Chairman's Remarks

Alan Greenspan

A defining moment may shape the direction of an institution for decades to come. In the modern history of the Federal Reserve, the action it took on October 6, 1979, stands out as such a milestone and arguably as a turning point in our nation's economic history. The policy change initiated under the leadership of Chairman Paul Volcker on that Saturday morning in Washington rescued our nation's economy from a dangerous path of ever-escalating inflation and instability. As I noted in congressional testimony before the Joint Economic Committee on November 5 of that year,

> We are here…to evaluate the moves of Chairman Volcker and his colleagues last month, implying that some alternate policies were feasible at that time. However, given the state of the world financial markets, had the Fed not opted to initiate a sharp interest rate increase in this country, the market would have done it for us.[1]

In a democratic society such as ours, the central bank is entrusted by the Congress, and ultimately by the citizenry, with the tremendous responsibility of guarding the purchasing power of money. It is now generally recognized that price stability is a prerequisite for the efficient allocation of resources in our economy and, indeed, for fulfilling our ultimate mandate to promote maximum sustainable employment over time. But the importance of price stability has sometimes been insufficiently appreciated in our central bank's history, and, as Allan Meltzer will soon point out, such episodes have had unfortunate consequences.

Far from being a bulwark of stability in the 1970s, the Federal Reserve conducted policies that, in the judgment of many analysts, inadvertently contributed to an environment of macroeconomic instability. We should strive to retain in the collective memory of our institution the ensuing lessons of that period. It may be the most fruitful and proper way to commemorate the events of October a quarter-century ago.

Tracing the roots of the 1970s inflation brings us to an earlier era. The Keynesian revolution of the 1930s and its subsequent empirical application led many economists to accept the view that through regulation, state intervention, and the macroeconomic management of aggregate demand, government policies (including those of our nation's central bank) could improve on earlier efforts to achieve and maintain "full employment." By the 1960s, policymakers seemed to concentrate their short-run objectives on maintaining a "high pressure" economy, in the belief that such a recipe could virtually thwart economic contractions at little or no risk to long-run stability and growth. If this high-pressure management inadvertently carried the economy beyond its productive potential, some costs in terms of inflation could be expected, but such costs appeared tolerable in light of the employment gains that came with them. Furthermore, policymakers hoped that additional tools at their disposal—so-called incomes policies enforced by "jawboning," guideposts, and price and wage controls—were ready to combat

[1] Alan Greenspan, "Statement," in *Domestic and International Implications of the Federal Reserves New Policy Actions*, Hearing before the Subcommittee on International Economics of the Joint Economic Committee, November 5, 1979, 96 Cong. 1 Sess. Washington, DC: Government Printing Office, 1980, p. 5.

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and control any resulting upcreep in inflation, with minimal macroeconomic cost. By the turn of the 1970s, the ugly reality of stagflation forced an overhaul of this policy framework. The corrosive influence of inflation on our nation's productive potential was beginning to take hold. Policymakers slowly came to recognize the adverse long-term consequences of compromising the purchasing power of our currency for economic well-being. Indeed, by the late 1970s, a consensus gradually emerged that inflation destroyed jobs rather than facilitated their creation. Unfortunately, a legacy of failed attempts during the decade, to restore stability with gradualist plans and with various incarnations of incomes policies, took its toll on business and household attitudes toward inflation and toward the prospects of our nation. By the end of the decade, an inflationary psychology had become well entrenched and complicated efforts to restore a sense of stability in the national psyche.

Little leeway for policy was left before the Federal Reserve took decisive action on October 6, 1979. In retrospect, the policy put in place on that day was the obvious and necessary solution to the nation's troubles. As events unfolded, however, the Federal Reserve did not escape criticism, and for a time it was not entirely obvious that the System could maintain the necessary public support to see its disinflationary efforts come to fruition. Though widely anticipated even before the actions of October, the recession and retrenchment in employment that followed those actions resulted in pressures on the Federal Reserve to reverse course. The 50th anniversary of the beginning of the Great Depression—the crash of 1929—was observed later during that same month, October 1979. I recall that this anniversary not only rekindled the question of whether such an event could recur but also inflamed sensitivities regarding the effects on unemployment that might stem from the new anti-inflationary action. Judging from the fate of earlier attempts during the 1970s to tame inflation in the face of a weakening economy, when short-run considerations appeared to trump policies oriented toward longer horizons, such fears of rising unemployment could have also derailed the reforms of October. In the event, they did not. We owe a tremendous debt of gratitude to Chairman Volcker and to the Federal Open Market Committee for their leadership and steadfastness on that important occasion and for restoring the public's faith in our nation's currency.

By the time that I arrived at the Federal Reserve, in 1987, the task of the Federal Open Market Committee had become easier precisely because of the perseverance and success of our predecessors in the turbulent years following October 1979. Maintaining an environment of stability is simpler than restoring the public's faith in the soundness of our currency. The task is easier still as we remind ourselves of the stark difference between the long-term prospects of our economy now, in our current environment of stability, and then, a quarter-century ago, before the reforms of that October.

In closing, I applaud President Poole and his colleagues for organizing this event to reflect on that critical episode in our nation's economic history. An appreciation of our history is, after all, an invaluable guide to sound policies for a better future.