L. Hetzel: Yeah.

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Ted Balbach: And that was not acceptable to Volcker, so he came in, called together the Executive Committee, and convinced them that they need somebody who has experience in financial markets, et cetera, et cetera. And Melzer was the one who they then selected.

Robert L. Hetzel: Yeah. Well, I think that's the way Volcker looked at the world. He looked at it through the eyes of the financial markets. He did come out of New York. I mean, he came up through the New York Fed in the 1950s. And he was a natural man to lead the Fed in the early '80s, because expectations of inflation were rampant. And the markets had begun to look at money, so he could fight inflationary psychology and be a quantity theorist. It just sort of followed. But once he'd gotten on top of that, then I don't think he had any use for the quantity theory anymore.

Ted Balbach: Exactly. Exactly.

Robert L. Hetzel: And do you feel like he led the Fed off track with Plaza and Louvre, that at the end he was not as willing to raise rates as he would have been if he hadn't gotten enmeshed in these agreements with these other countries to—

Ted Balbach: Definitely. Definitely.

Robert L. Hetzel: So, you know, the problem was that there was an outbreak of protectionism in Congress in the mid-'80s, because our current account deficit had gotten so high. The dollar was so strong. The farmers were hurting. Their exports were hurting. The dollar was strong. And so the feeling was that other countries around the world—Germany and Japan, the usual suspects—had to stimulate their economies to lessen our trade deficit. And so we got Louvre and—

Ted Balbach: Right.

Robert L. Hetzel: But then it was harder for Volcker to raise rates sharply if he was telling our partners to lower their rates or at least not raise them. So I feel like that he was constrained at the end in a way he wouldn't have been without these arrangements. I assume they came originally from the Treasury, the pressure for it. But, you know, he signed on without protest, apparently.

Ted Balbach: (00:55:42) Yeah, I don't know where they came from. But I think you're right, that those have become constraints. And, as a matter of fact, I am not sure that there was any reason to raise interest rates after that—after inflation began to decline.

Robert L. Hetzel: Well, the economy strengthened in early '87. Bond rates began to go up. And Volcker didn't respond the way he would have in the past, it appears from the record. And he may have thought that he would be reappointed and that he had a latitude, you know, about the timing of interest rate increases. If you didn't raise them in the spring, you could raise them in the summer. But he wasn't reappointed. Do you know anything about that story, how that—

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Ted Balbach: I don't. No, I don't at all.

Robert L. Hetzel: Do you have any recollections about the change from Volcker to Greenspan? As of now, you know, everybody has this—Greenspan has been apotheosized.

Ted Balbach: That's right.

Robert L. Hetzel: So it's hard to go back now and realize that when he came in he didn't have credibility and there was a lot of feeling that he was a—you know, a Republican appointee and so on.

Ted Balbach: Pure politician, actually.

Robert L. Hetzel: Yeah. And so, you know, he had to raise rates to establish his credibility. And then you get the stock market, the client, and all that stuff. So it was a pretty complicated period. And we just look back now and think, "Oh, yeah, Greenspan," you know, the guy with ultimate credibility and so on. But it didn't start—

Ted Balbach: No, it did not start. But you are absolutely correct, I think, that at the beginning there was sort of a—I think people sort of didn't know who they were dealing with, period.

Robert L. Hetzel: Yeah.

Ted Balbach: And then he made some moves. As you say, he raised some interest rates and so on, or at least allowed them to rise, and established credibility. But not—you know, a few minutes ago or half an hour ago you mentioned, you know, that now we control interest rates. I am not absolutely sure. The interesting part is that Greenspan says there should be a decrease in the Fed Funds Rate.

Robert L. Hetzel: Hm-hmm.

Ted Balbach: And somehow it happens. I kind of look at what happens to monetary base, and nothing happens. You know, in order to reduce interest rates, you've got to jack up monetary base if you really want them to decline. And yet it doesn't happen. So he is almost deified, you're right. But at the beginning, that was not the case.

Robert L. Hetzel: Do you think that the basic monetary policy that Greenspan has followed was put in place by Volcker, and he basically continued that overall strategy and that's why policy has been better? Or do you think Greenspan himself innovated in the—

Ted Balbach: Very difficult for me to say what's happening now.

Robert L. Hetzel: Yeah.

Ted Balbach: I have really tried to stay away from my colleagues, and they don't talk to me, and I don't ask the questions.

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Robert L. Hetzel: Yeah.

Ted Balbach: The short period of time in which I was at FOMC meetings that Greenspan was there, I would argue that he continued the Volcker policy, not exactly, but sort of with more conscious and more sensitive to inflation problems and was more willing to suffer the consequences of higher interest rates.

Robert L. Hetzel: Hm-hmm.

Ted Balbach: So in that sense, I think he did follow that particular policy. But I certainly cannot—I don't know what's happening now. Do you go to FOMC occasionally now?

Robert L. Hetzel: I have. I used to go a couple of times a year, but now Marvin Goodfriend is special advisor to the President, and Jeff Lacker is Director of Research. And so they pretty much divide it up. I have been, but not for, oh, about two years or so.

Ted Balbach: (01:00:14) Yeah. Wow. Yeah, I have not been there for 10 years, so I really don't know what's going on.

Robert L. Hetzel: Yeah. Do you have any advice now for what our research department should do now that there's a general association of Central Banks with inflation? No bank today does what St. Louis did, which is to identify itself with a particular analytical framework for understanding monetary policy. We seem to be back into this sort of, "Yeah, we're going to do the right thing at the right time."

Ted Balbach: Precisely. Precisely. And the reason for that is that now everybody believes that Greenspan can perform miracles.

Robert L. Hetzel: Yeah.

Ted Balbach: That's number one. Number two, I think that, except possibly your bank and maybe Cleveland occasionally, virtually nobody does any research on monetary policy.

Robert L. Hetzel: Yeah, exactly.

Ted Balbach: Everybody sort of goes off on his own way, and they build little—or big models where everything is assumed and you cannot make an error, and you calibrate them and come out with all kinds of things. But very little of any application to policy.

Robert L. Hetzel: Yeah. Well, if you have price stability, basically, then monetary phenomena are not so important. It's only when—

Ted Balbach: Exactly. Exactly. And that's—

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Robert L. Hetzel: And so—and so the people don't think, "Oh, well, these problems are difficult, and they don't seem so pressing. So let's sort of ignore them."

Ted Balbach: It's not just the Federal Res—What bothers me, really, is that there's virtually no academic institution that is interested in monetary policy. And so I would kind of like to see that the Federal Reserve, your research departments should be concerned with that and do research on these topics.

Robert L. Hetzel: Yeah.

Ted Balbach: And, unfortunately, it's not happening. So one day we're going to have a problem, and then the whole thing will boil up again.

Robert L. Hetzel: Exactly.

Ted Balbach: Yeah.

Robert L. Hetzel: Well, should I get anything else, reminisces or recollections? Am I missing something? We've talked about [unintelligible 01:02:43].

Ted Balbach: Oh, I think you covered everything very nicely.

Robert L. Hetzel: Well, I think you covered it nicely. I was just sort of hanging on. It's a—

[END OF RECORDING]

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