Reflections on the October 6, 1979, Meeting of the FOMC

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Sometime during the week of the October 6, 1979, meeting of the Federal Open Market Committee (FOMC), I received a telephone call from Chairman Paul Volcker, as I assume did the 11 other presidents of the Reserve Banks. Chairman Volcker had just returned from a meeting of the International Monetary Fund in Belgrade, where the air was charged with worries about inflation, the foreign exchange markets, and various other forms of speculation. In his call he stated that he was going to call a meeting of the FOMC on Saturday, October 6, to address possible changes in the operating procedures of the Committee to place more emphasis on controlling the monetary aggregates.

At the first two meetings following his appointment as Chairman, I had dissented in favor of tighter money because of worries of the type that boiled over in Belgrade. I had not taken these dissents lightly, because of doubts about my own judgment and the high esteem in which I held the Chairman, but I felt strongly that the Committee had been inadvertently too "easy" in a very volatile and inflationary environment that could result in serious consequences unless the Committee made a strong commitment to a "tighter" policy.

I believe I remember almost precisely my words to the Chairman as he outlined his intentions for the October 6 meeting: "Mr. Chairman, you won't get any argument from me. I've thought for a long time that we ought to adopt procedures of the type you outlined." My enthusiasm was tempered by only one factor—the necessity of missing my usual Saturday golf game, my chief outside diversion at the time. It was, however, a trade-off I welcomed enthusiastically, since I concluded that the meeting was likely to yield very positive results for monetary policy.

On October 5, the Chairman convened a telephone conference call with the Board and the 12 Reserve Bank presidents and described in more detail what he was planning and the logistics of the meeting. In view of the speculative fever then rampant and the damage that could have arisen if word of the meeting leaked out, he told us that reservations had been made for us at various hotels in lieu of the one where we typically stayed. He also pointed out that the Pope was in Washington and that the considerable press attention that would be devoted to his visit would provide useful cover for our meeting. Finally, he told us that we would each receive by confidential wire a memorandum from Messrs. Axilrod and Sternlight that would outline the possible procedures and targets that he thought we should consider.

I ate alone at my hotel that night and did not discover until the next day that at least one of my fellow presidents had also stayed there. After having studied the memorandum and other material as carefully as I could, I went to bed quite happy, since I was convinced that the Committee was about to make a major improvement in our operating procedures the next day.

THE OCTOBER 6 MEETING

The meeting opened with a briefing on the economy by Jim Kichline, the associate economist to the Committee who typically provided the Committee with an economic briefing, and was followed by some discussion of economic condi-

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tions by members of the Committee and nonvoting presidents. Messrs. Wallich and Volcker then added some brief comments on the troublesome situation that they had observed in Belgrade.

After having described his assessment of real and financial conditions, Chairman Volcker outlined his view of the possibilities for operating policy over the period ahead:

1. Taking measures of the traditional type, which would include a rise in the discount rate coupled with a "significant" increase in the federal funds rate and a possible increase in reserve requirements by the Board latter that day.
2. Adopting the procedures outlined in the Axilrod-Sternlight memo, which would entail tailoring Desk operations to place more emphasis on a reserve path that would achieve money supply targets accompanied by a widening in the range for federal funds.

The Chairman stressed that there were risks with either approach but suggested that new procedures seemed necessary because the old approach clearly had serious deficiencies. He also cautioned that it would also be necessary to move the federal funds rate down promptly if the situation reversed itself. He had concluded that both foreigners and the administration would welcome a strong package despite some uneasiness about a change in techniques. He emphasized that he did not think the approach should be purely mechanical, that it should give the Desk considerable discretion in conducting operations, and that it should be revisited when needed in the future. He also expressed the hope that whatever approach was adopted would have widespread support in the Committee.

Right from the beginning, there was broad support for the new procedures, although the strength of the support varied from participant to participant. I believe that I was one of the most enthusiastic supporters and would have favored a longer-term commitment to the new procedures than was subsequently adopted. I long ago had begun thinking of the FOMC as occupying the position of a monopolist that could control the aggregates, within reasonable limits, or the federal funds rate, but not both simultaneously. Since I interpreted the historical empirical evidence as demonstrating that the rate of growth in the money supply had a much closer relationship to the price level and output than did the federal funds rate, I was strongly in favor of placing primary emphasis on the money supply and letting the federal funds rate fluctuate as widely as necessary to achieve the money supply target. I even went so far as to say at one point during the meeting that I felt better about what I'd heard that day than at any time since I began attending meetings of the FOMC many years before.

THE DECISION

There was a great deal of discussion about what the appropriate numbers should be under the new procedures toward which the Committee seemed to be moving. Everyone was well aware that the nature of money was changing and would likely change further, that there was slippage between any reserve number and the aggregates, and that the institutional arrangements were not perfect.

After long and arduous discussion, the Committee settled on the following ranges for its targets for the September-December period:

1. M1—an annual rate on the order of $4^1/_2$ percent
2. M2 and M3—an annual rate of about $7^1/_2$ percent
3. Federal funds rate—a range of $11^1/_2$ to $15^1/_2$ percent
4. An initial borrowing assumption of around \$1.5 billion

Since such rates of expansion would produce growth in the upper parts of the ranges adopted during the previous July meeting, the Committee agreed that somewhat slower rates of growth would be acceptable.

The vote in favor of the new procedures was unanimous. The group agreed that an announcement of these changes should be made promptly, but no decision as to the exact timing was made before the meeting adjourned.

After the meeting, the Board approved an increase in the discount rate from 11 percent to 12 percent and established a marginal reserve requirement of 8 percent on total managed liabilities of member banks, Edge Act corporations, and U.S. agencies and branches of foreign banks.

I supported more emphasis on long-term targeting than did most of my colleagues because (i) I thought the market needed to be assured of our longer-run intentions and (ii) I still felt that targeting the federal funds rate without additional emphasis on long-run targets was unlikely to produce predictable behavior of the aggregates. My main fear was that we would not raise the federal funds rate sufficiently if we overshot the targets, since it's always less difficult to ease than to tighten. As I had observed the history of the System's past policy actions, I felt that there was little doubt that most of the errors of the FOMC had resulted from having adopted too easy rather than too tight a policy.

In subsequent meetings after October 6, I concluded that we still needed to move more rapidly to tighten than we did. This led to my dissenting for tighter money five out of eight times the next two times I was a voting member during the tenure of Chairman Volcker. On one occasion following a prolonged discussion, I looked up at him and said, "It pains me, Mr. Chairman, but I think that I should dissent again." He smiled, glanced at me, and said, "It doesn't pain me!"

His comment led to some playful speculation among some of my colleagues that he wasn't worried about what I said because no one would pay any attention, but I know that he never sought "yes" participants and wanted everyone to feel free to vote his or her convictions. Moreover, I think he may possibly have welcomed the dissent as a means of helping shift the consensus nearer the position he really wanted, since a Chairman doesn't have the luxury of dissenting!

SUBSEQUENT DEVELOPMENTS

Subsequent years have brought many and rapid financial innovations; it has become more and more difficult to determine the best aggregates to control; and the slippages between reserve measures and aggregates have become more troublesome. Accordingly, the FOMC abandoned the formal setting of monetary aggregate targets in the 1990s and began leaning primarily on the federal funds rate as its operating target. It wisely preserved, however, a willingness to move the funds rate more promptly over a wider range in response to inflationary and real economic developments—a procedure I consider the single most important decision reached that afternoon on October 6, 1979.

I think that the System has done a superb job in recent years under these revised procedures and deserves our highest praise, although I confess to some continuing discomfort about the absence of any formal aggregate targets. One thing seems certain to me, however. I do not believe that such success would have come without the bold decision the Committee made that fateful Saturday in 1979! It is quite gratifying to have been a small part of that group that initially launched the Committee in what I believe has been the correct direction. Our country—indeed, the whole world—has benefited greatly from its commitment and courageous decisions.