A Conversation with Tom Barkin, Federal Reserve Bank of Richmond President
Given on February 20, 2020, this discussion between Tom Barkin and M-RCBG Senior Fellow Megan Greene was as part of the Mossavar-Rahmani Center for Business and Government at the Harvard Kennedy School's weekly Business and Government Seminar Series.

Speaker 1:

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Scott Leland:

Okay. Good afternoon everyone. Thank you for coming. My name is Scott Leland. I'm the executive director of the Mossavar-Rahmani Center for Business and Government. We're delighted that you're here. We're obviously filming this event. And just a quick note, when we do go to Q and A towards the end of the event, even though this is a relatively small room and the acoustics are good, we are going to pass around microphones, so we would request that you use that so that your question can be captured in the audio. If you do not want to appear on film, obviously don't ask a question. We're only going to be getting the backs of people's heads, but if you have any objections to that, please do move to the side. You can drag a chair up into one of the alcoves.

Scott Leland:

I am going to introduce Megan Greene and she will introduce Tom Barkin. Megan is a senior fellow here at the Mossavar-Rahmani Center for Business and Government. She is a well known macro-economist, frequently appears on Bloomberg and other media outlets. You may have seen her on TV or cable. She is the former chief economist at ...

Megan Greene:

John Hancock Manulife.

Scott Leland:

Thank you. For 15 years she's been a source for media outlets and for people who are seeking policy advice all around the world. So with no further ado, I'll turn it over to Megan so that you can go from here.

Megan Greene:

Great. Thanks Scott. Thanks for that introduction and thanks to Tom Barkin for coming to talk to us. Tom is a president of the Richmond Fed, so one of the presidents in the Federal Reserve System is one of the newer members of the Federal Reserve System in a senior position at least, and comes from McKinsey as well, so has a different perspective than all the PhD economist nerds at the Red, which is really helpful I think in trying to figure out what's going on today. I'm just going to moderate kind of a Q and A session with Tom for about 30 minutes and then I'll open it up to all of you for your questions, so please be thinking of them while we're talking.

Megan Greene:

The Fed last came out with forecasts in December, but it's been a real humdinger of a year so far, so I'm curious to hear kind of how your views may have changed since you last submitted your forecast to the Fed.

Tom Barkin:

So actually here's the good news. The economy continues to move along in a very good, at a very good pace. 70% of the economy is consumer spending and consumers continue to spend. As long people have jobs and real wages continue to increase, and consumers have confidence and then they'll continue to spend and that keeps the economy in a good place.

Tom Barkin:

On the business investment side, it was weakish last year, and so I for one am hopeful that with reduced uncertainty in places like trade, places like geopolitics that you might actually start to see some recovery in business investment. Obviously, all of this is subject to one big unknown, which you'll read about in the papers, which is Coronavirus is a new thing that wasn't in the world when we were talking about it before. I think it's early to say on that, but that's something I'm watching closely.

Megan Greene:

Okay, thanks. You spend a lot of time going around and talking to businesses in your district. I'm curious to hear what they're saying. What they're saying about finding people to work actually, cause you talk about the strength of the labor market, but a lot of businesses would be complaining they can't find people to hire. Are you finding that that's still happening? What kind of workers are they having trouble finding and what are they doing about it?

Tom Barkin:

I think hiring is very tight, and it's particularly tight at what I'll call entry level. I think service employees at banks or at retail stores or at restaurants, think nurses, think IT and technology, certainly data scientists, construction is another place that's very tight. You do see a lot of innovation going on in those places. Some of it is classic. A bunch of major employers of banks, retailers have increased their entry level wages. There's a big bank in the Southeast that's up to $20. A lot of the big retailers are up to $15.

Tom Barkin:

But you also see a lot of people investing in stuff I'll call non-wage efforts to recruit people. Some of it is intensity of search efforts, but I was in a plant the other day that the manufacturer said they air conditioned because the best way they could keep workers was actually to have an air conditioned plant, and so it doesn't show up in wages, but it does show up in your ability to recruit and retain people.

Megan Greene:

Okay, and what about retooling education skills? Is that coming up much or not really?

Tom Barkin:

There's a lot of businesses that are doing partnerships with places like community colleges to try to invest in things like certificate programs to get people into particular jobs. I spent, our district for those who don't know, goes South Carolina through Maryland. It has a lot of small towns and rural areas, and in those places there are actually a lot of people out of work. Manufacturers in those areas are actually pretty interested in how do we get people off the sidelines and into the labor force. One of the things I do think that works very well in Greenville for example, where they've got a lot of pharma operations, they've actually partnered with the pharma companies in Greenville, North Carolina have partnered with a community college there to come up with a six, nine-week certificate program that teaches people to do pharma manufacturing. That's one very good way to get folks trained and tracked into those jobs.

Megan Greene:

Yeah. While we're talking about the labor market, I mean you say the labor market's been strong and that real wages have increased, but I think the perception out there is that affordability hasn't improved. In act, it's gone in the opposite direction. How do you guys kind of reconcile those, those two sides of the coin?

Tom Barkin:

What do you mean by affordability?

Megan Greene:

A household of four people, two adults and two kids used to be able to get by on a certain amount of money, now that money actually doesn't get them through the year, even though real wages have increased. Is that perception wrong do you think? I mean there is a feeling that it's been a recovery, but whose recovery has it really been? How is the Fed thinking about that sort of thing?

Tom Barkin:

Well, a couple of things that might be good news against that. One is if you look at wage increases overall last 12 months, it's about a 3-3.1%. If you divide that into the entry level workers versus more established workers, the entry level are actually getting much more towards 4.5%, and the established or more in the 2.5% range and it's a weighted average. I do think you're seeing that happen. I also think you're seeing people come in off the sidelines. Unemployment in historically disadvantaged communities is at all time lows in many of those cases. I do think there's more and more people with jobs.

Tom Barkin:

Affordability is a hard thing to measure. We try it with inflation and there are lots of questions about whether those inflation metrics measure the right numbers for everybody. I would add it's very different in my city. We've got some researchers who did a piece recently on affordability in our bigger cities. In San Francisco and Boston for example, it probably doesn't feel affordable at all.

Megan Greene:

Not really.

Tom Barkin:

But in Richmond where I live, it's quite affordable. For those of you who are interested, we're hiring. I'll just say one of the things our researchers worked on was the question of ... There's a lot of talk now about talent going to talent meccas and everyone aggregating and congregating in just a small set of places. Basic economics would suggest eventually those places will get expensive enough that people want to live in other places and technology today lets you live anywhere. I really do agree with the work done by our guys who suggest that there's a bunch of other cities, they mentioned Austin, Nashville, where people will start to live in part for these affordability reasons.

Megan Greene:

Okay. What are CEOs and businesses telling you about investment? You said you're actually somewhat optimistic about investment. What were they telling you before the coronavirus and what are they telling you now?

Tom Barkin:

Every time I do a business round table, I ask at the end tell me how your company's business is. Is it great? Is it good? Is it okay? Is it weak? It's two thirds good and a sixth great and a sixth okay. Then I'll ask them, are you going to be investing more or less or the same next year? Again, about half will say they're investing more and about half will say they're investing the same, and nobody is cutting back. Then I say, how do you feel about the U S economy? They go, we're going to have a recession almost any minute. Now those two things don't square. But I do think, and you could see it in the business surveys, the difference between how I feel about my own business and how I feel about the economy is a big, big ... There's a big gap between those two. Duke does a CFO survey that's pretty interesting that would show that.

Tom Barkin:

Last year people's businesses were still going well. But I think there was a lot of uncertainty in the air. You could call it regulatory uncertainty, you call it political uncertainty, for sure you could call it trade and tariff uncertainty. There's a Saudi oil refinery bombing. In January, we had a situation with Iran. There's a lot of stuff that went on last year that I think made businesses say, I'm not ready to cut back yet. My business is still good. I'm not cutting back, but I don't think I'm quite ready to double down.

Megan Greene:

Yeah.

Tom Barkin:

I don't think that's changed. I hear the same thing today, but I think it could change. What I mean by that is a lot of the big uncertainties that you heard about last year, everything I just went through, trade would be a great example. Brexit would be another one. They seem to have modulated, and so if you do have less uncertainty than the quality of a company's performance should lead it to be investing behind that performance. Now, as I said at the beginning, you get new uncertainties. Coronavirus would be a good one. Elections are another one that people talk about. But I think if we could settle things for a while, we do have a real opportunity to get people to have the confidence to get back into investing again, businesses I'm talking about.

Megan Greene:

We've had this phase one trade deal, but I know economists are somewhat skeptical that China can buy all the stuff they promised you, especially now. We might not make a whole lot of progress on that. Are businesses telling you that they feel like uncertainty is fallen with the phase one deal or are they sort of looking through that and saying there's still some uncertainty on the table so we're not sure we want to invest?

Tom Barkin:

Whenever we talk about the tariffs from the last couple of years, we have to distinguish the industries that are affected from the rest of business and both have been affected. If you're in an industry that's been affected, by the way, some of them positively, some of them negatively, you have a very specific and concrete point of view about how that's impacting you and how it's not. If you're a farmer who thinks they're going to export a lot more soybeans and has some questions about China's capacity, yes, you might be more uncertain. That's a small part of our economy.

Tom Barkin:

The bigger part of our economy is the people who care a lot about the climate for business investment and who wonder how they're gonna make decisions on investing if you're not clear on what the rules are going to be and who would like to have the rules settled. Those folks I think look at China and say, I don't know where this thing is going in a five to 10-year path, but I think I know where it's going in the next year. I think that is more settled for people who are more concerned about the climate for business as opposed to their own business.

Megan Greene:

Okay, and what about the coronavirus? Does that change what people are saying in terms of uncertainty?

Tom Barkin:

I think there's a lot of uncertainty about the coronavirus. Let me start with, I don't think anyone in this country really knows how serious it is and how much it's going to spread. Obviously, if you're affected by the virus, that's a tragic thing and there's well over a thousand people who've reportedly died and tens of thousands who are ill. It's also for sure the case that if you have operations in China or a critical part of your business is exporting to China, then you've been dramatically affected. You might have seen Apple did a message recently, I think it was Puma and Adidas did one this morning. Yum Brands said something about it and their KFC franchises in China. If you operate in China, that country has been shut down and it's been shut down for basically the last five weeks.

Tom Barkin:

You could also put countries in there, Australia is a very big supplier to China, South Korea and their supply. You've got a lot of companies and countries they're going to be affected by basically the idling of the second biggest economy in the world for the last five weeks or so. Where I'm spending more of my ... I should say, obviously if this becomes an epidemic that spreads, a pandemic, that's the ultimate uncertainty and all situations get redefined in that world.

Tom Barkin:

Where I've been spending my time is trying to understand the supply chain impact. Basically, the way you think about it is most businesses who first of all, supply chains are very interrelated, and you'll be shocked when you talk to companies, not only how many of them are sourced from China, but how many of them source from someone who sources from China, and maybe they don't even know that the second and tertiary suppliers come from China. You'll be shocked in certain industries how much back and forth there is between China and other operations. Supply chains are very complicated and many of them, especially in the manufacturing and electronics world, have a significant footprint in China.

Tom Barkin:

Now one small piece of good news is the virus was first uncovered during Chinese New Year, which is two weeks where that country largely shuts down, and so most of the contacts I've talked to during that period of time had built a buffer inventory. Those two weeks I think is sad but normal. Then you've got this big question, which is are the Chinese plants going to start up again? By the way, even when they do start up, at what percent of capacity are they going to be running? Because as I understand it, it's very hard to get workers to the factories. I think the number is 40% actually come from somewhere other than that city. The transportation logistics issues in China, it's also not operating well. If it's hard to get workers and it's hard to get parts, it's hard to operate at full capacity.

Tom Barkin:

What I hear is near Wuhan it's still pretty much shut down. That's most of your automotive assembly, think washers, dryers. That's sort of the manufacturing center. If you go to Shanghai, that's where a lot of the old big name companies first set up their supply chains. That's just gotten started back. Folks were pretty hopeful that southeast China, I think it is where most of the electronics stuff is about to start back. But even when it starts back, you're not going to be operating 100%. You'll be operating at 30, 40, 60, 80.

Tom Barkin:

Also, you've got companies that are affected on the other end. I've heard it referred to as an air pocket. You'll have an air pocket of parts or goods that you thought you were going to have that now you don't have. Now you can do some creative things. If you're a company that had pretty big inventories, then this may not hit you that much. If you're a company that had alternative manufacturing sites in other countries, for example, it won't hit you very much. If you're a company that can afford to fly a plane in there and not ship this stuff but fly it out, you'll minimize the damage. But I think companies with lean supply chains, companies where a manufacturer has to get approved and regulated and tooled in a sophisticated way, think anything in pharmaceuticals, for example. Folks who are more exposed to Wuhan obviously, are going to have a longer time to get back.

Tom Barkin:

You'll see, I've probably run on too long on this, but I'm interested in it. You'll see you'll start to see stock out. I had a colleague go on Amazon last week and try to get some home decorations and it was already we're running a month behind because of the thing in China. By the way, probably very low inventories. They think they can meter what they're doing. That might be fine. Then there are a lot of other manufacturers that are going to have to decide on do I preference certain suppliers do want to meter my product for certain people in certain ways and have delays? Do I stock out, do I raise prices? All those I think will be on the plate and we'll start to see them I think more in April, mid March to April than today because obviously stuff is on the water and it's shipping or not shipping. Sorry for going there.

Megan Greene:

No, that's okay. I mean, I'm curious. Investors are looking at the coronavirus and the assumption is it's just temporary. We've seen things like SARS and Y2K and foot and mouth disease in the past, and that was just a blip, and if it's not, the Fed is just going to come in and clean up this mess for us anyhow. Do you think markets are maybe out over their skis on that assumption?

Tom Barkin:

I've only been in the fed two years, but I don't think we have any disease curing capacity. This is a great big disease. That's a big, issue and that's not one that's easy to do much about. I do look hard at I'll call it market volatility and I don't mean just whether markets are volatile, but also the question of why aren't they volatile? One moment that I remember from January is in the middle of the weekend we took out the number two guy, I guess in Iran. While the bond market moved, the stock market didn't move at all. I have to say that surprised me because I would've thought there are a lot of outcomes coming out of it, but the risk profile of future outcomes just increased, and some markets may not be as conditioned to that as they could be.

Megan Greene:

Right, yea. Okay, so as everyone is looking for potential air pockets in the markets, maybe some are building up. Let's just switch gears a little bit from your economic outlook to this monetary policy review that you guys are conducting at the Fed. I'm curious what you think about the inflation target, about the conversation around the inflation target. I know that none of us know what the Fed will come up with in the end, but what are you thinking about the monetary policy strategy?

Tom Barkin:

I'll start with what problem do I think we have to try to solve. I think there are three problems that at least I'm trying to see if we can't solve. One of them is we are closer than we usually were to the effective lower bound to zero interest rates, and so the next time you have a downturn, what tools might you have to use that you didn't have before?

Tom Barkin:

The second problem that I'd like to solve is our inflation target is 2%. We're not far from 2% but persistently we've been under 2% for the last seven or eight years since we declared 2% as our target. If you say you're going to do 2%, you don't do 2%, there are some risks that you lose control of inflation expectations, and so the question of what else could we do on inflation is interesting.

Tom Barkin:

The third thing I'd say is I think the Fed did a great job in '08 and '09 of helping lead the recovery of our economy. But I do believe that recovery of the economy isn't just the Fed, and so I think there's some financial market participants and maybe some business people and maybe some government people who think that the Fed should be the only game in town. I think one of the things I'd like to accomplish is to make clear that there are many people who share responsibility for the success of our economy.

Tom Barkin:

Those are three objectives for me. Are there a set of ideas on the table? For those of you who are interested, a lot of it's been discussed in the minutes. The things that are less intriguing to me are things like negative interest rates, which we've tried so far in Europe, in Japan and don't seem to have had the impact on activity or inflation that you might imagine. I look at those and say I'd rather see them tried and successful before we rolled them out here.

Megan Greene:

Is there a real conversation about negative interest rates at the Fed?

Tom Barkin:

If you look at the October minutes, you'll see the conversation we had. There are folks who like makeup strategies and for those who don't know what makeup strategies are, they are long-term commitments to run rates low until over some period of time a target like inflation runs on average, let's say where you want it to be. There are many different varieties of it that we could talk about. But it's make a commitment now to do stuff over the long term until you hit a metric. I have to say that's another place where I haven't quite seen the case for how we're going to do that. In particular, my concern is around understanding and commitment. The simplest way to think about it would be commit to average price targets. If inflation runs under 2%, we'll keep rates low until inflation runs an equal amount over 2%, whatever version of that you want to do.

Tom Barkin:

The problem is, I just walked into the job two years ago and I didn't have to sign the loyalty oath to what some predecessor had said we had to do. You're assuming that a set of individuals at a time will make a decision that they objectively believe is the wrong decision for that time to meet a commitment that they made some time earlier and could be three, four, seven years earlier. I'm just not sure that's credible, but I'm open to the conversation.

Tom Barkin:

Some of the stuff I am more interested in certainly on the effective lower bound question we used for guidance, we use quantitative easing the last time I'd say we did it hesitantly and with much controversy and with many predictions that inflation would explode or banks would lose their grounding. I think now know that you can do that and maybe even harder and faster and with more conviction, so that seems reasonably straightforward to me.

Megan Greene:

Where do you come down on QE? Sorry to interrupt. But so having come from the private sector where everybody is a huge fan of QE and come to academia where everyone is actually pretty skeptical that it worked. Where do you come down on that debate? Was QE very effective? It sounds like you're saying go big or go home, so if you do it in a bolder fashion, maybe it'll be more effective. Is that what you're arguing?

Tom Barkin:

Let's start by saying and again, I was in business at the time when Bernanke stood up in whatever year it was at 2011 and said, we're not out of tools. We've got one more thing we can do. Independent of its actual impact, I think the perception that the Fed wasn't out of weapons was a pretty important weapon at that time. I do like a lot nurturing a broad set of tools and then bringing out horses for courses. I think QE is a good and effective tool and we've proven a bunch of stuff that people didn't think were true then, like you could do it without runaway inflation. But I do think it's most effective in a certain scenario, which is where you've got a relatively steep yield curve and you want to bring the yield curve down.

Tom Barkin:

If you've got a flat yield curve or if you have a downturn where we've taken rates to zero and the tenure rate is at pick your number, 90 basis points, its impact is also muted. I don't think any of these tools work great in every situation. You have to understand the situation you're in. But I think if you have a relatively steep yield curve at a time of a downturn, if you have a lack of conviction in the minds of financial market participants about the forward guidance you're trying to send, then I think those are real tools one can use to try to send a stronger message behind it.

Tom Barkin:

I want to come back just to finish the prior thought. One other thing I am actually interested in is the right kind of range and probably for reasons that are different than many people. Targeting inflation is a very imprecise thing, and so a lot of people who like a range like it because it's imprecise and you can talk about it as imprecise and I agree with that. But I also think there's some value frankly to getting a slightly higher number into the inflation conversation. If you did a range that was one-and-a-half to two-and-a-half, frankly, if you did a range that was two to two-and-a half, to get over the argument against a range, which is it's just an excuse for underperforming.

Tom Barkin:

Go with the range that's two to two-and-a-half. I think it puts two-and-a-half in the minds of consumers and businesses. Why does that matter? Our inflation targeting regime is built on a set of models that start with an assumption of firms as price setters. If we convince everyone that expectations are 2% a year, then they'll increase prices 2% a year. I actually think it's really hard for firms to be price setters in today's world at a time where market power has increased significantly in major retailers or government purchasing, think healthcare. You've actually got monastanistic competition on the other side and prices have gotten a lot more transparent.

Tom Barkin:

If you go to a bookstore today and you don't like the price of the book, you just go on your Amazon app and you look at the price. I think it's actually harder to raise prices and the more success we have with 2% as our target, I think the more conviction businesses and consumers have that if you raise prices more than that 2% then maybe they'll go shopping around. I think that creates an asymmetry which perhaps could relevant to why we're under delivering on a 2% inflation target. If you could put two-and-a-half into the conversation, even if it's a range of two and two-and-a-half, maybe that loosens that a bit.

Tom Barkin:

I think when it comes to the inflation part, I said we were persistently under for a long time and that's true. I want to emphasize we're modestly persistently under for a long time. Why do I say that? Because I think you have to be modest when you talk about moving inflation and there's a real risk if you do a helicopter drop of money that you'll try to move inflation, but you won't move it from 1.7 to two you'll move from 1.7 to four, and so I think little things are a lot more appealing to me on the inflation side then something that's that fundamental.

Megan Greene:

And you think that the Fed has a credibility to do that? Because I think core CPI, one measure of inflation has averaged something like 1.5% since the financial crisis, which is pretty far below the 2% target. It's just one measure and other measures might look better, but do you think investors or businesses and consumers might just say, yeah, great. There's a target now from two to two-and-a-half percent but you can't even get it to two.

Tom Barkin:

Well, I think the conversation about inflation is a really important one, so I'll just take the number you just talked about. Core CPI right now is 2.3% and it has been 2.3% or over 2% for 18 months. We could say yeah, we had a downturn, it was low. We never had an average target, we just had a bygones target and now we've gotten it to 2.3%. Isn't that great? That's a different conversation you could have. If we spent a lot of time talking about how we're failing, then I think the world will believe we're failing. If on the other hand, we sort of try to design a way towards success, then I think it's a different conversation. By the way, I don't think I would have the core CPI conversation because we set our target against PCE, so you're switching metrics. I'm not suggesting that.

Tom Barkin:

Canada does something interesting for example, and they say their target is headline inflation. They use CPI, but I'm not arguing for it. They say we're going to track how we're doing by using multiple metrics, and you know how these metrics are. We did a change in apparel price metrics last year and all of a sudden PCE plummeted. Maybe that was accurate or maybe it was a change in methodology. I think if you use multiple metrics, it's a more much more rounded conversation about where you are.

Megan Greene:

It is, but how do you communicate that to people? We've got multiple measures of inflation, none of which you understand.

Tom Barkin:

Remember who people are. There's financial market participants who are one really important set of people, but a relatively narrow slice and somewhat better educated than the average. Then there's people. I think if you ask people today, and this is one of the things we've heard in spades and the Fed listens. Our goal is price stability. If you talked to anybody in our country about price stability, they'd say yep, we're there. Inflation is low, it is not an object of focus of consumers or businesses. At some level, that's our objective. If you talk to financial market participant, they say wait a second, are you going to move rates up or down? If inflation is under your target, aren't you going to move into ... It's a different set of thing and I think you have to come up with a communication protocol for financial market participants that works. But by the way, Canada has done it. It's not undoable. You'd have to change the protocol.

Megan Greene:

Yeah. Okay, and we've talked a lot about inflation, but are there other ideas that are being discussed for the new monetary policy strategy that aren't just focused on inflation? Is there anything else getting any traction like nominal GDP targeting?

Tom Barkin:

I don't think GDP targeting is an inflation tool, so I put that into the makeup strategies bucket. There's price level targeting, there's average price, there's a lot of different ways to skin that cat. Those are all various versions of makeup strategies, which I would incorporate in what I described. Again, I come back to what problem do I think I'm trying to solve? I do think inflation is one of the big problems. We're asking ourselves whether there's a different methodology or something we should do differently. On the effective lower bound, we've talked about that.

Tom Barkin:

I do think it's worth us just stopping and reflecting on do we have the tools as a country to bring us all together in the next downturn. I think it's easy to make the argument. In the last downturn we put some fiscal stimulus in early and then the combination of state and local government constraints and then federal government constraints actually took away a lot of the juice from the investments we were making, if you will, in monetary policy accommodation. I think getting aligned on how does fiscal play, how does monetary play together also gives us the opportunity to put a little more juice into it.

Megan Greene:

Yeah. Is that a conversation that the Fed is having with Congress?

Tom Barkin:

I'm certainly not. I think it's an important conversation for us to put on the table is all I'll say, and that's my, my personal opinion.

Megan Greene:

Do you worry about independence, that independence in terms of trying to put that on the table? I mean you're not the only one that's trying to put that on the table.

Tom Barkin:

I live in Fed System every day and I'm working with a bunch of really dedicated public servants who are very independent. They're certainly independent of me and they're independent of the other branches of government with the understanding that we have a mandate that came from Congress and we're very serious about trying to deliver the mandate that came from Congress. I don't see any issues in the world that I live in.

Megan Greene:

Okay, great. Just to switch gears a little bit from the monetary policy strategy review. Cryptocurrencies are certainly a big topic and every central bank is looking into developing one. What do you think about that? Is that something that the Fed should do and to what end?

Tom Barkin:

I've been trying to get my head around cryptocurrencies and here's how I think about it. First of all, we already have in the U S a digital currency, it's called the US dollar. I have $100 in my pocket. I have more than that in my bank account. All that stuff on my bank account is digital. The digitizing of the dollar in and of itself is not of incremental value to me. When you hear about why a cryptocurrency might be of value to us, and the phrase that we've been using is central bank digital currency because you've already got a digital currency. One piece of it is you don't have to worry about deposit insurance because the central bank would guarantee the dollar. Again, I don't think deposit insurance is a big issue pain point for people these days, and even if it is, it's kind of a pain point for a certain class of people. It's not positive to me we'd go there to do deposit insurance.

Tom Barkin:

Another version of it is it would actually make more efficient a certain set of transactions, think cross country remittances, and I think there's something to that. I'm not sure that's the only answer to making cross country remittances efficient. In fact, I'd like to think that the competitive marketplace could do that too. But that's a a second version.

Tom Barkin:

A third version you hear is it's fine Tom, that you've got a bank account, but 40% of the people in this country don't have a bank account. I think that's true, but then when you push and say, so how exactly would the digital currency work? Most people quickly go, you'd have some app that you'd open and close. It sounds a lot like Venmo to me. Maybe I'm missing something there. But it sounds a lot like Venmo.

Megan Greene:

But you need a bank account for Venmo.

Tom Barkin:

You don't need a bank account for Venmo.

Megan Greene:

You don't? I thought you did.

Tom Barkin:

No, you just need someone to Venmo you some money into your account.

Megan Greene:

Into your account, I see. Then you can use it.

Tom Barkin:

I just want to say how much more millennial I am.

Megan Greene:

You're so much cooler than I am.

Tom Barkin:

Thank you. Again, I don't quite see that. You have to think that one through, but I haven't quite seen that. Then the fourth thing you say is yeah, but the whole rest of the world is going to go to cryptocurrency, and if you don't do it in the US you're going to lose some incredible advantage. I do think we have an incredible advantage in the privilege of the US dollar being the world's reserve currency. There are a lot of ways that could go away that we should talk about in addition to crypto.

Tom Barkin:

I do think if you're in Turkey or Argentina I understand why a different store of value would be interesting than your current currency. I understand there's some logic in China for why transaction tracking would be relevant to it. I don't think that same logic works in the US. As I've tried to work my way through it, I can see why we should test, understand, know how you'd launch it. The world can go in many different ways, but I haven't seen, if you will, the use case for why our country would benefit from it. I'm open if you've got a different or others have a different view on that.

Megan Greene:

There's one argument that you're not going to like and it just requires a cashless society, so a digital currency might help, but digital dollar helps too, and that's so you can impose negative rates without imposing them on everyone, right? You can control who you're disadvantaging with negative rates. That's Ken Rogoff's argument at least.

Tom Barkin:

We should talk to them for a second about negative rates because you're right, I don't like it. It's not because I don't like digital currency. The fundamental underpinning of the economic stimulus that's created by reducing interest rates is to pull spending forward. If I reduce interest rates, you're more likely to buy a car or buy a house or business to make an investment because you believe rates will be low today and higher tomorrow, so you'll pull some spending or investment forward. I think once they get negative, there's a psychological issue that goes on. Maybe it's central bank despondency, but you start to believe that you'll be down there forever, and of course there's no evidence in either Japan or Europe that you won't be down there forever.

Tom Barkin:

I think if you're down there forever, where's the pulling forward to spending. It'll be negative next year, it'll be negative the year after. Again, I'm more in the psychological part of why I'm against it. I think mechanically it would work better right now. In Europe, they have to go through a certain set of conniptions to get the banks in a healthy way. I agree with you, you would circumvent some of that problem. But my problem is not the damage to the banking sector as much as it is the damage to the psychology of the American spender or investor.

Megan Greene:

Right, so confidence various. Yeah, that makes sense. Okay. so we know a downturn is coming, we don't know when.

Tom Barkin:

You know, I don't know.

Megan Greene:

We know it's coming at some point, we just don't know when or what the choreography is and so it sounds like negative rates aren't really on your laundry list of Fed responses, but kind of what would be your laundry list? I know you're going to say it depends on what it looks like because different tools can be used at different times. What tools would you put on that list and for what applications specifically?

Tom Barkin:

As I kind of hinted when I talked about Bernanke in 2011 but I'd also say it's true of Dragy. The ability of the central bank to say we'll do whatever it takes is a pretty powerful tool. There's something about communication and commitment and behind that I think it is healthy to have a whole suite of tools. Obviously, reducing rates is a tool. Obviously, quantitative easing is a tool.

Megan Greene:

Not a lot of room if you don't want negative rates though.

Tom Barkin:

From where we are today. We'll see where we are 25 years from now when we have that downturn. Reducing rates is a tool, forward guidance is a tool, quantitative easing is a tool. Some of the stuff that was done within quantitative easy, like the twist or other maturity changes in there, those are all tools. Governor Brandon has mentioned yield curve control on short side.

Megan Greene:

Yeah, hat do you think of that?

Tom Barkin:

The risk of yield curve control is on an unmanaged basis you blow up the balance sheet. The benefit of it is if you give forward guidance and the market doesn't believe it, then you've made an extra commitment to it. I think it's a tailored tool for a world where you're giving forward guidance but the market hasn't believed it yet. There's some research that I'm sure you've seen that suggests you actually wouldn't have to blow up the balance sheet because once people believed you were serious, they are. But again, if we're in a yield curve like the one we had 10 years ago where low rates were zero and I think the two or three-year rate was 20 basis points, then yield curve control at the three-year thing has not got as much juice. It's the same issue we had with quantitative easings. But again, if you've got a steep situation, one where your forward guidance hasn't been seen as credible, it's a way to underline that.

Megan Greene:

Let's say you had to blow out the balance sheet. Does that matter?

Tom Barkin:

I'm sorry.

Megan Greene:

That's okay.

Tom Barkin:

Just to finish, and I did intentionally talk about policy that's not monetary policy and I do think a significant and extended fiscal stimulus would make sense. I also think there's a set of policies in our country that can help improve productivity or growth that are also relevant in that kind of situation. I think all those things together or the toolkit that I see, not just the monetary policy toolkit.

Tom Barkin:

In terms of blowing up the balance sheet, as I said earlier, there's some controversy to it when we did it. We have taken it back down, which is something that a lot of people did not think could happen or would happen, and so I think that buys some credibility in terms of doing it again. I do think there are political economy challenges at some scale and at some level, depending on the situation you're in.

Megan Greene:

Yeah, so the Feds brought it back down, but there was a whole repost like issue and it's been brought back up since then. Do you think that that's affected the political economy around the Fed's balance sheet? Is the Fed more likely to face resistance broadly now than they were before? Or is it not a factor?

Tom Barkin:

I hope not. My take by the way is we took the balance sheet up. At the time we said we'll go to the minimum level. We need to operate in an ample reserves regime and in a committed way we gradually and consistently took the balance sheet down. I would compare it to taking water out of a lake. As you train water out of the lake, eventually you're going to find a rock or a tree stump or something. I think in September we found a tree stump, so we put a little bit more water back in the lake. The amount we put back, roughly 1.5 trillion is the level we have the first of September, not the level of reserves that we had three or four years earlier. We've been trying to operate in and around that number since and so far successfully. When you commit to Congress that you're going to go to the minimum level that you need to operate monetary policy, it's hard to prove that until you found the minimum level, which maybe we did.

Megan Greene:

Right. Okay, so it's not QE adding to the balance sheet now.

Tom Barkin:

I don't see it that way.

Megan Greene:

Okay, and you mentioned ... This is my last question, so you guys get ready with yours. You mentioned measures to boost productivity growth are part of the toolkit. What does that entail, do you think?

Tom Barkin:

I really do think that it's interesting to see the weakness in productivity. I spent 30 years as a consultant. I actually thought I was pretty good at helping companies get more productive. You can't find it in the numbers. When you go in the numbers and ask why, the one thing that has really struck me is how much investment levels have dropped by companies over the last 20 years as a percentage of their profitability, as a percentage of their market cap, however you choose to look at it. I think you have to get underneath, and I would believe that when you invest you build productivity for the future. In other words, that's how you do it.

Tom Barkin:

Similarly, startup rates have dropped in half. That's another piece. I think it's worth looking and saying, what really are the things that are holding startups from forming, or businesses from investing? I think you'll find a set of things around uncertainty that we've talked about earlier that are part of it. I think you'll find some things around shareholder activism that are part of it, people thinking more short-term rather than long-term. I think there's been a very significant business hangover from '08 or '09. My dad was a depression child proudly and that was only 50 years out from the depression.

Tom Barkin:

I think people who went through what we went through as an economy in '08 and '09, just have a little bit more caution. I've been struck, I've met with several different executives in I'll call them classic cyclical industries, think chemicals, think airlines, and none of them are investing the way they've done at prior peaks. Because in prior peaks you always had somebody aggressive who was out there going to rule the world. That then led over building, which then led to a recession. I think it's much more controlled this time, and I just think there's a sense of caution around investment on American businesses that is holding us back as well.

Megan Greene:

Do you think a piece of that is it's a different kind of investment now, so it's intangible and we don't know how to measure it.

Tom Barkin:

If you get underneath the investment, you will see technology software has continued to be very strong whereas equipment and structures has been a lot weaker. I think some of that for sure is a move to a more digital economy. I actually think part of it is in a very tight labor market people are automating to reduce labor, think checkout scanners. Yeah, that's probably part of it. Again, total including it is down.

Megan Greene:

It's still down.

Tom Barkin:

Productivity isn't rebounding the way you think, so there's something going on with that.

Megan Greene:

Okay, great. Let's get some questions from the audience. If you just raise your hand, and when you get the mic, I don't know where the mic is right now, but when you get the mic if you could just say who you are and your affiliation, that would be great. Yeah, why don't we start here.

Irv Plotkin:

Hi, Irv Plotkin, MIT. Thanks for this very good presentation, especially from someone from the Fed that speaks in understandable English sentences.

Tom Barkin:

Thank you. Thank you for saying that.

Irv Plotkin:

I'm concerned with two somewhat related items. One, the lowering of the regulatory requirements for banks. I realize there was some dissension within the fed and that happened in October, and the large looming deficits, which I realize are on the fiscal side but that also impacts what you can do for stimulus. I would like your views on both of those.

Tom Barkin:

First of all, bank regulation. Just as a reminder, I spent 30 years as a consultant. The basic concept of similar safety with less administration and cost, is a friendly one to me, not an unfriendly one to me. I think the notion of taking a look ... Let me take a step back. Dodd Frank and increased regulatory environment came in at the end of the last downturn for 100% the right reason, which is that we had a set of banks that were in the middle of the biggest financial crisis certainly in my lifetime. It's 10 years later. They've all rebuilt capital. I think it's a reasonable task to say did we design things in ways that are most efficient?

Tom Barkin:

To the extent that what we were doing is making bank regulation administration more efficient while keeping the system as equally safe and sound, I'm 100% for that. I do think equally safe and sound is in the eye of the beholder, and so you'll see a lot of challenges around that. The simplest way to think about it is capital. Capital levels are massively up from where they were in '07 and I think depending on how you measure it, just modestly down from where they were two or three years ago. Depending on where you start your curve, you could have two different perspectives on it. I can assure you that certainly I take, and I'm sure my colleagues, very seriously the question of our obligation to keep this system safe and sound.

Tom Barkin:

On the deficit, you guys probably know this math, but 1993 federal deficit as a percent of ... Federal debt, sorry, as a percent of GDO was 43%, in 2007 after the Iraq war, 38%. Today, I think the CBO numbers are in the 78-80%. If you look at the forecast, they take it up to I think it's 98% with no recession implied in the forecast. They think it's going to be further away than you do. That's a big number. There's no evidence that's compelling that says that there's a specific number at which something tilts. I was blown away when I saw the other day that Greece, which I think is like at 170% borrowed at under 1%, which I don't understand. We have very low borrowing rates. People have not decided to take credit risk on this country.

Tom Barkin:

But at some point, and it's the Hemingway quote, you sort of go broke gradually and then suddenly. At some point, counter parties will say, we don't like this and you'll see long-term debt rates spike. It could be tomorrow, it could be 30 years from now, and that's a real risk and issue for us. You also worry about, I won't call it our capacity in a downturn because if we want to put $5 trillion in the next downturn, we have the financial capacity to do it, but the sustainability of our capacity ... How fast would you start to claw it back after the $5 trillion you put in? You'd love to have more ability to supplement the next downturn.

Megan Greene:

Okay, thanks. How about here?

Speaker 6:

It's a pleasure to hear your interview. Thank you very much.

Tom Barkin:

Thank you.

Speaker 6:

My question is about [inaudible 00:48:43] inflation target is a major part of this monetary police framework review. You talked a little bit about it. I heard last year, Chairman Powell talk about this. Please correct me if I am wrong. He said, we will not change inflation target, we will only change the ways to achieve this goal. I was just wondering what might be the results coming from this policy review from your perspective.

Tom Barkin:

I think we're still sorting through what the results will be, so I don't think I can give you a good sense of what they will be. What you're talking about is what I think is almost a constitutional document in terms of how we do monetary policy and the core of a framework. We have 17 people in the room who all have many points of view, I have given you some of mine today. I think we still have some work to do to know exactly where we're going to land it. You are right, he said at the beginning that he's taken increasing the inflation target off the list, so that hasn't been something that's on the list.

Megan Greene:

Let's see, how about back here.

Stuart Campbell:

First of all, thank you so much for being here. My name is Stuart Campbell, I'm a senior at Harvard Business School. I would love to get your take on the role of income and wealth and equality and how it impacts the Fed and your monetary policy and vice versa. Arguably, your district is perhaps one of the most unequal in the country. You've got coal producing counties in West Virginia all the way to the DC suburbs. I'd just love to get your perspective on can the Fed actually do anything and does it actually influence policies?

Tom Barkin:

Inequality is an important issue across this country and something that's well worth taking a hard look at. If I were to over simplify, I would say sometimes we take rates up and sometimes we take rates down, and it's hard to sort through exactly how that changes the distribution of either income or wealth within the country. But that's probably a little bit too cheap an answer. I think a better answer is we're doing something today that maybe our predecessors wouldn't have done, which is to run a relatively low interest rate at a time where unemployment is historically quite low.

Tom Barkin:

Our predecessors I think would have had more focus on inflation at this time and the worry about inflation. For good reasons that aren't just about inequality but about trying to fulfill our mandate but I think have a positive impact on inequality. More people are coming into the workforce. Most predictions with demographics were that participation was going to go down, it's actually been inching up. Employment to population now is ahead of where it was in 2007. Wages are up more than inflation, but maybe more interestingly, that increase in wages is significantly higher for entry level jobs than it is for [inaudible 00:52:11]. Inequality is a big issue, it's a legislative issue. We haven't been chartered in our mandate. But I think I would point you to things that are happening as we try to meet our mandate that I think at least analytically are changing the spectrum just a little bit.

Megan Greene:

Thanks. Why don't we go to the very back.

Speaker 8:

Thanks for the conversation. I'm [inaudible 00:52:44], I'm a visiting scholar at the Harvard Law School. Just now you mentioned, it seems that Federal Reserve is not very positive about digial currency and a central bank digital currency. But how about those [inaudible 00:52:59] and also about Libra. What are the attitudes of Federal Reserve towards Libra and other digital coins. We know that [inaudible 00:53:16] that de-nationalization of currency. Maybe you can mix that in the history, 90% of human history [inaudible 00:53:20] now controlled by the nation. It's a competitive condition of currency. Do we now in a way returning to the condition that is competition of different currencies not issued the national states?

Tom Barkin:

Okay, so there were a lot of questions in there. First of all, I should say I gave you my personal wrestling with digital currencies. I'm not speaking for the Federal Reserve System on that. Many of my colleagues would have many different views and nuances on it. Every conversation I have is just me and not the system, and that makes me freer to say what I think. As to whether we as a world are going to head toward a global currency, I don't sense frankly that we're headed toward more global cooperation at this point. I think the force of globalization is awesome and has a been a great force. But if you ask me actually the direction, I think we're headed against globalization rather than toward at this point. You don't have to look further than look at the challenge that Europe has had over the last several years to think about it. While open to the concept, I don't think that seems to be the direction we're headed in.

Tom Barkin:

On Libra and on Bitcoin and other digital currencies, I think you have to always think as you're using a currency, what or who stands behind it. You know what or who stands behind the US dollar or the currency of any other country, it's that country. Central bank, the money is usable to pay tax, all those kind of things. I haven't been able to really understand how you would get comfortable that behind Bitcoin is someone you don't know or don't really know who it is. You're putting a lot of faith in that algorithm to support that. The same thing I'd say about Libra is for a lot of very good reasons including its legislative mandate, we have a set of money control issues.

Tom Barkin:

Money laundering is a real risk. We don't let people do transactions more than $10,000 in cash without a certain level of registration. That helps you avoid all kinds of illicit operations that might happen in other places. When you get a private currency that doesn't have that amount of oversight and regulation, you have to ask yourself whether you think that's a good idea. It's the way you set the legislation up. In our country, and the Fed has, Jay said this in a press conference several months. I don't think we have an interest. We've got to enforce the money laundering statutes, I don't think we have interest in having a tool out there that isn't compliant with our money laundering policies. We've got to think about that as well.

Megan Greene:

Thanks. Great, how about here.

John Hartley:

Thank you for your talk. My name is John Hartley. I am a [inaudible 00:56:41] student here. I have a question for you about the Phillips curve, why it's kind of broken down and why it seems so difficult to get inflation expectations up? There's a number of different theories in advance, lower our star thesis kind of [inaudible 00:56:57] others put forth the Amazon effect, the technological changes, which you alluded to a little bit earlier and your colleague, [inaudible 00:57:06] which I'm a big fan of. Then I think there's other reasons, more behavioral reasons that people have adapted expectations, and 30 years of very good monetary policies anchor people's expectation toward a 2% target and maybe that's falling a bit. I'm curious what your thinking is around inflation and how inflation expectations are formed. Thank you.

Tom Barkin:

If you've got any capacity to do any more research at this university, the question of inflation expectations, where they actually sit because no one really knows and what moves them would be a brilliant place to do more research. I guess I should start, when I took economics here in 1980, I did learn the Phillips curve. I didn't realize that the Phillips curve at that time was a price tool. I thought of it as low unemployment, wages go up, made perfect sense to me at the time, and it still makes perfect sense to me. I actually think objectively it still works. In a lot of the new Kinsey models, they adopted/co-opted the Phillips curve to say it was also part of how we were going to move prices. I do think there's a significant gap between the question of wages going up and prices going up. As I think I alluded earlier, the kinds of things that I think about in that gap is I just don't think we're in a world where it's as easy to say my wages went up and therefore I'm going to increase your price. Part of that is globalization.

Tom Barkin:

With my research team, I always talk about a merchandise buyer at Walmart. If you go into Walmart and you say, I just had a union negotiation, I had to give my people 4% more, they'd say that sounds like a big problem for you. You'd say, no, no, no. I need to take my prices up 4%. They'd say, why? I measured on zero. If you want to do 4%, go ahead and say that, and then I'm going to put this up for competitive bid and someone from China or India or Malaysia or Vietnam will do the work for you. Of course, people are scared to go in with that. That's a little bit the assymetry I was talking about earlier.

Tom Barkin:

I think in terms of price setting, that's a real thing and I think market power on purchasers has greater and greater over time. Transparency of prices has gotten and great over time. Every year you've got a set of people who for whatever reason feel the need to raise prices more than inflation who are being beaten down. I think that's how you get an asymmetry and it's also how it translates to inflation, not just one time lower prices.

Tom Barkin:

Expectations. It's not at all clear to me that there's any issue with expectations. You can look at many different sources. You can look at professional forecasters, they're very grounded at 2%. You can look at the consumer sediment surveys, which depending on which one you look at will tell you it's 2.3, 2.2, 2.5. Someone will say, yeah but they're down from a year ago or three years ago or five years ago and maybe that's because you've got to take one out of everyone or maybe it's now they understand what 2% means, you don't know.

Tom Barkin:

Then you could look at TIPS market. But we had two days ago a pretty strong PPI inflation report and I think that day the 5/5 dropped eight points. There's a lot of stuff going on in financial markets other than people out there trying to predict inflation. We're not far from two, we might be at it, we might be a little above it, we might be a little below it. I think if we try to do the right thing, we'll keep it somewhere around two. By the way, I've talked a couple of times about Europe and Japan. If you look at the markets in Europe and Japan, their inflation expectations are still above one. After 10 years of basically no inflation in Europe and 20 years in ... I don't think there is some cascade down to zero. But if they're at 1.8 today, how would you move them to 2.04? That's a pretty hard puzzle. I think we know how to move them to five, I just don't know if we know how to move them to two.

Megan Greene:

Great. Thanks. We've got one last here.

Speaker 10:

Great discussion, so thank you for coming.

Tom Barkin:

Glad to be here.

Speaker 10:

Low interest rates are great for business but people who are retired find that they're in a different position than they were when the rates were much higher, and so you have a lot of people who are seeking greater returns and are going into different asset areas that they might not ordinarily do. How do you figure that into your calculations on future. The rates start to go up, what will people do?

Megan Greene:

Can I add to that question?

Tom Barkin:

Sure.

Megan Greene:

Off the back of it is we're all looking for bubbles in the public markets or some of them maybe in the private markets or in shadow banking and how is the Fed thinking about that?

Tom Barkin:

Again, multiple lanes. I totally agree that running low rates for a long is not costless. One of the costs or one of the risks of that is financial stability in particular around reach for yield behaviors. It's easy to look even today at corporate debt. I spoke to the CFO of one of the top 10 companies in the country who I think has $180 billion in debt and he said, "Why wouldn't I with these rates?" I'm like, that isn't exactly right. It spreads on higher yield, corporate debt is shocking in terms of where it sits, and many, many reach for yield behaviors.

Tom Barkin:

Also, by the way, a bunch of humans who did their retirement planning thinking there was an investment that looked like this and now there's not, and a whole set of sectors like insurance. People have been selling life contracts with certain assumptions about where their yields were going to be are not seeing those yields. There's a lot of costs, let's call them financial stability and the human end of it. I and many of my colleagues do try to talk about those.

Tom Barkin:

I also think another risk of low rates for a long time is I'll call it breaking the labor market. I was at a big food retailer that serves only rural markets. They can't find any workers. Their answer is we've got no option, we're going to automate our checkout lines. They were saddened about it but they can't find any workers. In the near term, that's a perfectly good strategy, but in the next downturn, those are jobs that someone would have held that are now going to be held by machines and that's an investment that they actually preferred not to make and felt like they had no choice but to do.

Tom Barkin:

Again, if you're worried at all about, we talked about it earlier, a polarized society where there are jobs up here and jobs down there. More of these jobs that get automated, the fewer of those jobs that are around the next time you need them, so that's a thing.

Tom Barkin:

Another risk of course, is stimulating inflation. Our predecessors would have thought about that hard. At some point, are we back to 1969 and '70? There was one other that I was going to hit. Oh, I talked about negative interest rates being a little depressive as a concept but there is some literature you've probably read it, Uribe Benhabib that talk about if you run low rates for too long, you actually settle people in at those low rates, a liquidity trap. I just think it's worth thinking hard about and certainly a place where I think hard about.

Megan Greene:

Excellent.

Scott Leland:

We may have time for one final question.

Megan Greene:

Okay, let's go in the back here then.

Speaker 11:

Thank you. Also a student at the business school. I'm wondering if you can help us paint three hypothetical pictures post November's election. If a progressive democrat candidate wins and if a moderate democrat wins and if President Trump wins reelection, particularly around the implications for the business community and maybe how does that change the possibility of a recession.

Tom Barkin:

Thank you for asking that question while I'm on television. I don't have any idea, actually. In part, because the question is too simplistic. I'm not trying to insult but what happens to Congress, what policies are and aren't enacted. I'd remind you that at the last election markets took a significant drop. I can't remember if it was the day of or the day after, and then the day after that had a significant rise as people stopped and said, different things are going to happen. I don't think you can find much in history. You can find people of either party who won and you can fill the entire matrix with party and good/bad. I don't know that I know where that's going to go.

Megan Greene:

All right, great. Thank you to all of you for coming. That's for your interest and questions and please let's all thank Tom.