

William C Dudley: Transcript of the Cornell College of Business Annual New York City Predictions Event

Transcript of a discussion between Mr William C Dudley, President and Chief Executive Officer of the Federal Reserve Bank of New York, and Ms Maureen O'Hara, Robert W Purcell Professorship of Management, at the Cornell College of Business Annual New York City Predictions Event, New York City, 15 February 2017.

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Maureen O'Hara:

Bill, let me start off with kind of the low-hanging fruit. The post-Trump economy has been confusing, with low Q4 growth, yet record-setting stock market levels. So let me just throw you an easy one here. What does the Fed see as the outlook for the next year?

President Dudley:

For the near-term I think more of the same. I mean, we think the economy is going to continue to grow, a little bit above-trend. That's going to generate job gains that put, you know, more pressure on the labor market, and as a consequence of that, we think inflation's going to move back towards our 2% objective.

So, you know, we could be completely wrong, but that – the data that's come out over the last couple of months, is very consistent with that pattern.

A lot of uncertainty in the outlook. I mean we don't know what's going to happen with the whole host of policy choices: healthcare reform, immigration policy, trade policy, tax policy, fiscal policy. So, how that, how those policy questions get answered will also be an important aspect in terms of how the forecast actually falls.

But the baseline forecast is pretty similar in 2017 to 2016, slowly above trend growth, a little bit more pressure on the labor market, gradual rise in inflation, back towards our 2% objective. And if that happens, if we stay on that trajectory, I think as Chair Yellen said yesterday and today, we would expect to gradually remove further monetary policy accommodation, snug up interest rates a little further in the months ahead.

Maureen O'Hara:

Well I think that's somewhat encouraging, isn't it?

President Dudley:

But the uncertainty around that forecast is pretty high.

Maureen O'Hara:

Is pretty high. Although, you know, it's interesting, think about the U.S., um, you know, our situation in the last couple of years has clearly been improving. What's been interesting is seeing the news out of Japan, that, you know, Japan seems to be able to keep out of deflation, which they haven't for a long time. Even Europe seems to be eeking some growth out.

Do – do you think everybody's going to be doing better or is this just a blip?

President Dudley:

Well, I think that – a couple of things. Just let me touch on the U.S. first. One thing that's

interesting is post-election you've seen a pretty big improvement in household and business confidence, especially business confidence among smaller businesses.

Now it's hard to say how much weight to put on that because historically consumer confidence goes up and down, and it doesn't just necessarily feed into consumer spending. But the increase in business confidence is quite striking, especially for smaller businesses. And so one of the big open questions that we're going to be assessing over the next few months is: is that improvement in animal spirits, so to speak, going to actually feed through and lead to more spending?

So, I think where a year or two ago, I think our anxieties were more about the risks to growth to the downside, so as that – well, a year ago, we were worried about events in China, we were worried about uncertainties about Europe. I think now the balance of risk is gradually shifting, where the possibility is that growth could actually be stronger than expected, rather than weaker than expected.

The markets expect fiscal stimulus out of this Administration. That's another factor that probably will over time tilt the equation more to the upside.

But on fiscal policy, it's really hard to factor into your forecast at this point because we don't know what it is, how big it is, or when it will happen. Other than that, we have it completely nailed down.

So, it's really hard to sort of put that into your forecast. And so the way I think about the fiscal policy outlook is that we're probably going to get some fiscal stimulus at some point. And so that's just another factor that maybe tilts the risk to the economy a little bit to the upside.

Maureen O'Hara:

So, Bill, how about we think a little bit more broadly. You talked about where – it looks like interest rates are going up, at least that's what, you know...

President Dudley:

Gradually, right.

Maureen O'Hara:

What Janet Yellen indicated would happen. There's this interesting question, though, about will interest rates over the next year go to quote normal levels, or is there a new normal, right? I mean we've struggled through how many years now of zero interest rates, and the distributional consequences those have had, is there a "new" normal? Do we have an idea what that "new normal" is going to be?

President Dudley:

Well I think if you look at what the FOMC publishes, the so-called Summary of Economic Projections, one of the things that they forecast, we forecast, is the long-run federal funds rate, where we think the federal funds rate is going to end up in the long-run. So think five, six, seven years out. And that estimate has come down over the last few years. So what that's telling you is that people on the FOMC think that the normal federal funds rate is lower now than it's been in the past.

And the idea behind that is a very simple one. One, there's probably still some residual headwinds left over from the financial crisis that are going to persist for some time. Think about how difficult it is to get a mortgage if you're a lower credit-rated borrower today compared to 2005, 2006. And two, productivity growth in the economy has been very anemic, and I think generally, most economists think there's a relationship between productivity growth and the

inflation-adjusted level of interest rates in the economy.

So, productivity growth is strong, you tend to have high real rates. At 2% inflation you get a relatively high federal funds rate. If productivity growth is weak, you have low real rates. Add 2% inflation, you get a little bit lower level of interest rates.

So generally, if you look at the FOMC projections, people think that the federal funds rate in the medium term is going to more like 3% rather than the 4% that might have been attained historically.

Now there's one little problem with this. Economists are terrible at actually forecasting productivity growth. So just because productivity growth has been weak over the last few years doesn't mean it will necessarily be weak over the next five years.

Maureen O'Hara:

Well, it's a tricky one. Here's one that's tricky, too. Are there issues connected with financial market valuations that concern you? And that's kind of the grown-up question. Here's the one we all want to know. Any predictions on the Dow reaching 30,000 this year?

President Dudley:

No way.

Maureen O'Hara:

Oh, quick, call your brokers.

President Dudley:

Let's put it this way, if it did reach 30,000, I would be concerned about the stock market valuation. I think one of the things that's interesting post the election is, I think the uncertainty level about policy has gone up enormously, yet markets have actually performed very well, especially the equity market.

And that's actually pretty unusual. Usually markets don't like uncertainty. And so, one thing to ask yourself the question is, why are markets going up even though the uncertainty level has climbed so much?

I think one of the reasons, perhaps, is the notion that political deadlock in Washington is going to ease. Another thing is maybe fiscal policy is going to ride in and provide some support for the economy. But it's an unusual environment, where uncertainty level goes up and the stock market goes up. There's a little tension there between those two things.

Maureen O'Hara:

The VIX which is –

President Dudley:

Well, that's the other thing. Volatility in the market is extraordinarily low. So, that's another thing that doesn't quite fit. You would think if uncertainty was high, you'd have a little bit more volatility. If I was going to write something down as a prediction, I guess I would think volatility will go up. At some point.

Maureen O'Hara:

Well, it is a confusing structure right now. I think it's hard for anyone to kind of predict this economy. But that kind of makes it fun. Let's talk about something else that is somewhat hard to fathom. What are your thoughts on the election? Let me make it a little more – are there lessons from the election that you think are particularly important for the economy going forward?

President Dudley:

Well, obviously, the Federal Reserve is completely apolitical, so we don't take sides in terms of elections, and whether the Democrats or Republicans win. But I do think there is an interesting lesson in the election in the sense of support around the country and around the world for globalization, and why that support did not seem to manifest itself in terms of our election outcome.

You know, I think that globalization has lifted literally hundreds of millions of people out of poverty over the last decade or two. And so I think net-net from my perspective it's been a good thing. But people have been left behind from globalization. I think a lot of people in the United States didn't put enough weight on those people. You look at income distribution in the United States it's become a lot more skewed. You look at income mobility in the U.S., it's not very good.

I think those are things that we really need to work on is the country. I think we really want to make it so that globalization lifts all boats rather than just some boats because if you don't have that, you're not going to have support for globalization. You're not going to have support for free trade. And if you don't have that, then I think that has its own set of consequences.

Maureen O'Hara:

Yes, well, I think you've raised a great point, that there are both positive and negative consequences of globalization. Let me raise something that may have similar negative and positive, and that's the impact of technology. I think we're all beginning to see a brave new world in which technology is entering ways that even 10 years ago were hard to fathom. And you know, I think that just as globalization seems to have made people nervous about the future, so has technology.

Now, what are your thoughts on that? Is technology going to be the bigger influence over the next decade? Is that what's going to change our economy and the ability of people to make that leap-up that you just talked about?

President Dudley:

Well I think technology is always challenging. I think it's been challenging for decades, even centuries. My mom for many years lived in Westville, Massachusetts, and if I have this right, it was the buggy whip capital of the world at one point.

Well, Westville had to make the transition from being the buggy whip capital of the world to other things. And I think – so, I don't think this is new. I don't think this is a new story about technology.

What I think is what's new is we have to do a better job in terms of retraining people, getting people the mobility they need so they can actually feel that they have a place in the new economy.

I was thinking about this question about technology and you think about the U.S. farm sector. You think about how many people in the United States worked on farms in 1900 and how few people work on farms today. Same kind of tech, same science and process of technological transition, but the good news is we were able to find things for those people to do.

People always have for many, many years, talked about how technology is going to put everyone out of work, and everyone's just going to have a lot of leisure. That has not panned out up to now at all, and so I'm just a little bit skeptical that now we're at that critical turning point. I could be wrong. This time could be different. But if you think about how long we've had these conversations about technology obsoleting everyone's skills and leading to massive unemployment, this has been a conversation that we've been having for hundreds of years, literally.

Maureen O'Hara:

It's tricky now, though, isn't it? I mean in the past, I think you used to think about technology as taking away some of the lower-skilled jobs, and yet now we're seeing it kind of marching its way up. I think it'll be awhile before it gets to Fed presidents. But I know...

President Dudley:

Well, there are some people in Washington that would like to make us conduct monetary policy by a rule.

Maureen O'Hara:

And there you go, a robot can do it.

President Dudley:

We don't think that's such a good idea, by the way.

Maureen O'Hara

It's an interesting challenging, and particularly here I saw some numbers the other day that the high school graduation rate in New York state is somewhere in the 70 percentage points. And again, as you think about the technology creating winners and losers, you know, obviously we're in education, all of us are committed to education, you know. Is that kind of crucial to the technology solution? What do we do with the people who don't?

President Dudley:

Well, I think – I mean look, I think education is absolutely essential. Giving people the skills they need to sort of navigate in the 21st century economy.

And the second thing we need to do a better job is actually retraining people so that the only education you get shouldn't just be when you're 18 to 22 years old or 25 years old. We need to have a better system where people can sort of retool themselves.

I think a third thing we can do is a better job of matching the skills that people get in universities to the business needs. One of the things that we've been talking about for a long time is that the New York Fed has tried to have better partnerships between businesses and education, so that the skills that people are getting when they go to the university match the opportunities when they actually graduate.

And I think we've made a lot of progress on that, but that's something that I think we could even do better on going forward.

Maureen O'Hara:

Can you turn us back to monetary policy again for a minute because, you know, one could argue that one of the major forces that helped us get through the crisis was monetary policy, with its

expansive, you know, quantitative easing with the role that the central bank took up and really helped keep the financial markets from collapsing, and now also keeping the economy from collapsing.

Now we have, as you mentioned earlier, the prospect for more fiscal stimulus, which in some ways makes it a little better...

President Dudley:

Potentially.

Maureen O'Hara:

Because it's not just monetary policy, we'll have fiscal policy. But we also have a variety of other factors that may influence monetary policy. One of which is the possibility that we as a country are going to become more isolationist. And that has implications, doesn't it? For your monetary policy and how you implement it?

President Dudley:

Well, I think we – as I said before, I think we have a lot of uncertainty about what's going to happen on immigration and trade. Most economists – the overwhelming number of economists – think that open and free trade is a good thing, comparative advantage, you want to produce the goods and services that you're best at producing and let other people produce the goods and services that they're best at producing, and that actually generates gains for both sides. That's really the theory of trade.

So I think that's – so I think we don't want to lose sight of that. Obviously, to the extent that we – I think it's very – it's way too soon to sort of see how this is going to evolve. It could evolve in the direction where we negotiate hard and we get somewhat better trade deals for the U.S. and trade barriers around the world don't go up very much at all, if at all. That's probably not a bad outcome for the U.S., and I don't think it's a bad outcome for the world. Or you could go down the path that was quite a bit more pessimistic than that.

So, I think it's just too soon to sort of see which direction. You know, the Federal Reserve is going to obviously take the world as it is. I mean we – our objectives are set by Congress. Very clearly, maximum sustainable employment in the context of price stability. So we have two goals: employment and inflation.

And if the world is a really good place, it maybe makes it a little easier to achieve those goals. And if the world is at a more difficult place, maybe it makes it a little harder to achieve those goals. But it doesn't change our goals, and it doesn't change our monetary policy mission.

Maureen O'Hara:

Let me turn that, our focus, just a tiny bit. You've been a leading critic of culture in the banking industry, and I kind of have a two-part question here. Do you think the era of bad behavior in banking is behind us? And here's the second part of the question: some people would argue that the behavior wasn't really that bad but instead the regulators...

President Dudley:

Who are those people?

Maureen O'Hara:

There was Elizabeth Warren, I'll say that, I think she's convinced. But some people would argue

that the regulators used the opportunity to extract excessive fines from banks for behavior that maybe wasn't ideal but wasn't so horrible. There's two different perspectives. I think no matter how we look at it, some of the behavior of the banks was sort of unacceptable. Are we past that, do you think?

President Dudley:

Well, first thing I would say is a lot of the behavior was just totally egregious, totally unacceptable. Not in the gray area. You know people talk about, well, it's hard to know where to operate in a gray area, I think a lot of the behavior was way over the line.

When people are getting together in chat rooms trying to talk about how they can collude to rig a market, that's not in the gray area. That's way over the line.

When people are consciously doing things to evade any money laundering rules and sanctions, that's not in a gray area, that's way over the line.

So I feel that most of the things that have resulted in fines can be tied to things that are not in a gray area. They're just way over the line.

Now the question of whether the fines are excessive – I mean it's hard to know how you take the behavior and then map it back onto the fine. I think the important thing, though, is to make the fines big enough so that the senior management of these institutions doesn't just say, "Well, I can just write a check, accept the bad behavior, and move on."

If the fines are substantial, then it actually gets some senior management's attention, and I think that's one of the reasons why banks are working harder on the issues of culture in their institutions.

I've actually been very – you know, you asked me the question, is bank bad behavior over? I expect not because I think there's always people that test the limits of the law and regulation and are always trying to see where they can go. And there are obviously going to be bad apples in any really large organization.

What I hope is that, one, the banks will sustain their effort to improve their cultures. Banks really are working on this. I spoke at a bank industry conference about a month ago, where they brought in all their very high potential mid-level people to talk about culture, and it was really them talking about bank culture and I came in for a very short period. I think I was the only person from the official sector that spoke there.

And I thought the fact that they were taking all these people that are high-performers and spending a day trying to inculcate them with the importance of culture maybe suggests that we've passed a tipping point. So, that's important.

I think the other thing that I'm hoping to see is the banks start to cooperate a little bit more with each other and share best practices on bank culture. Up to now it's been most banks working sort of on their own thing alone. I think if they actually shared best practices, shared survey results, to see how they were doing relative to their peers, that would also help them perform.

And the last thing I would say on culture, I think we've got to continue to work on incentives. I have a very simple mantra. Incentives drive behavior. Behavior sets social norms. And those social norms define culture. So if you have the wrong incentives, you're probably going to have bad culture. If you have the right incentives, you're probably going to have a much better culture.

One thing that Preet Bharara said when he came to a conference we had at the New York Fed, he said one of the big challenges that he sees is that people don't speak up early enough when they see something wrong going on. He said that if people spoke up early, a lot of these big

things would never have been big things. They would have been little things.

And so, the important thing also is to really educate people that it's okay if you see something that bothers you, that you're not comfortable with, raise your hand. You're not doing anybody a favor by keeping silent, hoping it will go away. You're not doing anybody a favor by thinking, well, if I raise my hand, I'm sort of tattling on my colleagues. That is not the right way to think about it.

Bad behavior is not good for you, it's not good for the institution. And so, if you do see bad behavior, or something that you're not really sure whether it's bad behavior or not, raise your hand and raise it to your manager, and have a conversation about it.

Maureen O'Hara:

Well, I think, I hope you're right that we're reaching a new awareness of the fact that some behaviors just can't be accepted. You know, I don't care whether they're legal or not. They're over any kind of ethical lines. And we shall see, it's a new world, isn't it?

President Dudley:

Yeah. It's very important that people understand that the idea is not to just perform to the regulation and the legal law. And one of the things we have, because we have a very legalistic system with lots of regulations with banks – people sometimes feel like, "Oh, well, given that, I can do anything within those parameters."

Well, the world changes faster than the regulations and law can sort of keep up. And so, using that as your guide in terms of what's good behavior, permissible behavior, I think is a very bad, bad guide.

Maureen O'Hara:

Well let me turn to one last question, and then we'll open it up to all of you. Would repeal of parts of Dodd-Frank, the Volcker Rule, be a good thing for the financial system? Any predictions about what's going to happen with financial regulation going forward?

President Dudley:

Well, I think that it's certainly going to be looked at, and obviously we'll have to see how it makes its way through the House of Representatives and the U.S. Senate. I'm perfectly – I think it makes sense to look at the Dodd-Frank Act, to see which parts are working and which parts are not working so well.

I mean, when I sort of think about the Dodd-Frank Act, I think there's really two things that we're trying to accomplish here. Number one, we're trying to make the probability of failure of large complex financial institutions a lot lower than it was before. So that means more capital, more liquidity, better governance, better risk management. And we want to keep all those things.

And the second thing we're trying to do is that if a firm does get into trouble, we can actually allow it to fail without it threatening to take down the rest of the financial system. So that means you need good resolution regimes, and you need a financial system where you don't have a lot of vulnerabilities.

You know, one thing, for example, that we've accomplished over the last year is we've had money market fund reform. Money market funds were one of the accelerants of the crisis after Lehman Brothers failed.

So, fixing the financial system to address some of those structural weaknesses is also important. So I think keeping that part of Dodd-Frank, central clearing of derivatives, I think is

something that makes the financial system more robust. Keeping all those parts I think makes a lot of sense.

Volcker Rule? You could probably do the Volcker Rule in a more efficient way to achieve the same objectives without the burden of regulation that you have right now. You know, right now, if you're an equity trading desk and the equity market falls very violently, you really aren't supposed to go in and buy equities unless you actually have customer orders. So, you actually have this crazy situation where the equity desk can't actually buy equities to support the market.

So, I'd like to see the Volcker Rule looked at to see if there's a way of doing it in a way that – if you're a client-facing business, and you're trading your own asset class, you have a little bit more freedom to buy and sell when markets are volatile and maybe provide actually a little liquidity support in the market. But also make it a lot easier, I think, to enforce the Volcker Rule.

The other thing I would say is relief for smaller banking institutions. The financial crisis was not about small banking institutions. It was about large banking institutions and particularly it was about large broker-dealers. And so I think the Dodd-Frank Act imposed a lot of compliance and regulatory costs on smaller banking institutions.

And I think – we have about 6,500 smaller banks in the United States plus a lot of credit unions and other financial intermediaries. Relief for those guys I think would be really, really valuable because the burden on them, they feel that burden disproportionately because they don't have as big an asset base to spread all those compliance costs across. And I think it has more of a real consequence because a lot of these institutions support small business lending, which I think is really important to have a vibrant economy.

Maureen O'Hara:

So given the two goals you said that there were for the Dodd-Frank Act, it does make you wonder how the Congo Minerals Relief Act ever got into the Dodd-Frank. But maybe we'll leave the Congo Minerals for another night. Well, I think the issues we've talked about here have covered a wide range of areas, and let me turn it open to the audience here and see if we can come up with some other questions. How about you? Yes.

Audience Member:

You alluded to China and the concerns we had about it last year that have now gone away. Why do you think the narrative changed on that, why do you think China is doing better? Also, you know, we're seeing more about rising inflation, so is this really about rising inflation or is it about the end of the disinflationary-deflationary scare? Thank you.

President Dudley:

Well I think last January, early February, the markets were under a lot of distress. There was a big flight to risk aversion and markets went down pretty hard around the globe. I think part of the story was China, but I think part of the story was also worries about the slowdown in China leading to a big commodity bust, and that commodity bust then putting a lot of pressure on especially emerging market economies that were actually selling a lot of the products to China.

China's been on a much more sort of stable growth path this year. They've also clarified what their foreign exchange rate regime is. So I think people are a lot more comfortable in terms of how they're managing the renminbi.

I think there are still challenges in China and they're still trying to reorient their economy from investment-led growth to consumption-led growth. They're still an economy that I think that credit is growing quite rapidly and so you sort of worry about how sustainable that is over the long-run.

But I think it's much less of a focus of the markets today than it was a year ago, and I think the anxiety about the emerging market economies is much more focused on individual countries rather than sort of broad like it was a year ago.

I mean financial conditions really, if you look at the financial markets post-election, we've seen stocks up, we've seen the dollar a little bit firmer. We've seen credit spreads narrow quite a bit, and we've seen bond yields up a little bit. But net-net, financial conditions haven't actually changed very much post-election. That was very different a year ago. Financial conditions were actually tightening quite sharply a year ago. And it wasn't really clear how far that was actually going to run.

Maureen O'Hara:

There we go, question?

Audience Member:

Can you talk a little bit about balance sheet normalization, how you think about that in the context of monetary policy? In the September FOMC, you guys talked about thinking about balance sheet normalization in terms of when your rate hikes are well under way. What does "well under way" mean, how are you thinking about that?

President Dudley:

I'm sure "well under way" means different things with different people. I think the — we made it pretty clear in terms of our statements that we sort of want the active tool of policy to be short-term interest rates. And the balance sheet to be sort of in the background. We've also said that we wanted to get some room off the zero bound before we actually start to normalize the balance sheet, to end the reinvestment.

Now I think my own personal view is, how soon you want that process to start depends not just about how much margin you have between the current federal funds rate and zero, but also how confident you are that you're actually not going to need to reduce the federal funds rate in the near-term.

So, to the extent that we become more confident, if we become more confident about the economic outlook, that the recovery will be sustained, then I think that for me — speaking for myself, and only myself — that might make me a little bit more comfortable to proceed with balance sheet normalization a little bit more quickly.

I think the important thing here is that when balance sheet normalization occurs and we start to end the reinvestment, don't think of it as an active tool of policy. Think of it as a passive tool, number one. And number two, to the extent that we then do decide at some point in the future to taper or end the reinvestment, that will also be a way of removing accommodation. And so that would be a bit of a substitute for raising short-term interest rates.

So, I would guess, my own personal view, is if we move to balance sheet normalization, that might actually stretch out the process of raising short-term interest rates a little bit because the two are substitutes for one another in terms of removing monetary policy accommodation.

The Chair said in her testimony that this is something we're going to be looking at over the coming meetings. We want to make sure that we know exactly what we want to do long before we have to do it, and so obviously the discussion and contemplation of what the right strategy is here needs to start relatively early, so it can be done absolutely as soon as you actually might want to do something.

People sometimes think that when we start talking about something in the minutes that that

means that we're going to do something momentarily. Usually it takes a while for us to develop those themes and issues, and reach a consensus.

So, I wouldn't take a lot of signals just because it was in the minutes last time and something here is imminent.

Maureen O'Hara:

Well, you'll have a few openings, too, in the FOMC that have to get filled in before you'll get full strength. So again, a slightly different Federal Reserve Board going forward, too.

President Dudley:

Yes.

Maureen O'Hara:

An excellent point, an excellent point. What have we got? Here we go.

Audience Member:

If the new Administration continues with this isolationist policy, is able to successfully put tariffs on imports, would that have an inflationary impact and would the Fed have to address that?

President Dudley:

Well, again, I don't think that's – I don't really think that's the professed goal of the Administration. I think the Administration wants better trade deals and not – I think the question is whether they'll get better trade deals without actually having to put, you know, higher trade barriers in place.

Obviously to the extent that trade barriers go up and that would tend to raise import prices, that would feed into price level in terms of inflation, and so obviously, we had to take that into consideration in terms of how we do monetary policy.

But going to be happening in a dynamic world where a lot of other things are going on. So, I wouldn't want to take one thing and say, "Oh, if that happens, we're going to do X," because it really depends on, one, it's highly speculative what's going to happen on trade policy, and two, even if it happened, it would depend on magnitude and it would depend on a lot of other things that are going on.

So I think it's really hard to speculate about something like that.

Maureen O'Hara:

Okay, I see some hands way back there. So if you can hand the microphone to someone who's got their hand up, way back there, that'd be great.

Audience Member:

Recently, it's been speculated that the Trump trade policy actually will evolve into a border tax. It's been in the works in the Republican Party for the last several years. This would simply entail an increase across-the-board in taxation on imports and an equal proportional across-the-board decrease on all exports.

First question would be, what do you think of this type of proposal? And second, if this were implemented, what do you forecast the impact to be?

President Dudley:

Well, there's been a lot of discussion in Washington about this border tax adjustment. If you were starting with a corporate tax code from scratch, it would be, I think, quite attractive in a lot of ways because it basically eliminates a lot of the incentives to engage in games of transfer pricing. It reduces a lot of the incentives to book your intellectual property abroad.

So, it actually has a lot of attractive features. I think the challenge is that it's very different than the current tax regime, and so there really would be some pretty significant adjustment costs and frictions of moving from the current regime to that new regime.

And so, I think the question is really going to be: do people think those adjustment costs are a price worth paying for what I would agree is probably a better corporate tax regime. Certainly, a much better tax regime than the one we have today.

But you know, there's going to be a lot of people that are going to be worried about how that adjustment is going to affect their particular industry. If you're an importer, you're going to be worried that your price of imports is going to go up.

Some people argue that the dollar will move proportionately with the size of the import tax, so the import prices won't go up at all in dollar terms.

But, you know, that's theory, and people worry about how it will actually work in practice. So, I think this is just going to be a very heavily debated topic in Washington in the coming weeks and months.

Maureen O'Hara:

I think we have time for maybe one or two more. Let's let some people in the back again.

Audience Member:

Hi, Mr. Dudley, nice to hear from you. I've got lots of questions, but I guess everyone gets to only ask one.

President Dudley:

You can ask more than one, but I'll only answer one.

Audience Member:

Okay, so, I was going to ask some sort of structuralist post-Ricardian question, but I'll set that one aside.

President Dudley:

Thank you.

Audience Member:

On a similar vein, to what degree do you think that this challenging of facts and these threats about what is truth and, you know, journalistic integrity, to what degree did this affect the financial system and to what degree did this confidence in what the Wall Street Journal might say or the New York Times might say as a fact can affect confidence in financial institutions? And what remedies do you have, or does the Fed have, to combat that?

President Dudley:

I don't think I have any good real answers to that. I'll just have to say that I'm fact-based. New York Fed is fact-based. And I hope we stay that way.

Maureen O'Hara:

Do you have alternative facts? Just checking, just checking.

President Dudley:

Look, I think a healthy debate is a good thing about what facts matter and how the world works. You know, people can have different models about how the world works and what's important, and what's not. But I think that they have to be based on real evidence. So, I'm going to continue to live in my world, which is very much fact-based.

Maureen O'Hara:

I think we have time for one more question, and we have someone back there who's got a mike.

Audience Member:

Yeah, Mr. Dudley, I have a question. You mentioned that there was some nefarious behavior by banks. I heard you mention that there was some nefarious behavior going on by banks during the financial crisis.

President Dudley:

Well, the employees of banks.

Audience Member:

Ok, employees of banks. My question is, there was – some of the big banks, including J.P. Morgan and Bank of America, basically bailing out the government and the FDIC, buying institutions like Countrywide, Merrill Lynch, Washington Mutual.

In some of these cases, they were given winks and nods by the government that they were not going to be held accountable for let's say the sins of these institutions that they took over.

But then what happened, they did this, and then later on, these institutions were fined billions of dollars by the government. And I guess my question is would you call this nefarious behavior on the part of the government to do this to these companies that basically helped out the government and the FDIC, in taking over these insolvent institutions?

President Dudley:

Well, I wasn't part of any of those conversations, so I don't know what winks or nods were actually exchanged.

Look, I think the banks are, people are, managers are big boys and girls. And I think when they were making these transactions, they had the ability to negotiate whatever terms and conditions that they wanted to negotiate.

Now, I understand that there's some bad feelings after the fact, to the extent that the sins of the institutions that were acquired went along with those entities. But it'd be a little bit sad if you can have institutions do lots of bad things and then have them acquired and then have their sins sort of automatically forgiven because they were acquired by another institution. That would be a sort of "get out of jail free" card. And so I'm not sure that's necessarily the right approach either.