

FEDERAL RESERVE

Birds of a Feather

BY TIM SABLİK

Fed watching can seem a lot like bird watching. “Behind the Fed’s Dovish Turn on Rates,” reads a recent *Wall Street Journal* headline; “Fed Hawk Down,” reads the *Washington Post* announcement of the retirement of a Fed bank president. “Hawk” and “dove” have commonly been used by the financial press to describe Fed policymakers since the 1980s, and the term “inflation hawk” can be found as far back as the late 1960s. Both birds have even longer traditions as wartime metaphors. The dove has been a symbol of peace going back to biblical times, and leading up to the War of 1812, American politicians who advocated confrontation with Great Britain were labeled “War Hawks.” But what do these terms have to do with monetary policy?

Hawk and dove are often used to describe a divide over the Fed’s dual mandate of promoting maximum employment and price stability. Hawks are said to worry more about price stability and favor relatively tighter monetary policy to keep inflation in check. Doves are viewed as more open to the possibility that monetary policy can keep unemployment low and more inclined to use accommodative policy to attempt to do so.

The reason for the perceived divide is that the Fed cannot always achieve both objectives at the same time, at least in the short run. Expanding the money supply to boost aggregate demand during a recession can help lower unemployment, but it also can create inflationary pressure. By the same token, tightening can reduce inflation but it can also raise unemployment, as it did during the recession of 1981-1982.

In the past, Fed officials disagreed about the proper focus and targets for monetary policy. But has that debate changed today? In 2012, the Fed adopted an explicit long-run inflation goal of 2 percent, suggesting a consensus on the goal of price stability. In the

wake of that decision, then-president of the Cleveland Fed Sandra Pianalto commented that the bird labels had become obsolete. “We now have agreement” on inflation, she said. “So I don’t think the titles of hawks and doves are useful.”

Have Fed officials all become birds of a feather now? Dissents at Federal Open Market Committee (FOMC) meetings in recent years would suggest otherwise. Indeed, while “hawks versus doves” is a simplification of the disagreements at the Fed, the terms do serve to highlight important differences in policymakers’ economic forecasts and their confidence in the Fed’s ability to influence the future path of the economy with monetary policy.

Inflation and Unemployment: A Tradeoff?

Economists have long understood that inflation and unemployment tend to move in opposite directions. But the

Does the hawk-dove distinction still matter in the modern Fed?



idea that policymakers could exploit this tradeoff to target specific levels of unemployment came to prominence in the late 1950s following a paper by New Zealand economist A.W.H. Phillips. Phillips traced the history of wages and unemployment in the United Kingdom over the previous century and found an inverse relationship — later dubbed the Phillips curve.

Massachusetts Institute of Technology economists Paul Samuelson and Robert Solow found a similar pattern for prices and unemployment in the United States. In a 1960 paper, Samuelson and Solow produced a Phillips curve that they presented as a “menu of choice between different degrees of unemployment and price stability.” Although Samuelson and Solow cautioned that attempting to exploit this tradeoff could very likely shift the curve in the long run, policymakers in the 1960s latched onto the idea of manipulating the tradeoff to achieve maximum employment.

President Kennedy’s economic team articulated this belief in the 1962 *Economic Report of the President*: “Stabilization policy — policy to influence the level of aggregate demand — can strike a balance between [price stability and maximum employment] which largely avoids the consequences of a failure in either direction.” These economists recognized that policies designed to stimulate aggregate

demand to lower unemployment would generate inflationary pressures, but they were optimistic that they could respond before inflation climbed too high.

Some economists at the time also went as far as to argue that policymakers should seek the lowest unemployment rate possible, even if it meant higher inflation. They viewed the costs of inflation as small and confined to the wealthy, compared with unemployment, which had a widespread effect. Leon Keyserling, an economist who served as chairman of President Truman’s Council of Economic Advisers and as an economic consultant to members of Congress from 1953 to 1987, wrote in a 1967 journal article: “It is utterly unconscionable that we should ask millions of unemployed and their families to be the insurers of the affluent against somewhat higher prices.”

But by the 1970s, steadily rising prices had become a concern for more than just the wealthy. A 1974 Gallup poll reported that 81 percent of Americans cited the high cost of living due to inflation as the country’s biggest problem. Moreover, episodes of “stagflation” — simultaneously rising unemployment and inflation — further called into question the ability of policymakers to reliably exploit the Phillips curve tradeoff. Economists and Fed officials largely agreed that double-digit inflation was proving costly, but they disagreed over how

Richmond’s Hawkish Tradition

In the Fed’s flock, Richmond Fed President Jeffrey Lacker is often counted among the hawks by outside observers. While he joked in 2013 that he wouldn’t mind being a different bird, such as one of the great blue herons he sees flying outside his office window, it’s not hard to see why the hawk label has stuck. In 2012, he dissented at every FOMC meeting against the Fed’s accommodative actions. In those dissents, he expressed concern that the Fed might fall behind on its price stability mandate and also voiced opposition to the purchase of instruments like mortgage-backed securities, which he argues constitutes fiscal rather than monetary policy since it directs credit to specific sectors of the economy. Ultimately, he argued, that could jeopardize the Fed’s monetary policy independence and thus its ability to keep inflation low — a hawkish argument indeed.

Lacker is certainly not the first Richmond Fed president to object to the Fed’s conduct of monetary policy. He currently ranks third in dissents by bank presidents, immediately followed by Robert Black at number four. Black was the first Ph.D. economist to serve as Richmond Fed president, starting in 1973. That decade was marked by vigorous debate among monetary policymakers about the cause of mounting inflation. Black drew from his own understanding of economics as well as the work of Richmond’s growing staff of research economists (many of whom had a monetarist background) to argue that the main cause of inflation was the growth of the money supply. It was a view that was not widely held at the

time, and Black’s calls for substantial monetary tightening to rein in double-digit inflation put him at odds with members of the FOMC who favored a lighter touch. His stance was given credence by the disinflation that occurred through monetary tightening under Chairman Paul Volcker, and today the idea that inflation is largely a monetary phenomenon is part of the Fed’s statement of principles.

Richmond’s focus on price stability continued under Black’s successor. Alfred Broaddus became president in 1993, having served as a key economic adviser to Black. Although inflation had fallen substantially by that time, Broaddus was concerned that the Fed might become complacent and lose the credibility on inflation that it had fought so hard to obtain. He maintained Richmond’s hawkish tradition and was a vocal proponent of a singular inflation target, or at the very least a numeric inflation goal, as a way to anchor the public’s expectations that the Fed would keep inflation low. While the Fed has not adopted the former, it did announce a long-run inflation goal of 2 percent in 2012.

In a 2012 interview, Lacker noted that the record left by Black and Broaddus was “a real inspiration” for him. Through speeches and dissents, he has often returned to the theme of price stability and the “hawkishness” with which the Richmond Fed has come to be associated. Indeed, Lacker recalled that when he dissented for the first time in 2006, then-Chairman Alan Greenspan told him: “I would’ve been disappointed if you hadn’t.”

— TIM SABLİK

much the Fed could or should do to bring it down. Some, like Chairman Arthur Burns, argued that inflation was driven by other factors in the economy and that using monetary policy to combat it would result in even higher unemployment.

After the experience of the 1970s, as well as advancements in theory suggesting that expectations are an important determinant of inflation, economists now generally agree that there is no long-run tradeoff between inflation and unemployment. But there is still disagreement on how much the Fed can do to bring unemployment down in the short run. “It’s a debate that has continued over time and still exists today,” says David Wheelock, vice president and deputy director of research at the St. Louis Fed.

Monetary Policy Goals

At the crux of that debate is the Fed’s ability to predictably affect unemployment in the short run. Economic theory suggests that when the economy is operating below its potential, monetary policy can stimulate growth without generating inflationary pressure. But economists are generally skeptical that we can accurately predict the economy’s potential, and they differ on the cost of guessing wrong.

Stanford University economist John Taylor reframed this debate in 1993 when he proposed a mathematical formulation for how central bankers set nominal interest rates. Under this “Taylor rule,” monetary policymakers respond to gaps in both inflation and employment targets. Policymakers assign weights to each of these responses, and while Taylor proposed that the weights be equal, it is clear that not everyone at the Fed agrees.

“Hawks argue that monetary policy can affect the unemployment rate but not as reliably as we would like,” says Wheelock. “So the best that you can expect from monetary policy is price stability.”

This suggests that hawks assign a larger weight to monetary policy responses to inflationary gaps, but it doesn’t mean that they assign no weight to employment gaps. Instead, hawks argue that the Fed can best achieve maximum employment by focusing on price stability. William Poole, who served as president of the St. Louis Fed from 1998 to 2008 and was labeled a hawk, captured this idea in the title of a 1999 speech: “Inflation Hawk = Employment Dove.”

“I put inflation as the Fed’s primary objective, but by no means did I put employment as a nonobjective,” says Poole. “The reason is that once you lose on the inflation front, then you lose the possibility of success on the growth objective. I think the 1970s demonstrated that.”

These views have been echoed by other hawks, such as Philadelphia Fed President Charles Plosser. In an Oct. 16 speech, Plosser noted that economists do not know how to “confidently determine whether the labor market is fully healed or when we have reached full employment.” Waiting to raise interest rates until it is clear the labor market has fully recovered risks falling behind on inflation, he said.

Doves, on the other hand, tend to be more willing to risk temporarily falling behind on inflation. “If you’re uncertain

about the natural rate of unemployment but you have a very high weight on policy responses to unemployment, that means you’re more willing to test the waters,” says Frederic Mishkin, a professor of economics at Columbia University Business School who served on the Board of Governors from 2006 to 2008 and was often labeled a dove. “If you overshoot a little bit and a little inflation occurs but you lowered unemployment, then doves see that as a good thing.”

Recently, some Bank presidents have argued that the Fed should be willing to tolerate overshooting the 2 percent inflation goal because inflation has been consistently below that target in the last few years. In an Oct. 13 speech, Chicago Fed President Charles Evans remarked, “One could imagine moderately above-target inflation for a limited time as simply the flip side of our recent inflation experience ... hardly an event that would impose great costs on the economy.” He proposed in 2012 that the Fed should commit to keeping interest rates near zero even after inflation reaches 2.5 percent or 3 percent. This was dubbed the “Evans rule” — a “dovish” alternative to the Taylor rule.

But hawk and dove are used to describe more than just policymaker preferences and risk tolerances. They are also used to describe how FOMC members vote on changes to the federal funds rate, the Fed’s primary policy tool. Committee members who favor higher rates or raising rates sooner are labeled hawks, and vice versa for doves. In this context, the boundaries between hawks and doves are much more nebulous, as such decisions depend heavily on ever-changing forecasts of economic growth.

Looking Ahead

It is tempting to think of hawks as always favoring higher interest rates and doves always favoring lower. But Fed officials base their recommendations in large part on their expectations of future economic growth, and those expectations change as new information becomes available. This is particularly the case in times of economic uncertainty, such as the run-up to the financial crisis of 2007-2008. In the Aug. 7, 2007, FOMC meeting, Poole noted that markets were “very skittish,” but he and others recommended keeping the federal funds rate “steady.” Two days later, however, Poole had reassessed the need for action. At his request, St. Louis proposed lowering the discount rate — the rate it charges on loans to individual banks.

“I was a hawk, but I was a hawk who was ready to respond to changing conditions,” says Poole.

Indeed, there are many instances of policymakers alternating between dovish and hawkish recommendations based on their forecasts of economic conditions, making it difficult to pin just one label to any Fed official. For example, when Janet Yellen first came to the Board in 1994, unemployment was falling, and by 1996 it had fallen below what many economists considered to be the natural rate. Yellen warned that the Fed needed to be concerned about inflationary pressure and should consider raising rates — a hawkish move. But during the recession of 2007-2009, Yellen faced very

different economic conditions. Unemployment was elevated and inflation was low, and Yellen supported the Fed's low rates and quantitative easing. This prompted the financial press to label her a dove when she was nominated to succeed Ben Bernanke as chair.

More recently, Minneapolis Fed President Narayana Kocherlakota has been perceived as switching sides. In September 2011, he dissented against the Fed's efforts to lower long-term interest rates by purchasing bonds with long maturities (a procedure dubbed "Operation Twist"). Kocherlakota explained that inflation was approaching the Committee's stated goal of 2 percent and that the Fed should not risk diminishing its credibility to keep inflation on target by pursuing further expansionary policies. But in 2013, Kocherlakota noted that employment and inflation had both grown more slowly than he had previously expected. Given this new information, he began advocating more accommodative monetary policy to return inflation to the Fed's goal of 2 percent, along the lines of the Evans rule.

Poole says that differences in forecasts, rather than disagreements about the Fed's long-run objectives, are what account for much of the debate at the Fed today. "I think there has been a substantial convergence of views on what the objectives of monetary policy ought to be," he says. "The disagreement between hawks and doves today is more a matter of the judgment you bring to the table about the state of the economy and what risks you want to run."

Still, forecasts and preferences for the focus of monetary policy often go hand in hand. "Your forecasts are tinted by the glasses through which you view the world," says Mishkin.

A Broader Debate

The perception of the Fed as a feuding flock may also arise from the fact that debate among monetary policymakers has become much more public in the last 20 years. Prior to 1994, FOMC decisions were not made public until years after the fact. Over the same period, bank presidents have also become more vocal participants in the policy debate.

"Until relatively recently, it was rare for a Reserve Bank

president to be a Ph.D. economist," says Wheelock. "This has led to the presidents having a stronger and more independent voice on monetary policy than they once did."

But the impulse to group policymakers on one of two sides can obscure more subtle disagreements. In a recent St. Louis Fed paper, Wheelock and former St. Louis Fed vice president and economic adviser Daniel Thornton catalogued dissents at the FOMC from 1936 through 2013. They grouped dissents as favoring either tighter or easier monetary policy, but Wheelock notes that not all of them fit neatly into one of those two buckets. For example, in the 1960s, the United States was still on a version of the gold standard and some Fed governors dissented because they were worried about a balance of payments deficit that might jeopardize gold reserves. During the recession of 2007-2009, Richmond Fed President Jeffrey Lacker supported the Fed's expansion of the monetary base, a dovish move, but he dissented over the decision to implement that policy through the purchase of assets like mortgage-backed securities rather than U.S. Treasuries.

There are also important points of agreement among Fed officials that the labels can gloss over. Doves are sometimes portrayed as being unconcerned with inflation, but all members of the FOMC seek to keep inflation expectations low and stable over the long run. "On that, there's no difference between hawks and doves," says Mishkin. "I'm certainly not as hawkish as Jeff Lacker is, but both of us were very strong advocates of inflation targeting. And both of us are equally concerned about unhinging inflation expectations."

Nevertheless, the idea of a split between two camps is likely to persist if for no other reason than the Fed's primary policy tool — the fed funds rate — moves in only two directions. And for the most part, monetary policymakers don't have the option of not taking a stand.

"When you get to an FOMC meeting, you have to make a decision given the best information you have," says Poole. "You need to be ready to change your mind, but you can't just say 'I'm going to wait until we do more studies.' That may work for an academic, but it won't work for a policymaker." **EF**

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