You Might Be Right – Is the Federal Reserve Doing Its Job? - Transcript
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Charles Calomiris: The key problem the Fed faces is the presidents want things to be a little better, but then when you goose up inflation, it can be hard to bring it back down, and there are lots of costs from that inflation. So we can't trust presidents to really determine our monetary policy.

Austan Goolsbee: And I always say our motto at the Fed is like in the Midwest, there's no bad weather, there's only bad clothing. You give us the conditions and we figure out what's the right jacket.

Marianne Wanamaker: Welcome to "You Might Be Right," a place for civil conversations about tough topics. Brought to you by the Baker School of Public Policy and Public Affairs at the University of Tennessee, with funding support for members of our Producers Circle. To learn more about how you can support our work, visit youmightberight.org.

For decades, the Federal Reserve has been responsible for maintaining economic stability in the United States. In recent years, it has faced unprecedented political pressure amid a rapidly evolving economic landscape, characterized by inflation, global uncertainties, and changing public priorities.

In this episode, our hosts, former Tennessee Governors Phil Bredesen and Bill Haslam, and their guests, discuss the challenges the Fed faces in balancing independence with accountability and the potential policy reforms that could modernize its approach.

Bill Haslam: Well, Phil, welcome back. I would say these days the political environment in our country leaves us no lack of subjects to talk about.

Phil Bredesen: That's good for our podcast. Maybe not for the country, but–

Bill Haslam: One of those things, obviously, is the Federal Reserve, and I think most Americans, like us, probably don't understand everything that we should about who it is, what it does, its purpose, but also the recent controversy about political pressure applied to it and whether that's appropriate or not.

Phil Bredesen: Right. Well, I think that I agree completely that people read about it in the context of setting interest rates, and of course it does a lot of other things and was founded, I guess, over a hundred years ago now to solve some problems in the financial sector, and the appropriateness of how it's organized and stuff, I think, is a real question.

Bill Haslam: Right. So while this is not a topic that normally gets discussed at cocktail parties or Thanksgiving dinners, there's a reason for its role, and I think right now we're starting to see how critical that mission is and why, though it's set up to be independent, why there's a lot of question about it.

Phil Bredesen: Yeah, the independence thing I think is something I hope we have a chance to talk about because, on one hand people talk about it being independent, on the other hand, it's the political creation. It's created by the Congress, and you can't avoid the political considerations that are out there as well.

Bill Haslam: There's a lot to discuss and a lot to learn, so let's just dive right in.

Phil Bredesen: We'll do it.

All right. Well, Bill, our first guest is Charles Calomiris. He's a professor emeritus of financial institutions as well as international and public affairs at the Columbia University Business School. He's done a lot of research and had advisory roles with policy organizations, Manhattan Institute, Hoover Institution. Has a bachelor's degree in economics from Yale University, magna cum laude, Ph.D. in economics from Stanford, and has an honorary doctorate from the University of Basel. He's also an author of Fragile by Design: The Political Origins of Banking Panics and a book called Scarce Credit, which critiques how regulation and policy incentives shape financial fragility. So I think we think we have a great guest to begin this conversation.

Bill Haslam: Charles, thanks for joining us. Let me ask the first question. I think it's fair to say that the Federal Reserve has been more in the news recently than ever, and it's also fair to say that most Americans don't really grasp what it is the Federal Reserve does, why we have it. So tell us in simple language for our listeners like what's the Fed, why do we have it, what's its purpose.

Charles Calomiris: Great to be with you, Governors. It's a privilege to be here. I think the important thing for everyone to recognize is that the Federal Reserve plays a central role in trying to maintain macroeconomic stability. That is, it's the main tool by varying the supply of its own liabilities, which we call money, which most of us carry around in our pockets from time to time. By doing that, it accomplishes the macroeconomic goals of trying to stabilize employment while also trying to make sure that the value of that dollar remains stable in the long run.

Bill Haslam: Can I stop you? Just so we know, when you say macroeconomic, what are we talking about?

Charles Calomiris: We're talking about the aggregate economy. Is the economy growing? Is the economy shrinking?

Bill Haslam: Okay. Got it.

Charles Calomiris: Are we in a boom? Are we in a recession? How are we doing in the aggregate? And that's the macro picture. The Fed's job is not to try to decide who the winners and losers are in the economy. It's really trying to keep the overall level of economic activity stable and make sure that the level of inflation also remains low and stable. That's its function.

Bill Haslam: Charles, in short summary, what has the Fed done well and what has it done not so well?

Charles Calomiris: Unfortunately, as the great, late economist and Fed historian Allan Meltzer pointed out, you can only really say that over its now a hundred plus years of existence, Fed's really only been successful at its job about a third of the time. So that's not a very good record, right? But what we could say is in the 1920s the Fed discovered the capacity of smoothing the business cycle and did so pretty effectively. We could also say that from about 1991 till about 2001, the Fed seemed to also get it right and do quite well. Unfortunately, most of the rest of the time either the Fed made dramatic errors or the Fed was removed from power. One thing people don't even know generally is that from 1934 until 1951, the U.S. Treasury ran monetary policy and just basically took the power away from the Fed.

So the Fed has not been a great success story. I think most recently we would say that the inflation that we experienced in 2021, which the Fed got very wrong. The Fed bought into the administration's argument that the inflation was transitory, and so it delayed by a full year really the battle against that inflation. That's an example of a mistake. The Fed also made a similar mistake in the 1960s and '70s, when it allowed inflation to accelerate in what we call The Great Inflation and waited far too long to do anything about it. And when Allan Meltzer talks about these mistakes, he tends to point to two kinds of underlying problems. One is bad thinking. There's a lot of evidence that the Fed doesn't really, hasn't through most of its history, really had a good grip on what it's doing and how it affects the economy. I know that seems hard to believe, but there's a lot of evidence.

But secondly, there's also this problem of political influence. Under our constitution, monetary affairs are supposed to be under the authority of Congress under Article I Section 8, but the president can exert under the current setup a lot of influence. That's not what our founders had in mind. They realized the temptation that presidents would want to goose things up to make themselves look good and maybe get reelected, and so to make things not myopic, they decided to give the legislative branch the real control. And so the Fed has, unfortunately, made both mistakes in its thinking, but also allowed itself to be manipulated by the president. I would say that's less of a mistake of the Fed than it is of the whole institutional construct of the Federal Reserve Act, which basically creates the possibility of presidential intrusion.

Phil Bredesen: Is there any way to move these – this is a question for an economist – is there any way to move these kinds of decisions into a more objective form, looking at statistics in some way or economic results as opposed to the opinions of the sort of board members about what should be done?

Charles Calomiris: I think a lot of economists have argued that there is. It's not so much that we think that we can get rid of human error. We're not going to put AI in charge or anything like that. But one of the things that we recognize a human failing is that people don't like accountability. I don't know, both of you were governors, you probably loved accountability, but most people don't, and Fed officials don't, and they won't make themselves accountable and, therefore, more disciplined. They won't make themselves accountable unless we force them to be. And the way to force them to be accountable is they're always talking about how they're data-dependent, and that data dependence really does boil down to a kind of algebraic responses, which we call the reaction function of the Fed, how it responds to a rise in inflation or a rise in unemployment, or other kinds of indicators.

We know that the Fed is quantitatively mapping all that and deciding how to respond, but it doesn't tell us in advance how it does that. And so many economists like myself have argued force the Fed to be explicit, not just vaguely say data-dependent. That'll give Congress a way to ask questions that are more pointed, more germane, because it forces them to in advance say what they're going to do, be systematic. And they can change their systematic approach. They can announce that they're following a new kind of data dependence, but require them in advance as a committee, the so-called Federal Open Market Committee that determines monetary policy every six weeks, make that committee have to be really transparent.

And they don't have to all agree. You could say, "Well, our committee, some of us are doing this, some of us are doing that," put different weights on different variables, but the point is, if you really want to have accountability both to prevent political influence – because if you explicitly state what you're going to do, it's harder for the president to force you to abuse your discretion because you're limiting yourself, you're disciplining yourself in advance. And secondly, bad thinking can get corrected better because people can question what you're doing, but if I never tell you what I'm doing, it's hard for you to really question it in a germane way and it's also a lot easier for the executive branch to influence it. So this has been something the economists have been pushing for, not all, but a lot of us, for a long time. We think that this would really be the most effective change.

Bill Haslam: Well, let me move to some of the questions of the day. There's some folks that would say that the Fed is being too conservative now, that it's holding interest rates too high, it's overly afraid of inflation, or maybe it just has an ideological blind spot. What's your reaction to that?

Charles Calomiris: I try to always ground my opinions in something objective. So let's point out that first of all, the Fed starting about 15 years ago for the first time declared a long-term inflation target of 2%. The Fed has failed to achieve that target pretty egregiously since 2020. The Fed started to expand it–

Bill Haslam: Can I stop you?

Charles Calomiris: Yeah. Mm-hmm.

Bill Haslam: Let me stop you for a sec. The Fed, I mean, obviously the country has failed that fairly systematically, but how much of that can you lay on the feet of the Fed? I mean, there's a lot of other factors that–

Charles Calomiris: A hundred percent.

Bill Haslam: Okay. That's a lot.

Charles Calomiris: A hundred percent. Look, if you gave me the monopoly over the supply of something and you told me that you wanted to determine its price, I could do that. The Fed has the monopoly over the supply of money, and so when inflation happens, it's because either the Fed did something to cause it or didn't do something to prevent it. So the Fed has 100% responsibility. Now, that doesn't mean every blip in inflation we can hold the Fed accountable for because, obviously, things happen, the Fed can't control day-to-day everything.

Bill Haslam: I look at the recent bout of inflation we've had and I'd say it was at least somewhat, if not largely, driven by spending.

Charles Calomiris: That's right. And so the failure of the Fed was not to offset the predictable inflation that was the result of the fiscal spending.

Bill Haslam: So they should have done what?

Charles Calomiris: They should have tightened by raising interest rates in 2021 instead of waiting until 2022 to do it. And what happened was the administration was arguing, again that sort of myopic tendency of administrations to not want to see tightening. "Oh, this inflation is happening. That's not a problem. This is transitory. We shouldn't worry about it." It's the Fed's job to be able to say, "We are going to worry about it and we're going to fight back."

Not only did the Fed – and by the way, it's a great example – notice that Chair Powell was not announced to be reappointed until November of 2021, the most delayed reappointment in Fed history. I think that President Biden used the reappointment to provide implicit pressure to get the Fed to accept the administration's argument that tightening wasn't really needed. And it was very different for President Trump, very quiet. Biden never said, "That Powell, you better do what I'm saying." He was soft-spoken, more effective for being soft-spoken, and he had the effect, I think, that he wanted, which was to delay the Fed's aggressive reaction to that inflation, which you're correctly saying was the result of a spending spree.

But the Fed is the one to blame for not reacting to it because the Fed, that's the Fed's job. The Fed has a monopoly on the control of this asset called the dollar. If it wants to make the dollar more valuable and reduce inflation, it can do that. So the Fed likes to put blame on others. And I agree with you, the Fed can't control for month to month or even quarter to quarter what the price change is, because there are a lot of other influences, but yes, the Fed does have all the tools it needs to long-term control inflation. And what you see happening is people have lost faith in the Fed's long-term target. It has failed to convince people that it is targeting inflation because it's been so bad at it in the recent past. It's lost its credibility.

Bill Haslam: Everybody talks about the concern about the loss of independence with the Fed. As an everyday American, what are the practical concerns? Why should that bother us?

Charles Calomiris: Two reasons. First of all, on principle based on our constitution. Our constitution says that under Article I Section 8, it's Congress's responsibility to govern the monetary policy. So when the president interferes, that's a constitutional breach. This should bother us all as a matter of principle in our republic.

But secondly, we know that there's a logic underlying that, which is that executives tend to be short-sighted because they want to achieve reelection, and so they will have a tendency to prefer actions that goose the economy and, therefore, create long-term problems of inflation. The key problem the Fed faces is everybody always wants in the short term, the presidents want things to be a little better. But then when you goose up inflation, it can be hard to bring it back down, and there are lots of costs from that inflation. So we can't trust presidents to really determine our monetary policy because they will tend to be biased toward creating inflation that's hard to get rid of.

Phil Bredesen: Is that an outgrowth of having a fiat currency or would that be true under other circumstances?

Charles Calomiris: You're right, it's mainly the outgrowth of having a fiat currency, because if you don't have a fiat currency, inflation is not something that you're really determining with your monetary policy because you're maintaining the discipline of the convertibility.

Bill Haslam: And for us lesser mortals, what's a fiat currency?

Charles Calomiris: Fiat just means that you're issuing a currency that's not convertible into something real, like gold or something else. It's just the Federal Reserve, the value of the currency just comes from the fact that the Federal Reserve limits the supply of it. It's the monopoly supplier of dollars, and so the value of the dollar ultimately is determined by the quantity of it.

Phil Bredesen: I'd like to close with just one final question, slightly change the subject. This podcast that we're doing takes its name from Senator Baker's quote about listening and keeping an open mind because sometimes the other person might be right. Just in your own experience, do you have an example of a time when by being open and listening to someone who you might not have originally agreed with came to change your mind on something consequential?

Charles Calomiris: You know, I remember I was a young junior professor, and I was there at a conference, and I was arguing a point with a famous, older professor named George Kaufman, and it was about the Continental Illinois bailout of 1983, and I was sort of more sympathetic to it than he was. And I remember him saying to me, "You should try reading more." And I did read more, and ultimately I came to agree with him that the Continental Illinois bailout was not a good idea. It was something that he and I liked to laugh about quite a bit.

Bill Haslam: We appreciate that, and thank you for your time. Your insights are helpful. One of the things we've discussed is that this is one of those things that people talk about the Fed a lot. Very few of us, and I'd include myself there, really understand how it works, so we appreciate the education you've given us this morning.

Charles Calomiris: I sure enjoyed it.

Phil Bredesen: Thank you.

Charles Calomiris: Thanks very much for having me.

Phil Bredesen: Thanks.

That was interesting. I mean, somebody who lives in the academic world looking at this as opposed to the more political world of being involved I think brings a really interesting perspective to it.

Bill Haslam: It does. It reinforces to me though the importance of why we want a Fed to be, as much as it can be under our current setup, independent from political pressure.

Phil Bredesen: And I guess my question would just be is an entity which is set up by a political body in a political world, is it ever really possible to do that?

Bill Haslam: Maybe not, but it underlies the importance to all of us of at least stressing why. Like I said, we're never going to have it be purely non-political, but all of us need to keep the pressure on to make certain we're making the best long-term decisions, because as you said, whether it's in business, you're goosing earnings for the quarterly report, or you're in politics, you're trying to make it as great as you can for your four years, that's not really good for the long term of the country.

Phil Bredesen: Well, it's like, I mean, both of us have had the experience as governors of– I mean, you're caught between two rocks in the ocean or something. On one hand you've got things you have to do politically to keep your relevance to the issue, on the other hand you're trying to do things objectively right, and I guess different presidents have handled that in better and worse ways.

Bill Haslam: Phil, I'm particularly pleased to have Austan Goolsbee with us this morning as we try to figure out and help explain and talk about the importance of the Federal Reserve. Austan is the president and CEO of the Federal Reserve Bank of Chicago, a role he's had really for about two and a half years. He's also a professor of economics at the University of Chicago. He served as chair of the Council of Economic Advisors under President Obama and played key

roles in the economic recovery efforts during the 2008 financial crisis. There's probably a few things to talk about there. He's advised the Congressional Budget Office. BA and MA in economics from Yale and a Ph.D. in economics from MIT.
Austan, we're really pleased to have you with us.

Austan Goolsbee: Yeah, thank you for having me.

Phil Bredesen: Great. Well, let me start out. I think when people read in the paper about the Fed, they're often thinking in terms of Powell and the Fed Board in Washington, appointed by the president. You're the CEO of one of the 12, I guess there's 12, regional Feds. Tell me what it is that a regional Fed does and how it fits into that system that we have.

Austan Goolsbee: Yeah. And look, people say, "Why does Chicago even have a Fed? There's another Fed in D.C." So the thing is, when they made the Federal Reserve with the Federal Reserve Act in 1913, a lot is different in the country. But some things are evergreens, and they were fundamentally uncomfortable at that time, as they are today ,with Washington, D.C. plus Wall Street controlling the entire financial system of the United States with no input from the rest of the country, so they built in a form of monetary independence, as I see it, by adding 12 reserve banks sprinkled around the country. Now, it looks a little goofy right now because in 1913 the economy was distributed differently, so there wasn't a whole lot in the West, so San Francisco covers the whole thing. I heard they needed the votes of both the senators from Missouri, so two of the 12 banks are in Missouri.

Bill Haslam: There's usually a little of that history.

Austan Goolsbee: Yeah. I understand that it was birthed out of a political compromise, but that aspect of incorporating 12 of the 19 people sitting around the table when we're talking about interest rates in the economy are not political appointees, are not from Washington, D.C. They're there representing regions of the country. That's actually a really powerful and important idea. And that's not true – the U.S., I think, is basically the only central bank that has that. But it was kind of a stroke of genius.

Then to the second part of your question, what do they do, they come every six weeks and they sit around the table for deciding monetary policy. But these reserve banks are a much more operational job. We got a little less than 2,000 employees at Chicago Fed. Much of the payment system of the United States is run over the Fed rail, so the majority of wire transfer, the majority of ACH, and direct deposit, and now with the instant payment FedNow, and we are a bank to member banks, so we got a vault with billions of dollars of cash in there, and our banks, when they want money for their ATMs, they call up and order us and our machines catch the counterfeit and send it out and we do financial services. We employ the bank supervisors and bank regulators who are down there making sure that the banks have capital and are following the rules. And we're members of our community, and we're out, and we have a community development function.

Bill Haslam: Also, I think most of us would, we agree, we love that it's not just folks from D.C. and Wall Street. And I know it's not that simple of an answer. How do the regional chairs get appointed?

Austan Goolsbee: They have boards. They're not actually government agencies, they're not-for-profits, and loosely the boards have nine people that are kind of three bankers, three business people, and three civic leaders. Not exact numbers, but that's basically what it is. And the non-bankers on the board do a search, they do national searches, and when the jobs are open, they'll be posted and they get nominations, and that board forms the search committee, and that's who picks the heads.

Phil Bredesen: The system you're describing is set up to give some independence of central authority of this decision-making to take into account the economic realities outside of Wall Street and Washington. And yet when I look at it from the outside, it seems like the president – President Trump doing it very explicitly, but certainly other presidents doing it more quietly – have a lot of influence about the way the Fed acts. Given the fact that the central board is appointed for long terms, which can't be renewed and these regional boards are really independent from that, how does a president have that much influence over what's happening? How can you jawbone the Fed in the way that happens?

Austan Goolsbee: You kind of shouldn't. It's bad idea to design a system where there can be direct political interference in the setting of interest rates. That's not just in the U.S. I'm coming on three years at the Fed. Before I was ever at the Fed, I was an economic researcher. Economists are basically unanimous, in all rich countries of the world, central banks are independent precisely because if the sitting government can have an extra influence on the setting of rates, their interests are not necessarily the same as stable prices and inflation comes back. And it is not rooted in theory, it's just rooted in observation. Just look around the world when there's not Fed independence or central bank independence. Inflation comes roaring back and growth is worse. So it pains me a little that we're in an environment where you've had some people literally questioning, "Well, maybe the Fed shouldn't be independent and the administration should be setting the rates." That's a bad, bad idea.

Historically, as you say, there are 12 reserve banks around the table and not all of them vote every year. And there are seven political appointees, one of which is the chair. Those are confirmed by the Senate to 14-year non-overlapping terms. And the chair is a four-year term, which is as far off the presidential cycle as it can be. So they've tried to design this thing to be as independent as you could possibly be in a democracy, for good reason, and the historical influence of any president is by who they appoint to the board, but it's usually relatively limited in how quickly they can appoint such people.

Phil Bredesen: The Fed is designed today – obviously, it has evolved in some ways, but the basic structure of it in the legislation is over a hundred years old now – was created in obviously a very different economic environment and very different country than we are today. Are the things that you can see, and I'm going to put you on the spot as an operational because of your responsibilities, but are things that you can see today that may have outlived their usefulness or holes that may exist in what the Fed does and what powers it has and so on that could be reformed?

Austan Goolsbee: There were. There have been. It's a super important subject that we should always be thinking about. It's a little easier to look in the recent past to see how some fundamental things have changed. When we went to the financial crisis of 2008, there weren't stress tests of the big financial institutions. It wasn't obvious how, in their language, you would resolve some of these big institutions if things went wrong. How would you shut them down, who were the regulators, and who oversees their actions on the run up, and what do you do on the way down?

With the Dodd-Frank Act and the re-regulation of the financial sector, they tried to address some pretty fundamental problems in the system. We can quibble and adults can disagree over the details of the rules. I felt that if you fast-forward to 2023, when Silicon Valley Bank collapses and you get the First Republic collapse, and it certainly had this smell of this is how financial crises start, where it's one collapse and then there's a run on the next one and the next one, that we went through that episode of pressure, and the biggest financial institutions of the country, the ones that were put under Fed oversight, were the strength of the financial system this time. In 2008, they were the weakest link, the biggest risk. I think that, at least, is a success.

I do think as the nature of money and the nature is shifting to be more digital and more concentrated in money markets and repo markets and commercial banking explicitly, kind of old-fashioned banking, taking deposits and making loans, has gotten smaller and smaller over time. We're still as a society, not just the United States, the whole financial system of the world is still coming to terms with how do we treat non-banks that are big financial institutions. I don't have a– You get in the Fed, you're kind of out of the legislation business, but this space still feels like one that's really important. Big insurance companies, big money market funds, they're not banks anymore, and so how we treat them, I would say, is the space.

Bill Haslam: Austan, let me take you back. We we talk about when the Fed meets. What you're really talking about, it's the Open Market Committee with the seven political appointees, the five regionals that rotate, I guess, except for the New York spot.

Austan Goolsbee: Yeah.

Bill Haslam: So when those 12– Take us in the room there. Tell us what that's like, what the discussions, and maybe specifically a question. Like I said, take us in the room. But then the second part, there's some feeling that there's a lot of consensus usually out of those meetings. Is there enough intellectual diversity? I guess reassure us as Americans that there's a healthy debate going on there.

Austan Goolsbee: Yeah, both fascinating. First, let's just start with the– If you're an econ nerd, like I was, it's probably the coolest room and the coolest thing you've ever seen. You go in, it did not disappoint. I didn't know what it would be. You come in, there's a big room. They lower the shade so nobody can spy on 'em. And there's a huge table, biggest table I've ever seen in my life, and everybody sits around this table and they literally, it's 9:00 AM, the thing begins, and we're going to go around the table. Day one is about the economy. Day two is about the rates, where they're going to go around the table, and it's going to be Jay Powell's going to express seven, eight minutes, "Here's where I see the economy." And then we're just going to keep going down the line and everybody give their opinion.

It's a little formal. Maybe that's not a surprise that it's the Fed. So it's not really like a freewheeling debate where they're, "No, no, I disagree." It's not like that. But it is a lot of very different views. And you can see in the minutes, which they put out, and then with a lag they'll release the word-for-word transcript. The voting, I agree with you, has been, it's usually unanimous and occasionally somebody dissents, but it's hardly ever more than a couple of dissents. And I think part of that is we want to find consensus, but a big part of that also is Jay Powell, who's the only chair that I have worked under, he's really excellent at building, forging a consensus, and writing the statement in a way that people can agree even if they're coming from different spots or they have different worldviews.

I think if you look at the background of who the people are sitting around the table, it's pretty interesting. You got some people with a business background, some people with a kind of banking or markets background, you got a couple economists, and then they come from all these different regions. So I think you have a pretty decent representation within the economic realm of diversity of thought. And I don't mean to offend the Senate when I say I think for the 21st century, this is the world's greatest deliberative body, not the U.S. Senate. Everybody on there takes it really seriously, and you can see that in the transcript, you can see that in the minutes, you can see that from the way they talk. You join the Federal Reserve, you're out of the elections business. It's one of the last places on earth that is truly driven by content.

Bill Haslam: Reassuring.

Phil Bredesen: The last couple of years has seen enormous changes in the world being driven by AI, by artificial intelligence, which has shown itself to have a lot of value in looking at very large complex data sets and trying to pick things out from that in a way that simple formulas don't do. Is the Fed looking at AI as a way of getting a better understanding of the economy?

Austan Goolsbee: I would say the Fed is exploring uses of AI that are in more tailored examples, not so much the let's just take all the data, stick it into the AI and say, "What do you think the interest rate should be?" And I would caution everybody who has that in their mind because AI is as good as the training sample, and this inflation that we just went through and the coming out of it is a perfect example of where that can be really dangerous if conditions are not very similar to what has existed in the past.

Okay, so most recessions in this country are caused from demand. There's overheating or overcooling. And normally the Fed, which really has only one tool, which is a screwdriver for tightening or for loosening, that still kind of works because the most cyclical, let's call them cyclically-sensitive industries, like durable goods manufacturing, business investment, residential construction, the things that characterize the business cycle, those are also the most interest rate-sensitive parts of the economy. So when the Fed goes and sees overheating, it raises the interest rate and that tends to cool exactly the industries that are the ones that are overheating.

Now, fast-forward to COVID times, we have a recession that looks nothing like previous recessions. It's not driven– Durable goods consumption goes up. People start buying more TVs and more Pelotons because that's all they can spend their money on. And the thing that drives down the economy is nobody can go to the dentist. That's never happened before. And then as inflation comes, if you had asked the AI in 2023, "What should the Fed do? Inflation is well above the target," it would've said, based on past experience, "Jack up the interest rate and have a nasty recession. That's the only way to ever get rid of inflation." That's not what the Fed did, and actually in 2023, the inflation rate fell by close to as much as it has ever fallen in a single year and the unemployment rate never even went above 4%. There was no recession. AI would not catch that. To do that, you have to have some fundamental understanding of what's happening in the economy.

Bill Haslam: While you're there, and not related to AI, but when you look back at our recent bout of inflation, is there something the Fed could have done differently?

Austan Goolsbee: Probably. I think the Fed was not alone, but it was the most prominent in moving too slowly. I think most folks think that if the Fed had moved quicker to raising interest rates, there would've been a little less inflation. But I'm of the camp that thinks most of what happened was actually happening at the same time across the world and it was coming because on the supply side of the economy, where we're getting slammed on the supply chain, oil prices, a bunch of things on the supply side of the economy that were driving inflation that were outside of the Fed's control. So I think there are things they could have done, but it would've been 20% effective, not 90% effective.

Phil Bredesen: You described earlier, you used the analogy of the tool you have is a screwdriver, which I really liked, and that's just a question about whether the knob you're turning in fact is the only or the most effective one. Are there other tools that if the Fed had them statutorily and so on, that could add to the effectiveness of your ability to manage the economy?

Austan Goolsbee: Yes, but it would probably be unwise to do so. The obvious, monetary policy is kind of in its lane right here. That is the setting of interest rates or influencing credit conditions. That's what the Fed does. Everything else in the whole universe is by that definition fiscal policy. If the Fed had some authority on fiscal policy, it could influence the economy more directly, but I think it's largely dangerous to do so. That's the job of Congress and the president, and they can decide whatever policies that they want, and I always say our motto at the Fed is like in the Midwest, there's no bad weather, there's only bad clothing. You give us the conditions and we figure out what's the right jacket. And the fiscal policy things that happen, just like if geopolitics drive up the price of oil or if the supply chain has problems, all of those – the Fed can't make vaccines, the Fed can't pump oil, the Fed doesn't just set tax rates. It has to take all of that as given. All we do is, I hope, stay in our lane.

Bill Haslam: All that's true, but, I mean, did the Fed specifically think, "Well, this is all just transitory, and so we're going to be reluctant to raise rates as much as we should because we think all these supply blips are just temporary?"

Austan Goolsbee: Yes.

Bill Haslam: Okay.

Austan Goolsbee: I think it did. That was their mentality, and as I say, they weren't alone in that mentality. If you looked at private sector forecasters, they thought the same thing, and that proved– The argument that it was going to be a transitory hit to inflation was largely premised on, "Hey, the supply chain's going wrong, but how long can that last? That'll be quick to go away," and it wasn't quick to go away. Steve Liesman at CNBC described, in a funny way, and I agree with, he said, "Well, it turns out Team Transitory was wrong. They should have been Team Transsssssssitory."

Bill Haslam: Who knew economists were funny?

Austan Goolsbee: There is an element to that.

Phil Bredesen: This is new for me.

Austan Goolsbee: The only thing I'll say about that is that colors my experience now with tariffs. Okay, so tariffs are inflationary, but only temporarily. In theory, they're supposed to only be a temporary inflation shock. So there are people arguing, "Let's look through it," and that was the same thing they said when inflation started growing before. "If this is going to be transitory or temporary, then let's try to look through it and we shouldn't adjust the policy based on something that we know is going away." That didn't work out that great the first time around, and I'm just uneasy making the same argument because that's quite literally the same argument the first time around, and maybe it'll be right this time, but maybe it won't, and then people are going to say, "How dumb do you need to be? You just did that and now you did it again," and they wouldn't necessarily be wrong.

Bill Haslam: It's different now because the color of the jerseys of the people making the argument are different than they were last time.

Austan Goolsbee: Yeah, that's fair.

Bill Haslam: Austan, one final question. We always ask all of our guests, it's from Senator Baker's famous reminder to always remember the other person might be right. Can you think of a circumstance where you realized, "I didn't quite get this right. The other side had the right argument and I understand that now"?

Austan Goolsbee Yeah, many times, but I'll give you one very specific to the Fed. I mentioned at the beginning that the Fed has a 2% inflation target, and a lot of central banks around the world have adopted this 2% target. It originally came from New Zealand. The head of the central bank's taking a shower or something and he was like, "Two percent's a good number." But everybody is centered on that. And the Fed – I wasn't at the Fed then – around 2012 the Fed made explicit that a 2.00 inflation target is what they were aiming at. Now, I was kind of critical in public when they did that because I said, "That's falsely precise. The inflation numbers, they bounce around a lot, they have a big margin of error. To convey that we could somehow hit exactly 2.00%, that's a false precision and we shouldn't do that."

Fast-forward to the inflation coming out of COVID. One tiny detail I got to add, the Fed's 2% inflation target is not on CPI, which is the measure of inflation that everybody's familiar with. It's of a different one called PCE, personal consumption expenditure, and just for technical reasons, we think that a 2.3% CPI is around the same thing as a 2.0% PCE, okay? There is a market measure of what do people think inflation is going to be. That's called the TIPS. It is a TIPS bond, and it's indexed to CPI.

So come forward to the inflation coming out of COVID, we get way high, way higher than 2%, almost double digits, in the CPI. And if you look at this TIPS inflation expectation for 10 years, where you ask people in the market, "What do you think the inflation rate will be for the next 10 years?" the answer remained 2.3% CPI exactly, and it never moved even as actual inflation was approaching 10%. And at that point, I completely reversed my position and said I was wrong, and I said, "Either that's the biggest coincidence in the history of price indices or else the 2% target is exactly the anchor for inflation expectations that its advocates said it was." And I changed my views from that and I admit I was wrong. Two percent is super important and we should absolutely insist on it.

Phil Bredesen: Thank you. This has been great.

Austan Goolsbee: Guys, I'm so glad you do this and show that we can think like intelligent adults and discuss issues and we don't have to everybody be yelling at each other.

Bill Haslam: Well, we appreciate it. Thanks. I can see why students line up to get in your class. I learned a lot this last half hour and we appreciate it.

Austan Goolsbee: Great to see you.

Bill Haslam: Well, Phil, that was actually really helpful for me, and like I said, having the perspective of someone who's actually in the room when the Fed meets was enlightening and I will say encouraging that he said these are folks that really are trying to do the right thing.

Phil Bredesen: Yeah, I had exactly the same reaction to that. I mean, standing up for the fact that it's a great deliberative body and there actually are a lot of ideological variation in people in the way they look at it and that the chairman does a good job of trying to come up with a consensus. That's the way these things ought to work. It was encouraging to me.

Bill Haslam: Yeah. A couple of interesting points. I thought his recognition that they probably, like I said, using his screwdriver analogy, should have tightened it down a little bit more amidst the COVID and all the ramifications. And then the second was, we can't always be fighting the last war. Because this happened under those circumstances, it doesn't mean that the circumstances driving it are the same today, sort of his answer to your how will AI impact this question.

Phil Bredesen: I think he's exactly right that AI is powerful, and certainly in economic activity there's a lot of data out there for training, but when you have a circumstance like COVID where just the conditions are just very different from a previous sort of crises, it can go very wrong and that's where you start to need some sensible human judgment.

Bill Haslam: Well, I hope our listeners have learned half as much as I have in preparing for and doing this episode. I will say I come away even more convinced of the critical importance of the Fed being independent. I understand all presidents have and will continue to try to influence it because it does impact what's happening in the nation that they're leading, but also think it's even more important that we use the Fed to make the right long-term decisions for the country.

Phil Bredesen: No, I certainly agree with that. I came away with, I guess, a renewed appreciation for the importance of independence in setting these things. It's just too tempting if you're in an executive position like the president to try to use the Fed to accomplish other things than what it's designed to do.

Bill Haslam: The last point I'd make is this, institutions of all type are seeing dwindling credibility in the country, and that's just a fact, and I'd say some of that is earned and some of that is almost a product of our age, where it's so easy to comment on things on social media and to have an opinion about things. I will say the more I understand about the Fed and how we have it set up, we've gotten some things right as well, and so let's be really careful as we start to tear down those things that have made us great.

Phil Bredesen: I think that's called conservatism, isn't it?

Bill Haslam: That's what I would argue.

Marianne Wanamaker: Thanks for listening to "You Might Be Right." Be sure to follow on Apple Podcasts, Spotify, or wherever you listen to your favorite shows. And please help spread the word by sharing, rating and reviewing the show.

Thank you, Governors Bredesen and Haslam, for hosting these conversations. "You Might Be

Right" is brought to you by the Baker School of Public Policy and Public Affairs at the University of Tennessee with support from the Boyd Fund for Leadership and Civil Discourse. To learn more about the show and our work, go to youmightberight.org and follow the show on social media @ymbrpodcast.

This episode was produced in partnership with Relationary Marketing and Stones River Group.