Federal Reserve Board Oral History Project

Interview with

James L. Kichline

Former Director, Division of Research and Statistics

Date: September 21, 2007

Location: Philadelphia, Pennsylvania

Interviewers: David H. Small and Joyce K. Zickler

Federal Reserve Board Oral History Project

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

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

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

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MR. SMALL. Today is Friday, September 21, 2007. This interview is part of the Oral History Project at the Board of Governors of the Federal Reserve System. We are interviewing James L. Kichline. Mr. Kichline worked at the Fed from 1966 to 1987. He was director of the Board's Division of Research and Statistics (R&S) from February 1977 to August 1987.[1] This interview is taking place at the Federal Reserve Bank of Philadelphia. I am David Small from the FOMC (Federal Open Market Committee) Secretariat in the Board's Division of Monetary Affairs, and I'm joined by Joyce K. Zickler, a deputy associate director in R&S. Mr. Kichline, thank you for participating in this interview.

MR. KICHLINE. Glad to be here.

Educational Background

MR. SMALL. Let's start with how you came to be interested in economics.

MR. KICHLINE. I went to Franklin and Marshall College in Lancaster, PA. I did very well in my freshman year, but then I joined a fraternity, moved into a fraternity house, and promptly was placed on academic probation. I took a bunch of tests to determine what I was really interested in, and somebody suggested economics. I took some economics courses and absolutely loved them. I had a mentor who was particularly interested in financial markets.

I graduated from Franklin and Marshall and went to the University of Maryland graduate school. Lyle E. Gramley arrived that same year to teach monetary theory and policy; he was one of my mentors. He was a young Turk at the time and very aggressive. That is basically it. Charles L. "Charlie" Schultze was one of my professors, so I got what would have been, at the

[1] Guy Noyes was R&S director until 1963, followed by Daniel Brill (1964–69), Charles Partee (1969–74), Lyle Gramley (1975–77), and then Mr. Kichline.

time, the standard classic macro. I presume it's called East Coast salt water and not a freshwater kind of training.

MR. SMALL. That was at the time of the debate of the tradeoff between inflation and unemployment and the stability of that tradeoff. That was the macroeconomics of the Board staff.

MR. KICHLINE. A lot of it was pretty primitive, when you think about it now. My dissertation came out of a neat data set at the Fed. So there was a lot of focus on the monetary side of Milton Friedman's then still-early pronounced statements about the stability of the money demand function, no interest elasticity, and the monetary base—those kinds of issues. On the macro side, that was it. It was standard post-Keynesian analysis. Economic modeling was in its early days, basically.

MR. SMALL. What was your thesis topic?

MR. KICHLINE. The interest elasticity of claims at depository institutions, mutual savings banks, savings and loans, and commercial banks. In the summer of 1966, there was a mini crisis. I had just started working at the Fed. Because of the rise in interest rates and regulatory ceilings on rates, the Fed's research division weekly monitored deposit flows, particularly at mutual savings banks. The Fed was concerned about the need perhaps to extend Federal Reserve credit to those institutions. I was actively involved in the gathering and interpretation of these deposit flows.

MR. SMALL. Who was on your dissertation committee at Maryland?

MR. KICHLINE. Well, Lyle Gramley was at the Fed at that time. Paul A. Meyer and Clopper Almon were on my committee, reflecting their interests in monetary policy and econometrics. Lyle, however, was a member of the group conducting the oral defense.

MR. SMALL. Did that help prepare you for life at the Board?

MR. KICHLINE. Oh, I think so. Lyle set high standards and had a lot of energy. He's still at it. I can't imagine that I would have had the desire to continue to be that aggressive, but Lyle has it, a real desire.

Responsibilities in Early Years at the Board

MR. SMALL. So you came to the Board and went directly to the Capital Markets Section?

MR. KICHLINE. I worked in a summer program in the Capital Markets Section in, I think, 1964. I'm not sure if R&S still has that program. Under the senior economist, Bob Fisher, I worked on a project about financing the purchase of commercial office buildings. Then I was working on some dissertation issues when I got a call from Peter Kier, the section chief of Capital Markets. This would have been in late 1965. The person who was monitoring the bond markets, both municipal and corporate bond markets, had resigned. Peter wanted to know if I was interested in taking that on. I worked three or four days a week until I could get out of a couple of seminars at Maryland. I did that for half a year. Then I worked full time in the middle of the year or so, in 1966. So my first entrée into the Board came via the summer program.

MR. SMALL. Did you monitor the deposit flow pretty carefully when the Regulation Q ceilings became binding in 1966?[2]

MR. KICHLINE. Yes. There were two hot issues at the time. One was in the bond markets; early bids for municipal bonds were virtually drying up. That period was intense. This is six or eight months after then Fed Chairman William McChesney Martin was called to

[2] Regulation Q, originally part of the Glass-Steagall Act of 1933, regulated interest rates on various bank accounts, but it was whittled away by 1980s deregulation legislation. The prohibition on interest payments for commercial accounts, other than to sole proprietorships and nonprofits, survived until the Dodd-Frank Act in 2010.

President Lyndon Johnson's Texas ranch in December 1965, I think. It was a period when monetary policy was clearly focused on the concerns about having both guns and butter, and no one focused on the consequences to come from that. Also, in a world in which you had serious binding constraints under Regulation Q, you didn't at that time have any structure for securitizing mortgages and laying these things off the balance sheet—all of the things that evolved over time in the late 1970s and on. So disintermediation was often one of the consequences of this, because regulators did not move aggressively to change the interest rate ceilings. Hence, one of the consequences of monetary policy, and really yet one of the tightening aspects, was the disintermediation process.

MR. SMALL. Much of the authority or regulatory responsibility for adjusting Regulation Q rates was outside the Board, wasn't it?

MR. KICHLINE. Correct. And, over time, a group consisting of a Fed Governor and representatives from the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the [Federal] Home Loan Bank Board met regularly to discuss Regulation Q rate ceilings. I think that evolved in the early 1970s.

MR. SMALL. If you look back at the rise of inflation at that time, wouldn't you say that controlling inflation was not that difficult—you just raise interest rates until you get the level of inflation where you want it? To what extent did Regulation Q interest rate ceilings affect the policy process? Once you got over the ceilings, you had the disintermediation. You had a "knife's edge" type of problem—or was it not a big issue?

MR. KICHLINE. I think it was a big issue. At the time, I was a junior staff member, so I wasn't privy to the thinking of principals up close and personal or in FOMC meetings. But the disintermediation and its effects on the real economy were clearly part of the thinking; it was an aspect of monetary policy. Related to that, aside from this disintermediation area, were the credit conditions on the banking side. The New York Fed, for example, had a long-held and fairly well-developed view that credit conditions—as opposed to interest rates directly and the terms of lending, for example—were also an important aspect of monetary policy and its effect on the economy and inflation.

MR. SMALL. You mentioned that, before your arrival at the Board, there was the famous increase in the discount rate in early December 1965, and then a few days later Chairman Martin visited the LBJ ranch in January 1966.[3] Do you remember the hallway talk at the time among the junior economists about what that was all about and how important it was, or was it not much of an event?

MR. KICHLINE. Oh, it was an important policy event. However, at the time, I was more impressed with having the opportunity to interact with a large number of economists with varying backgrounds. That's probably one of the continuing features of life at the Federal Reserve that can be intellectually invigorating and challenging—at least I hope it is. While I can't recall particularly the excitement of the moment that came out of that policy event, clearly there was a feeling that something important was happening.

MR. SMALL. Did you have a sense of the type of work or analysis that Chairman Martin expected or what it was like for a section chief or an officer to work with him?

MR. KICHLINE. Not directly. Daniel "Dan" Brill, the R&S division director, had high expectations and was instrumental in bringing in talented people like James "Jim" Pierce. And, I think, Edward "Ed" Ettin came in that era. R&S wanted to obtain the best economic talent.

[3] President Johnson had wanted the Fed to hold off on any action to increase interest rates until the President's budget was released, but the Fed acted anyway, and the President summoned the Fed Chairman to his ranch in Texas for an explanation.

Providing a product to the Chairman or Governors certainly influenced the work, no matter who the Chairman might be or what economists on the staff might be talking about. Chairman Martin was very different from Arthur Burns, and they had different backgrounds. I think R&S developed very strongly under Dan Brill in bringing in people who could do the kind of rigorous analysis that one might expect.

MS. ZICKLER. Is that when Lyle Gramley and Frank de Leeuw came to the Board, and the modeling group started?

MR. KICHLINE. Yes.

MR. SMALL. And you were involved in the upgrades on the technology side in studying financial markets. Were you part of a younger generation that was bringing in more advanced econometrics?

MR. KICHLINE. Not from me.

MR. SMALL. There wasn't an old school–new school distinction?

MR. KICHLINE. Well, computing power was a serious constraint during that period, and, unfortunately, it persisted for all of my time at the Fed. We had these mainframes sitting in an air-conditioned space available to you for some limited period of time overnight. And when you made a mistake in one of your punch cards, you would come in the next morning and find that your job had not been run. I vividly remember lots of effort expended—a lot of input, very little output. So, I think the period that we are talking about has to be put in the context of the technology that was available at the time. It was fairly primitive. Now you have an HP calculator that could do more in your pocket than sitting overnight waiting for this mainframe to disgorge something from a fairly primitive program. I don't think I was part of that. I had enough to do with it to be sufficiently frustrated with the process. It was just part of developments over time; the technology wasn't there to support some of these things. That persisted into the 1980s. This is all a period of time before distributed computing power. I have no notion today what the Fed is all about on computing power.

All I do know is that, as division director, I probably spent an inordinate amount of time on computing issues—buying computing services, budgets related to computing services, and on and on—because it was the case, as in many organizations, that the outside world was changing, and technology advanced a great deal. There were issues about what you could do at prices lower than using a mainframe computer as a word processor. For example, one of IBM's many innovations in the 1980s was a simple word processing program to be run on mainframe computers, which is laughable today. Nevertheless, it was a reflection of what theoretically you could put together and then say that these are meaningful models that would give us a clue on the impact of alternative policy structures, for example. It was difficult to get that done in a timely fashion and to be able to do enough of that so that you have sufficient confidence in the output. Joyce, you're nodding your head.

MS. ZICKLER. Well, I know the history of it. Hiring people like Frank de Leeuw, Roger Crane, Jim Pierce, all that group—and I can't remember who else in the IF Division—provided the intellectual fire power behind the policy analysis. Today we think of it more in terms of modeling that we did then. But back then is when it really started. Peter Tinsley, Frank de Leeuw, and Jerry Enzler were in that group; Jerry came in the late 1960s.

MR. KICHLINE. Right. He was in my summer program, same year.

MS. ZICKLER. You're right. Then there was an evolution of that into the forecasting, modeling realm. Lyle Gramley was hiring some of the best and the brightest people and thinking about policy options and policy analysis.

MR. SMALL. When I came to the Board in the early 1980s, computing was still done on the large mainframe computer. Senior staff clearly expected work that used the computers.

MR. KICHLINE. Very much so.

MS. ZICKLER. In September 1975, when I came to the Board, a statistical assistant wrote the staff forecast down on a piece of paper and then typed it—the so-called Greensheets. There wasn't a Ruth program to do the calculations. Lawrence "Larry" Slifman and Steve Roach wrote the computer code to process the staff GNP (gross national product) forecast. Then we wrote one for the labor market and one for some code to produce the price forecast automatically. Now it is well computerized, but we used to write it down. At some point, before I came, Cort Peret was doing it in nominal terms, not real terms. That was the story. Later we started doing real GNP. It was a long haul to get to where we are now on computing and the ability to turn around iterations.

MR. SMALL. Going back to your experience in [the] Capital Markets [Section] and computing power, was there an explosion in collecting data so that you could see more of what was going on in markets in real time, what prices were doing, et cetera? Was the power to observe the economy increasing?

MR. KICHLINE. Oh, a lot. And when I first started in Capital Markets, as I noted, Peter Kier was a section chief. He was followed by Ed Ettin. Ed had visions of enhancing the availability of data, and in real time. We made sporadic efforts at putting together a variety of programs. We hired a lot of people who were writing a lot of things down and putting them on punch cards. And, as one of them once remarked, "I keep feeding this fellow, but he never does anything, no tricks." It was a case where we had more data than one, on occasion, might productively be able to deal with. There were substantial efforts to improve our data and the interpretation of those data. Great strides were made.

Capital Markets, at the time, also had a lot of responsibilities in securities markets. Let's say, they were taken more seriously then—in the sense of setting initial margin requirements, maintenance margin requirements, esoteric issues with regard to Regulations T and U, and those sorts of things that were not exactly on the front burner but could be, depending upon market developments.[4] There were a lot of things in that section that weren't necessarily frontline for the Board, but when they were, they were demanding. The people in that section, myself included, would often be involved in Securities and Exchange Commission matters or other securities matters. That was a part of Capital Markets in 1966 as well as in 1969 and 1970, in which there was a good deal of financial distress.

MS. ZICKLER. What was your relationship with the Federal Reserve Bank of New York on some of those issues? Martha Scanlon used to say they had different views from time to time on margin requirements.

MR. KICHLINE. They did. On occasion, their market folks would have input that was not necessarily the prevailing view of the Board. They were often consulted, or, if not, they raised their own issues on security and market matters. That persisted for a long time and, I think, rightfully so, even though, at the time, as a staff member at the Board, you wouldn't necessarily appreciate that kind of input.

MS. ZICKLER. What was the nature of the staff briefings to the Board when you started under Chairman Martin and then the transition to Chairman Burns?

[4] Regulation T governs the extension of credit by securities brokers and dealers, including all members of national securities exchanges. Regulation U governs the extension of credit by banks or persons other than brokers or dealers to finance the purchase or the carrying of margin securities.

MR. KICHLINE. Let me explain my first briefing to the Board, which occurred somewhere in 1967. You're talking about the regular flow of information and an update on markets. We would give information to Peter Kier, who briefed the Board on capital markets. Peter was a great fellow, but he would not necessarily think to take staff members along to Board meetings when he had the opportunity to do that. One night, maybe a Thursday night, I got a call that Peter was ill, so I would have to do the Board briefing. I knew where the Board Room was. I had been in the room, but I didn't know where to sit. Peter said he had made an effort at writing his briefing, but that turned out to be a very limited effort, in my view. It was a very stressful intro to Board briefings. Under the circumstances, the briefing went well enough, but it could have been done better. One of the things I tried to do as division director was to expose people to some speaking courses and to get section chiefs to have junior staff members attend Board meetings and see what transpires so that people weren't introduced to the Board Room with a "Where do I sit?" kind of circumstance.

MS. ZICKLER. I had the same experience in 1976. I had never been in the Board Room before I gave my first briefing. But it has evolved. It was standing room only at the last pre-FOMC briefing. Many staff people attend. At the beginning of your time and mine, it was a small group of people.

MR. KICHLINE. You asked specifically about the evolution of staff briefings in the transition from Chairman Martin to Chairman Burns. The evolution wasn't necessarily in the transition. It was the ability of the staff to communicate in a more meaningful way or have a greater degree of confidence that they had something that was worthy and not a waste of the Board's time. Over time, the economics profession advanced a great deal. In consequence, the staff was able to provide stronger policy inputs to Board members.

MR. SMALL. As the research function at the Board was built up over time, which you mentioned earlier, did more research get into the briefings in the analytic content or the results?

MR. KICHLINE. Yes, very much so. That process evolved over time. Under Dan Brill, Chuck Partee, Lyle Gramley, and, hopefully, while I was division director, R&S took opportunities to have special briefings on subjects or areas where we felt the Board would have an interest. We tried to cultivate an interest in which we felt we were making some progress on whatever the issue may have been. Special briefings addressing more technical matters were used in regular staff analyses. Those sorts of things exposed the Board to issues in a deeper way. We strengthened the regular briefing process and also enhanced our ability to respond to specific questions that may have been asked by the Board. As a process, one would find new developments working their way into the briefing material or written materials.

MS. ZICKLER. I still have copies of a special briefing that Steve Braun and Peter Clark prepared when Jim was division director. It was on the productivity slowdown and sources of productivity growth. That's a good example of a special briefing on a topic that was really hot, about what was potential GDP.

MR. SMALL. Were any Governors particularly supportive of the research computing effort, in a budgetary sense, or particularly open to briefings and receptive or thankful for the more research granted?

MR. KICHLINE. There were a number of them. Early on, you had those who had specific economic training. Robert "Bob" Holland was one. Henry C. Wallich was interested and supportive of R&S and its efforts. At one period of time in the budgetary process, three Governors were assigned to the R&S budget—Governors Partee, Wallich, and I forget the third. Henry Wallich particularly appreciated a project. I can't remember the details, but it was fairly expensive. We put the project at the end in our list of priorities, but Wallich wanted it done. That was unfortunate, because it was one of those things that we put on the list that Governor Partee, a former director of the R&S Division, fully appreciated was designed to be one of the things to cut as a budget savings that the committee could claim. But Henry Wallich wanted the project done, and that was quite discouraging to us.

MS. ZICKLER. Andrew Brimmer and Henry Wallich were both economists. Each of them hired special assistants from the staff and from the Reserve Banks. Wallich had people on a rotating basis to work with him. They generated a lot of interest in economic issues and had some special assistants working from the staff.

MR. SMALL. During your years in Capital Markets, do you remember any particularly severe financial crises and how the Board approached them?

MR. KICHLINE. Well, as I mentioned, we had that in 1966, 1969, and 1970. There were questions on the thrift side about lending to nonmember institutions or the possible or actual need to extend credit. I was moved from Capital Markets then also. I was in the Banking Section for a few years in the late 1960s, early 1970s, and then I went back to Capital Markets. That was a period where there were a number of things happening on the banking side. I wasn't particularly involved in any of that. For Penn Central, I was on the sideline. But it was a period in which early on there were a lot of stresses and strains in the financial system and concerns about keeping the system intact and questioning how far one needed to go. It was reminiscent of events of today. [Laughter] There's no master plan that tends to work for all time in how you resolve issues. But institutional memory is beneficial. It helps to have been through those things in the past.

MS. ZICKLER. Arthur Burns became quite interested in the New York City financial crisis. That was my first briefing. Christopher A. "Kit" Taylor from the Capital Markets Section and I did a special briefing. Kit, who worked on municipal finance, briefed the Chairman on the financial aspects of the New York City crisis. I briefed him on the regional economy and how the city's economy fed into the financial crisis.

MR. SMALL. During your earlier years, inflation was on a general uptrend. One area of response was in the financial markets themselves. Do you remember any financial innovations? Later on, there were shifts in the types of accounts that were offered in the markets and by banks, which might have thrown off the money estimated demand functions. For example, money market funds came into existence in a big way. Over the longer term, there was a sense of a financial market response to inflation and Regulation Q ceilings. Did you monitor that, or did the Board keep up to speed on those developments?

MR. KICHLINE. The Board was fine in keeping up to speed, but as you got to 1979 and 1980, the markets moved ahead of the Board. If you try to throw a roadblock in the way of innovation, markets react, and people in the market are bright enough to invent something or create something that will be effective in circumventing your roadblocks. I think there was monitoring of it. Nothing comes to mind at the moment that I can particularly add.

Evolution of Staff Forecasting

MR. SMALL. How did staff forecasting evolve? Were forecasts presented formally to the Board? How did forecasts work their way into the Greenbook and FOMC processes? Now they are a central part of those processes, but not early on.

MR. KICHLINE. Early on, I was on the financial side of this. The process of putting the Greenbook together was laborious, as Joyce has mentioned. It was not an automated process. And, as I remember, the FOMC meetings were held every four weeks.

MS. ZICKLER. They were held on the first Tuesday after the first Monday of every month.

MR. KICHLINE. Yes. And I thought, "What can I say? What's different this month?" There were periods in which there wasn't a great deal to say that was different from what you said a few weeks prior. It's not clear to me why any principal would have wished to read the Greenbook cover to cover every three or four weeks. It would be a grim process. But it was a historical record on the staff's thinking that was there. Again, I was mainly on the financial side involved in Bluebook issues, as a staff member, rather than on the real side and in inflation and that sort of thing. I am familiar with Joyce's notion of this process—getting to the point where we wanted to upgrade in a substantial way—not necessarily reflecting pressures from the Chairman of the Board, but rather reflecting frustrations on the part of the staff about our ability to make changes and be comfortable with the forecast. And doing it in a way that we felt was the best one could do. That was the goal.

When you got to the mid-1970s, there was a substantial change in the Greenbook from the days when I first arrived in the mid-1960s. That process was producing reams of paper that did not necessarily prove to be anything more than a historical record; the information wasn't being read. That still was the case when I left, because summaries turned out to be important. If somebody had a particular question, they might find additional information buried further back in the Greenbook, but executive summaries were important pieces of information. Board members just got bombarded with tons of material—which now, when I am thoroughly, fully retired, would bore me to tears.

MS. ZICKLER. Larry Slifman would know better the motivation behind making the staff forecast more regular in the mid-to-late 1970s. We also needed to make it internally consistent so that all the pieces hung together, and you weren't just reading the analysis of this person and that person. We needed to have the inflation, labor market, and GDP forecasts internally consistent so that you could easily make changes in the forecast and identify those changes from FOMC to FOMC. Whether or not, at that point, it was as integrated with the financial market conditions as it could have been is still a question, but that evolved later.

MR. SMALL. You mentioned the Bluebook. Did you have a sense of the Bluebook process?

MR. KICHLINE. Early on, when I was in the Banking Section, I was involved in that process.

MR. SMALL. Did you still give the alternatives of tighter, easier, no change?

MR. KICHLINE. I don't remember the details from way back then.

MR. SMALL. As the forecasting became more formal and analytically model based, did the forecast tend to go out farther? Also, did you start doing what we'd now call alternative scenarios—for example, if you wanted to get inflation down, you'd have to raise interest rates a certain way?

MR. KICHLINE. I don't remember what was presented in the Greenbooks on whether the forecasts went out farther. I think we always had a minimum of four full quarters or something like that beyond the quarter in which we were dealing.

MS. ZICKLER. Yes. We had at least four, if not six. But I can't remember whether it was while you were director or when Michael "Mike" Prell was director that we added an additional year sooner than we normally would extend it. As for the alternative simulations, I don't know whether they were part of the Greenbook.

MR. KICHLINE. We didn't publish them in the Greenbook, as I remember. The forecast came out of a judgmental process. But the individual-sector experts did not necessarily do purely judgmental forecasts; some of them had more rigorous modeling as well as the full modeling experience. Once we finalized a forecast, at the senior staff, we did have alternative forecasts, alternative monetary policies, and what the impact would be. Peter Tinsley and his group had been working very strongly on degrees of confidence one might associate with particular forecasts and the policy impacts of the changes in that. So, if not published in the Greenbook except, I think, rarely, they may have been used in chart shows or the more extensive briefings prior to the FOMC meeting that lead up to the Humphrey-Hawkins reports. Those were periods when alternatives were discussed in a greater fashion. But I don't recall a regular process of publishing alternatives in the Greenbook or elsewhere.

MS. ZICKLER. I think we did that during Mike's tenure. We started putting some of the alternative simulations into Part 1. When the Wages, Prices, and Productivity (WPP) Section was created separate from the National Income Section, staff members who were much more comfortable with model-based forecasting started to come in.[5] We hired Rosemary Rainey, who had worked with Joel Popkin on stage-of-processing price modeling. Larry DeMilner was also more comfortable with doing model-based forecasting. In the late 1970s, there was a real shift from truly judgmental forecasting to judgmental forecasts that were informed by various models

[5] From 1977 to 1984, what is now MCR (Macroeconomic Analysis) was two sections—WPP and National Income. From 1984 to 1998, the combined section was called Economic Activity.

not only on inflation, as I just said, but also in the labor market side, with James "Jim" Annable, Susan Vroman, me, and other people who came in during that period. The same thing was happening in the National Income Section on the C [consumption] + I [investment] + G [government purchases] side. The newer staff members were more comfortable and better equipped to start doing that sort of modeling. That transition occurred when you first became division director and then in the years thereafter, when James "Jim" Glassman and David "Dave" Stockton arrived. It was taking advantage of what was happening in the profession at large in studying inflation, productivity, consumption, and investment.

MR. SMALL. So you went from Capital Markets to Banking back to Capital Markets?

MR. KICHLINE. Right. I went back as the chief of the section for a couple of years, and then I was promoted. I became an adviser over Capital Markets and on the financial side of the division. Then Lyle Gramley left for the Administration in 1977 and I was appointed division director. I had grown up on the financial side and was involved in the Greenbook in a variety of ways. I did not devote my time and attention to the real side or the price side, but that changed quickly. [Laughter]

MS. ZICKLER. Your deputy director, Joseph S. "Jerry" Zeisel, was on the other side. Jerry had come up through the National Income Section, and he created the WPP. Jerry was the real-side adviser to the division.

Being Director of the Division of Research and Statistics

MR. SMALL. Was it a shock to all of a sudden be responsible for the whole real-side stuff?

MR. KICHLINE. Yes. The division director of research was held accountable for the forecast on the real side and inflation. Research did that briefing for the FOMC. Research did other things, but that was its FOMC responsibility.

There's a history. Some people can work together well and others less well. One needs to find ways to make productive citizens of a variety of people. You can change structures. The Board was reasonably creative in trying to change positions and to accommodate individuals that were available. When I became division director, the structure was one in which the R&S director briefed the Board or the FOMC on prices, real-side developments, that sort of thing.

MR. SMALL. And Stephen "Steve" Axilrod had his own separate unit.

MR. KICHLINE. Right. He was responsible for the Bluebook and monetary policy. It was a structure in which Steve's resources were largely in R&S. To get something done in his office entailed dependence upon largely, not entirely, folks in R&S. You were one of those. [Laughter]

MR. SMALL. I was in the Banking Section. You were my division director, but everything went to Steve Axilrod.

So when you became division director, what new projects or innovations did you add?

MR. KICHLINE. R&S had a long history of having, on average, high-quality people. It was reasonably well managed. I didn't say, "Gee, this is terribly broken, and it needs to be fixed." It was a matter of trying to nurture over time what we had. In some cases, during budget crunches, you needed to protect what you had. As I look back now, a lot of what was happening was dictated by events. And in the mid-1970s, enough was going on to keep your attention, let's put it that way.

Rise in Inflation

MR. KICHLINE. We had a different experience on the inflation front—one that was largely beyond the experience of most of us, judgmentally. Not a lot of data were cranked into models that could reflect what was going on. This was an outlier in many ways. It was also a period of time when people began to understand that it wasn't just actual, but rather expected events that were important—expected inflation as opposed to actual inflation.

Those kinds of issues were raising their head. As a group, R&S pretty much decided we were on the right track, we just needed to continue to work hard. As Joyce had mentioned, we were coming out of a period where, three or four years earlier, most of this was written down and typed into a spreadsheet or some little grid that one would put together. That was not just on the GDP forecast, but throughout. There were limits to one's ability and the technology available. So, we had been making efforts in that direction. And I think that continued nicely, thank you.

The events of the late 1970s were very demanding for the staff—trying to grab hold of what was happening and understand it. In retrospect, some of it didn't take a lot of understanding. It became clear that monetary policy was much easier than it was intended to be. Good intentions didn't lead to good results, in my view. And so, when you have negative real interest rates for a sustained period of time, bad things often happen. That was the case that persisted in the mid-1970s.

MS. ZICKLER. I looked at transcripts of the special briefings and the memos on inflation. We didn't fully understand why productivity growth slumped. We didn't fully understand the extent to which oil shocks did or did not contribute indirectly to what we now call core inflation. I had to write down a 9 or 10 percent unemployment rate in the forecast, which had never happened before in recent memory. It was a lot of work. There was a lot of uncertainty and a lot to sort out. Now, with hindsight, folks can analyze a lot of what happened and can provide some of the answers.

We had an ongoing debate with Lyle Gramley about the timing of the 1975 recession or the peak before the recession. And he was involved in a debate about what trend productivity we ought to write down in the forecast.

MR. SMALL. Writing down NAIRUs (non-accelerating inflation rate of unemployment)?

MS. ZICKLER. Oh, yes, that was another one. Chairman Burns had spent a lot of time talking about structural changes in the labor market. I was heavily involved in that, but then we were moving into what potential output was and what a NAIRU was, as we now call it, and how that was related to inflation. You look at the literature at the time, and all those issues were being debated among those in the profession. We were just as involved, but we had to make forecasts for the FOMC. We couldn't just do academic papers.

MR. SMALL. What caused inflation to rise? What were the perceived costs of inflation? Did policymakers think of inflation as costly or undermining long-term economic performance? Greenspan and Volcker talked about price stability as being when people don't have to incorporate inflation into their planning. What were the perceptions about the cost of inflation relative to recessions and the values placed on that tradeoff—not the technology or the economy underneath, but the preferences?

MR. KICHLINE. Throughout my time at the Board, policymakers held a strong view that inflation was costly. What you get involved with, and you still do today, is the issue of moderating various problems that arise. Some of those problems relate to recessions, for example. Some of those problems relate to financial stresses and strains. But beneath it all, there was this clear sense that containing inflation is an overriding responsibility of the monetary authority.

Arthur Burns had a great fear of inflation. He once told me that he was invited to his son's first-grade parents day. He tried to instruct the children in that class about the dangers of inflation. Now, that's a man who takes inflation seriously. [Laughter]

During his chairmanship, Burns gave a number of speeches and testimonies that dated the rise in inflation from the mid-1960s and the Vietnam War, loose fiscal policy, and structural issues, as Joyce mentioned. The Davis Bacon Act of 1931 constrained wages and prices. Burns had a list of 25 or 30 things that you could go through. Inflation was tantamount to the enemy in his thinking. But translating that into an acceptable policy among your colleagues and convincing people that it is the "right" policy to achieve your objectives is a different matter when you don't quite understand all of the things that are happening currently.

One thing that was and is still absolutely critical is the lag in the effects of monetary policy. Forecasting, in part, was always done with conditional forecasts of explicit policy assumptions for monetary policy and fiscal policy, as well as other things deemed to be important. And when that is said and done, one has to have a clear notion of how a change in policy could influence the economy over time.

MS. ZICKLER. Early on, wasn't Henry Wallich also really hardcore on fighting inflation?

MR. KICHLINE. Yes, very much so.

MR. SMALL. Some might say that if the Fed and its staff had better understood the economy or inflation process, we wouldn't have had the problem of rising inflation. But even if there had been a better understanding, there were external constraints: the public's tolerance for recession, political pressures from the Congress, and working with or against the Administration. Do you have a sense of how these external constraints were perceived and how they might have limited policy, if at all?

MR. KICHLINE. I have a sense of those constraints. I don't know the extent to which they would necessarily have been major influences on policymakers in the way they were willing to ultimately come to a policy decision. There was President Ford's WIN (Whip Inflation Now) Campaign around 1974, 1975.[6] By then, we already had a few years of inflation that were problematic. During the 1973–75 period, lots of bad things were happening in the economy. We had the aftermath of the oil crisis in 1973. There was a major downturn in financial markets; the stock market and economic activity plunged. During a period of time when you have a significant recession in your midst, it is hard to say that you're coming out of that and you don't like the inflation rate, so let's do something now.

I hate to think of bringing this to you, and I won't say anything more than this today, but to the year 2007, I think the current Chairman is inheriting problems that didn't occur yesterday. There are lags and things that, when you look back, you say, "Maybe I should have done something differently." In the context of the disruptions in the 1973–75 period, it was difficult to say, "Now we need to really do something and move aggressively to get the rate of inflation back to an acceptable level." By the time you get to 1979 [and] '80, the constraints were quite severe in bankruptcies. R&S used to get letters that were being almost trucked in from small business owners who were irate and those that were suffering serious damage.

MS. ZICKLER. Was that the housing?

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[6] WIN was an attempt to spur a grassroots movement to combat inflation, encouraging personal savings and disciplined spending habits in combination with public measures, urged by President Ford.

MR. KICHLINE. The homebuilders mailed bricks, 2x4s, and other things. On occasion, there were protests outside the Federal Reserve building. Just getting to work was an interesting adventure. Those issues didn't result in a change in the way policy was adopted, but they had to be in the back of one's mind about what was really necessary and not overdoing it or underdoing it.

MR. SMALL. Do you think the first OPEC shock threw people off, in the sense that, in coming out of it, inflation would come down because it was just an oil price–related episode? I'm trying to connect back to your sense of how inflation depended on expectations and how that shock might have changed dynamics in a way that weren't perceived at the time.

MR. KICHLINE. I think that's quite correct.

MS. ZICKLER. It was a readily identified event, and you could ask how much of the productivity slump, how much of the run-up in prices was just simply that and not inflation expectations or some more underlying policy factors—fiscal and monetary.

MR. SMALL. So, if you just waited.

MS. ZICKLER. Well, it was part of the debate. Remember, at the time, they were debating the Humphrey-Hawkins legislation. So, in the political realm, there was the dual-mandate issue. You weren't going to have a Humphrey-Hawkins Act, because that didn't have the dual mandate. And some people read the dual mandate as getting unemployment back down to whatever level. Was it 5? Was it 4½? That was a big political debate.

MR. SMALL. Was there a lot of debate within the Board about the level of NAIRU?

MR. KICHLINE. Yes. [Laughter]

Chairman Miller

MR. SMALL. Did you know Chairman Miller's views on either the costs or the cures of inflation or how he approached the problem?

MR. KICHLINE. His view was that of a businessman, not an economist. His views were framed by a business environment. On the positive side, his view would be one that the extent to which you had high and variable rates of inflation—say, that interrupted business planning—he would understand those sorts of things and would focus on that kind of question or those aspects of it. He would come to a conclusion on the costs of inflation that, I think, would be shared by many.

On the other hand, he also had a perspective that higher rates of interest would dampen business investment that he perceived to be critically important in his view of the world—business investment would affect productivity, so you would want to encourage additional business investment. He's not here to speak for himself, but my view would be that he perceived rising interest rates to be a bad thing. That was a period where interest rates or the federal funds were on the rise, but if one could take that period back, he might say, "The FOMC was a little slow in adopting policies that might have been much more restrictive in giving us better outcomes from 1979 to 1983." That's a guess.

As Joyce had mentioned, the staff was struggling with some of these same issues about what was going on. There was a staff study on demand for money—for example, why, in looking at what was happening, did we get it wrong? Lower or slower growth rates of money didn't result in as necessarily restrictive policy as you might have thought. And there was the substitution out of money into other instruments.

Dave, as you mentioned earlier, it was a period with high interest rates giving you a lot of impetus to a broader acceptance of money market funds and mutual funds generally, not just the banks offering new instruments that would pay a little bit more. So perhaps you were getting, in a real-time way, a misread from the data because you were a little slow in interpreting that things were changing. I think that was an honest appraisal across the board and certainly was not something that was restricted to the Federal Reserve. It applied to the economics profession at large. This was a pretty dynamic period.

MR. SMALL. How would you contrast working closely, one-on-one, with Chairman Burns and Chairman Miller, discussing an issue?

MR. KICHLINE. The public persona of Arthur Burns was different from reality, in my view. Arthur Burns had a greater degree of interest in some of these issues and would delve deeply and ask questions that might push staff members. That was useful, because the staff did better work rather than poorer work. The fact that he was not willing to take sloppy thinking as acceptable was a real plus, in my view.

Chairman Miller was much more of a delegator on some of the technical issues. He did not necessarily have the expertise. He didn't especially wish to get involved. In my case, where an issue arose, if he felt comfortable, he would just assign it to me: "Go do it." He was much more in a business mode, a kind of manager who would attempt to get some people around him and delegate.

MR. SMALL. Paul Volcker said that Chairman Miller was very successful and helpful in dealing with the Congress in legislative matters such as the Monetary Control Act of 1980.

MR. KICHLINE. That would have been more when he was at Treasury than his stay at the Federal Reserve. I really can't comment.

FOMC Meetings

MR. SMALL. What were FOMC meetings like under Burns, Miller, and Volcker? Was it unusual for a member to dissent?

MR. KICHLINE. The FOMC meetings were run differently. [Laughter] Chairman Miller did not want to prolong the meetings. He wanted to move things along. He wanted a prompt business meeting, so to speak.

Dissents were unusual, as indicated by the record. But dissenters made their points of view known. Under Chairman Burns, there were some dissents, but they came in cases where Board members or presidents felt very strongly in the opposite fashion. None of the Chairmen, including Paul Volcker, relished having folks dissent from a majority decision. In the FOMC framework, a dissent should only occur when the dissenter feels strongly about the position he or she has taken and that position should be clearly described. Paul Volcker felt strongly about dissenting in his position as the president of the New York Fed and member of the FOMC. That didn't occur frequently. They weren't always pleasant times, either.

MR. SMALL. During the first half of 1979, before Volcker came on board as Chairman, how was the Fed handling the shocks on the economy? What was the internal view of where we were and how well we were doing?

MR. KICHLINE. There was an internal view that we didn't fully understand everything that was happening. It was clear that we didn't like the outcomes—the collapse in productivity being one. There were lots of things happening on the real side and, ultimately, inflation, which were not very attractive. As a staff, you can chitchat about policy decisions, but it wasn't the staff's function to sit around questioning FOMC decisions. You had a lot on your plate in providing principals with what you thought was the best information.

MS. ZICKLER. You can take a look at these two or three years in GDP growth rates that went all over the map. This was not the period of moderating economic activity. [Laughter] There was a lot happening from quarter to quarter.

One thing that you didn't talk about during this period is the relationship of fiscal policy and monetary policy. You were a Charlie Schultze student. Fiscal policy, government stabilization policy was a big thing coming out of the 1960s and in the early 1970s. And then, controlling budget deficits gradually became the big issue. I remember occasions where the staff had to be careful about criticizing fiscal policy, when we were doing special studies and writing papers and *Federal Reserve Bulletin* articles that were published regularly.

MR. KICHLINE. Often, highly sensitive issues were addressed using "Fedspeak." I don't know whether it's still referred to as Federal Reserve speak.[7] But that's clearly important. At the time, the Carter Administration always promised that fiscal policy was going to be improved, that the structural deficit would be cut, and things are going to be better, but that never quite materialized. So we would make assumptions about fiscal policy that would prove not to be correct. Over time, my view was that trying to change fiscal policy to influence economic activity was not very productive. It happens either in the wrong amount or with the wrong timing or in ways that are not meaningful.

MS. ZICKLER. Coming out of the 1975 recession, these countercyclical stabilization policies were still being discussed. And, of course, the timing was off for that investment tax credit or whatever it was.

MR. KICHLINE. Right. I actually loved that stuff but just lost the faith. [Laughter]

[7] The notion of Fedspeak originated from the fact that financial markets placed a heavy value on the statements made by Federal Reserve Governors, which could in turn lead to a self-fulfilling prophecy. To prevent such an occurrence from happening, the Governors developed a language, termed Fedspeak, in which ambiguous and cautious statements were made to purposefully obscure and detract meaning from the statement.

MR. SMALL. When Paul Volcker became the Fed Chairman in August 1979, he quickly took strong, decisive action. Leading up to that, do you think the Board staff and the other Board members, through 1979 or even 1978, were starting to see that things were progressively getting more dangerous—the fall of the dollar, increased inflation—or was that more particular to Volcker?

MR. KICHLINE. I would concur with the way Joyce expressed it. We were looking at a process over time. There was a great deal of volatility in the economy. There were all of these small problems, either policy or fiscal policy issues. The Congress was part of the mixture of coloring the flavor of the times. And there was an understanding that, despite having as its major mandate influencing the rate of inflation, or keeping inflation low, inflation rates were in the 10 percent area, and clearly the objective was not being achieved.

By the time Paul Volcker became Chairman, there was a great deal of frustration among many that something more had to be done, because there was a history here of what appeared to be an accelerating trend rate of inflation. So the timing was right. There were also members of the FOMC and others who were ready to adopt something different. This was in the context of seeing that progress was not being made, and a great deal of time had elapsed. The data show that inflation inexorably was creeping higher over an extended time period.

MR. SMALL. Over this period, inflation and then nominal interest rates marched up together, reflecting your earlier point that real rates were low and pretty stably low until the Volcker era, when real rates jumped.

MS. ZICKLER. Around that time, too, in the profession at large, Thomas J. Sargent's rational expectations view started to become discussed more—whether or not policy and behaviors had an expectations component. I can't remember exactly when he started publishing that.

October 1979 Change in Operating Procedures and Fighting Inflation

MR. SMALL. Do you remember what led up to the October 6 new operating procedures? Was work going on before October 6? Did Volcker have the staff involved in background studies or preparations for the change in procedures?

MR. KICHLINE. A lot of that was being done through Steve Axilrod and his operation and out of the Banking Section in R&S. That was an important period. I was doing other things. I remember that time reasonably well, but there are things I don't recall.

MR. SMALL. How did the change in operating procedures affect your forecasting ability, in pegging everything off of the monetary aggregates and letting interest rates go where they may? Did this make the Greenbook process particularly difficult?

MR. KICHLINE. Very much so. We could frame monetary policy in terms of growth rates in some monetary variable, but ultimately what affected people's decisionmaking and economic activity was the resulting interest rates, and particularly real interest rates. One did not have a reliable way to forecast likely outcomes using past judgmental approaches. The range of uncertainty associated with any given forecast was much larger compared with earlier. That applied to the formal econometric models as well. Moreover, the way in which expectations altered the behavior of market participants was a further source of uncertainty. So, overall, it was a rather demanding period.

MR. SMALL. Was part of the problem in forecasting interest rates financial innovation that was going on, affecting money demand? The link between money and the interest rates was thrown off with innovations and new products.

MR. KICHLINE. It was. In some sense, you're talking about an unstable money demand function. And we were adding new elements to the mix. That's part of it. We had gone well into double-digit interest rates on the short end of the curve and had a steeply inverted yield curve. There were many financial institutions and others making bets that, through the traditional expectations hypothesis, an inverted yield curve portended a fall in interest rates. But, indeed, what happened is the entire yield curve remained inverted and marched ever higher. With that came additional financial stresses and strains.

MR. SMALL. Do you remember any surprises of how long rates did or didn't react early on? One could think that if a program was credible, long rates could decline, because expected inflation declined. Was there surprise amongst the staff or between the Chairman and the markets about what they thought would have happened?

MR. KICHLINE. I don't remember.

MR. SMALL. In the early 1980s, President Carter authorized credit controls under the Credit Control Act. They had a significant impact on credit and the economy. What do you recall?

MR. KICHLINE. Well, the R&S staff expanded with that. It was part of the deal here. Eleanor Stockwell was actively involved. It took a good deal of time and effort to set up a whole program and monitor it. The end result was designed to impede the ready availability of credit. I think it was a contributing force to the ultimate downturn. I don't think it was by any means more than trying to demonstrate to the outside world that people cared and were serious about this. But, in some cases, it really proved to be an impediment to borrowers. And that was as intended.

MR. SMALL. During this period, 2x4s were sent to the Fed, demonstrations were held in front of the Fed buildings, and people cut up their credit cards and sent them to the White House and the Fed.

MR. KICHLINE. It was all of the above and even more. The Fed received an incredible volume of mail, and the views expressed were intense. A number of folks ran businesses that were on the edge of bankruptcy, so one could empathize.

MR. SMALL. How would you describe your personal stress level, given your responsibilities and the uncertainties about where the economy was going?

MR. KICHLINE. I expressed to a principal once that I felt I should get more than one day's credit of retirement for one day of this kind of work. It was just long days, but people were serious.

MS. ZICKLER. I was in the lower trenches with the economic forecasters, but people from the Special Studies Section, the ongoing forecast sections, and Axilrod's office were all engaged. It was a big deal. I was on the nonfinancial forecasting side. I don't know that we had strong views about right or wrong. We knew this was an important decision, and we had to work hard, like Jim said, to sort out the nonfinancial forecast—the inflation, GDP, and unemployment forecasts. I don't know what was happening on the financial side, but I got the impression there were a lot of people working nights and weekends.

MR. KICHLINE. All the way around, it was just an intense environment.

MR. SMALL. This was painful to the economy. Do you think it took a longer or a shorter period of time to bring inflation down than you expected? Were there questions about whether the anti-inflation program was going to succeed, whether you were going to go through this for any real substantial benefit?

MR. KICHLINE. I don't remember any questions about whether efforts to control inflation would be successful if you hung in there. I think that wasn't as much the question. It was, perhaps, on the part of some, framed the other way around, whether or not you could stay the course—that is, could you take the pressure. You have to keep in mind that there was also a presidential election coming up. While that didn't influence policy directly, let's be candid, some folks took notice.

I don't think the costs were understated by any stretch of the imagination. It was all a matter of uncertainty about how much it was going to take, and for how long, to bring down the rate of inflation to a level that one deemed to be acceptable. In the end, the NAIRU (non-accelerating inflation rate of unemployment) concept—or the notion that you don't get inflationary pressures when you are running with monetary growth that may be perceived as relatively high if it's occurring in a world in which there's a huge amount of slack resources—was not where we were starting. The problem was, you had high rates of unemployment, very high rates of inflation, and confusion about how long the disinflation process was going to take, even though you had, at the time, the view that there was a good deal of slack in the economy in that recession. It's just the persistence of some things that had built up over a period of time. So it was longer than one might have liked to work its way out of the system.

MR. SMALL. Was Chairman Volcker deeply involved in the details of figuring out the economy and the forecast and where it was going?

MR. KICHLINE. He didn't get involved in the details. On occasion, he would question something if he didn't like the outcome, but he didn't try to influence the staff. At a broader level, he had his own views about what may evolve and where the staff may be wrong.

MS. ZICKLER. I remember that we brought an inflation forecast to you indicating that we thought things might turn out better than the FOMC did. The FOMC was still pretty skeptical about how fast inflation could come down. It was when David Stockton was doing the price forecasts.

MR. KICHLINE. That was probably in 1982 or so.

MS. ZICKLER. There was a lot of uncertainty about what the NAIRU was. We knew there was a lot of slack, because a 10 percent unemployment rate was a 10 percent unemployment rate. Nobody thought the NAIRU was that high.

MR. SMALL. During this period, did you assist Governors with speeches and help them communicate to the public the policy and the commitment to bring down inflation?

MR. KICHLINE. Yes, R&S provided a good deal of assistance. It was not always viewed as a fun chore to draft speeches, but that was a normal part of the function. Joyce, you may have done a number of those along the way. I was broadly involved in many.

Historically and continuing on, the Federal Reserve has always been asking how much information to provide and when and in what fashion. Is it in some carefully guarded Federal Reserve speak, as we used to refer to it, or is it in simple English and done promptly? That has been an issue that continues on even today. At the time, events began to force one to provide a bit more information, because you can view it as helpful in the implementation of policy but also helpful if you tried to encourage a set of expectations on the part of the public about where we were going.

So this information came out in public speeches and changes in the way information was slowly coming out of FOMC deliberations or in reports to the Congress, such as the Humphrey-Hawkins reports. All of those kinds of things led to more information being provided in a more timely fashion and probably more understandable than used to be the case. In spite of all its efforts, in lots of ways, the Federal Reserve was never a great messenger of clarity. The Fed was precise, but if you wished to understand what the Fed was doing, it just never got an A.

MS. ZICKLER. A lot of people worked hard, particularly on the *Monetary Policy Report*s and the testimonies. Joe Coyne, the Public Affairs liaison, was always a good sounding board for how we were saying something and whether what was being said was clear and could be understood. He was a great help.

MR. SMALL. Was writing the *Monetary Policy Report*s and the Chairman's testimony particularly difficult during this period?

MR. KICHLINE. I don't think so.

MR. SMALL. What was the relation with the Congress like at that time?

MR. KICHLINE. I used to spend a good deal of time on the Hill accompanying the Chairman and others when they gave testimony. There were a number of issues involving the Administration that caused stress and differing views, but not so much with the Congress. The congressional hearings weren't always a search for truth and information, but rather for showcasing a particular viewpoint of members of the Congress on any given issue. I'm not sure that has changed. It's Washington.

MR. SMALL. Did you have much interaction with congressional staff?

MR. KICHLINE. Yes—with the staffs of the banking committees, but not outside of those committees.

MR. SMALL. Did you get a sense that the banking committee staff understood the new policy and why it was needed?

MR. KICHLINE. Yes, I think so. There was recognition that the U.S. economy was on the wrong course and that we weren't making progress. So my impression is that there was a great deal of support to do something different.

MR. SMALL. Did you have much interaction over the years with the members of the Council of Economic Advisers?

MR. KICHLINE. I had interaction with some members over the years—Lyle Gramley, Charles L. Schultze, and William D. "Bill" Nordhaus—but not a great deal of interaction.

MS. ZICKLER. Did you have lunches with Treasury staff?

MR. KICHLINE. Yes, we had lunch every Wednesday.

MR. SMALL. At some point you must have felt that the Fed policy was working: Inflation came down, success was achieved, and Volcker's place in history was solidified.

MR. KICHLINE. I was never working for Volcker's place in history. [Laughter] But, by the second half of 1982, it was clear to us that inflation was coming down. Then it was a question of when the recovery might start; that was being actively debated. By the second half of 1982, the staff had a sense of who was winning the war, and that maybe this war was almost over.

MR. SMALL. On the political side, you certainly put the first Reagan Administration through some stress early on.

MR. KICHLINE. Well, true. At the same time, the Reagan Administration adopted fiscal policies that were of interest. A number of its economists were of the so-called supply-side ilk, with the view that this magic elixir always worked, there were no consequences from deficits, and the government could do no evil in borrowing. That was a time when there were a number of tax cuts coming up, and we moved on with no spending restraint other than the veto power of the President on the spending side. So we had large secular structural deficits at work and differing views on whether or not deficits mattered.

MR. SMALL. I presume that when some of those tax cuts were proposed or contemplated, the Board staff would make projections of the full impact of the tax cuts on the deficit, whether it would go up or down.

MR. KICHLINE. Right.

MR. SMALL. Did you share these views with the Treasury? Were you at loggerheads?

MR. KICHLINE. We were not at loggerheads. We weren't arguing whether or not tax cuts were desirable. I guess a recent Chairman has made some comment about having not been sorry that he said that 2000 or 2001 was the perfect time for a tax cut. It really wasn't that. As Joyce noted, we had been putting a lot more emphasis on sorting out the full employment surplus or deficit. I think we did good work on that. And that was one of our ways of judging the ease or restrictiveness of fiscal policy that was conditioning the economic forecast. We shared those numbers with senior staff, or I had a discussion with senior staff of OMB and Treasury. But those things really didn't matter to someone with a strongly held view that, if you cut taxes sufficiently, the economy will grow strongly, government revenues will rise to an even greater degree, and amazing things happen with regard to the economy. If you're of the view that you will be generating additional revenues forever and they're going to be immense, the work we were doing, as well as the NAIRU stuff, was totally irrelevant to those with that viewpoint. So much of the way we had developed thinking about the economy over time, and working towards improving our understanding of issues, was perceived as incorrect or perceived as irrelevant by various parties outside the Federal Reserve.

MS. ZICKLER. During that period of time, the Congressional Budget Office (CBO) proved beneficial. Right after I started, the CBO was formed. A number of Board staff members actually went over to the CBO. I think, at the outset, Frank De Leeuw may have been one of them. Over the years, as the CBO received attention and prominence for its research and its budget estimates, we had a collegial relationship with the office. So we weren't out there fighting about what the fiscal impact of something was going to be on budget deficits or fiscal policy. We had an independent CBO, and our fiscal people had a very good relationship with the CBO and the Joint Committee on Taxation on estimating fiscal effects. We were doing our own research on high-employment budget deficits as well. We weren't the only one in Washington talking about fiscal issues. We had lots of help.

Fed Independence

MR. SMALL. It's often stated that the Federal Reserve is not independent of the government, it is independent within the government. What are your views on the independence of the Fed and how that's changed over the years?

MR. KICHLINE. Has it really changed? I don't know that the issue is any different today than it was 30 or 40 years ago. The Fed's independence has been protected when under siege. I don't know that I have any particular insight.

Board Responsibility for Banking Supervision and Regulation

MR. SMALL. There is an issue of whether the bank regulation function should be housed in the same institution that the monetary policy function is housed, and whether there's some cross-fertilization there. Now, maybe there's not any cross-fertilization in forecasting, but maybe in other areas such as payments, risk, and contagion in the financial markets. In your work, was that cross-fertilization helpful even if it happened in other parts of the Board?

MR. KICHLINE. In my experience, I don't think there has been a great deal of cross-fertilization. One might argue perhaps that, out of the regulatory side, you had special input into what was happening at banks during key periods of time, but that information was also gleaned from sources independent of the bank supervisors and regulatory process. And one did not see that supervision and regulation process being used as an adjunct to monetary policy at that time.

Life after the Board

MR. SMALL. Where did you work when you left the Board in 1987?

MR. KICHLINE. It was a partnership, an investment advisory firm—Miller, Anderson and Sherrerd. It was located a few miles from here. Then I retired in 1996, and we sold our firm to Morgan Stanley.

MR. SMALL. When you made the transition from here to the investment company, did the Fed look different than it had from the inside?

MR. KICHLINE. During that time period, on average, the Fed was getting rave reviews in the financial community. Volcker's actions to break the back of inflation were handled well. It was early in Alan Greenspan's chairmanship, so there was a question mark about how that was going to work out, but there was no reason to suspect it wouldn't work out just fine. Alan Greenspan was an older hand that had been around and was known. Among many financial folks, the Fed was given high marks, and I think that has continued to be the case. Now, on any individual policy issue, there are questions about why did the Fed do this or didn't do that, and you received differing views. But the experience, coming off the Volcker period, has been a positive one that hung on.

As I said before, the Fed's communication with the public and even financial professionals was unnecessarily complicated. You shouldn't need to have an advanced degree in economics or finance or to spend a great deal of time reading FOMC minutes to figure out what they're up to. There are simple ways—using declarative English sentences—to say what you want to say and be done with it. And I think markets tend to help you out, understanding what's going on. Even under this post–Paul Volcker period, there continues to be this same sort of Fed thing. It's much better today than it was, but it persists. That complicates the Fed's communicating with a broader cast of folks. Many people, if they know about the Federal Reserve Board, might know about the Chairman, but they don't necessarily have a clear understanding that there are six other Board members when all the seats are filled. And they don't know about the Reserve Banks and the whole structure of the Federal Reserve System. But there's no need for that. Why would one wish to get engaged in that detail?

MR. SMALL. When you were in the private markets, did you have a sense that when you were on the inside writing it, it seems clear—declarative sentences—but then from the outside it was less so?

MR. KICHLINE. In my case, I had been writing that sort of stuff for more than 20 years, after having had courses in writing in college that I thought were very well done, and then having the editors at the Federal Reserve tell you that you can't write in your first *Federal Reserve Bulletin* article. Eventually, you learn how to write in Federal Reserve style. And if you've been there a number of years and have done a lot of writing, you probably do it pretty well. But that is a very different animal than what folks write in the business world. I think if you were to expose Federal Reserve writing to many, it'd be a big yawn. Are they trying to tell me something? Because it's really subtle on occasion.

MR. SMALL. At the time, you must have thought you were writing clearly.

MR. KICHLINE. Sure.

MR. SMALL. In the past, the Fed didn't announce its interventions in markets and its target rates. The Fed would convey that through its operations and let the dealers figure it out. Now the Fed seems to have gone to the other extreme of communications, with transcripts, media statements, and the minutes of the FOMC meeting, explicit inflation targets, and talking about its current setting of the funds rates and how that path might change over time. Communications has evolved tremendously. But during your time here, people must have still thought they were writing clearly and precisely.

MR. KICHLINE. Well, they did, yes. I didn't say unclear. But it's a subtle form of writing. And you certainly can appreciate that. You wanted to be clear and not misleading, but, at the same time, in the event that contingencies arise, you wanted to have those covered. So it probably takes a great deal—especially if you're not used to it—more time and effort to write in that fashion than to just simply jot something down that's accurate and let it go.

MR. SMALL. What do you think of the subprime mortgages crisis? How do you think the structure of conducting policy has changed with globalization and the growth of markets? Does this place policy in a really different position?

MR. KICHLINE. Yes, I think it has been helped in many ways. And the development of financial markets has been useful for new instruments. Globalization and the integration of markets in many ways are clearly helpful. But even when evolving in this attractive fashion, markets tend to repeat past mistakes. The individual players of markets don't necessarily learn well from past mistakes, or you get new players with the view that—as the phrase goes on Wall Street—"It's different this time. I'll figure it out." It's always different this time. The asset class may be different, the Ponzi schemes may be different, but it's always "I know that it's different this time." And that goes for respectable central bankers who say that this time it's different. Often it is different in some way, but there are lessons to be learned from the past. And financial institutions, not just rogue individuals, are involved in this. There may be rogue individuals in financial institutions, but all put together, it's extraordinary. There is that classic book *Extraordinary Popular Delusions and the Madness of Crowds,* by Charles Mackay. There's a long history. You can go way back to the tulip market in the 17th or 16th century or pre-B.C. times and find similar scams at work.

MR. SMALL. There almost seems to be a danger of "mission creep" for the Fed: Why doesn't the Fed get involved in this market regulating that or supervising this? Do you have a sense of what you would think is the Fed's proper role in supervision and regulation in this world where there's an ever-increasing number of instruments where things can go wrong and it will reflect badly back on the Fed? Why wasn't the Fed more diligent? Do you think that the Fed should focus only on the depository institutions, or is there a payment system component? Is there a role for it further on?

MR. KICHLINE. No, I don't think there's a role for it further on. I think that does spread the Fed too thin, and it is unnecessary. The Fed needs to have a seat at the table to fully understand what the regulations are, be able to talk about that, but one could clearly argue that it need be the sole regulator.

MR. SMALL. What are your current views about inflation targeting by the Fed?

MR. KICHLINE. My focus on the Fed and financial matters now is only to mind my own portfolios, and I don't need to worry about that.

MR. SMALL. Thank you.