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SYMPOSIUM

**“The Interaction of Markets
and Policy”**

Introduction

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This discussion of the interaction of markets and policy contributes to the Fed’s review of its strategies and its communication policy. But here are some comments that I offer for the Fed. First, when I was secretary of the Treasury, I appointed a little committee to advise, and I persuaded my friend Bill Martin, former chairman of the Fed, to become a member of it. After I left office, I also became a member. We were sitting and having a discussion, and Bill Miller, who then was chairman of the Fed, came to see us. He was for some reason getting worried about foreign exchange problems and he was worried about the dollar. He said, “I’ve said *this* about the dollar, I’ve said *this* about the dollar. What should I say about the dollar?” And there was a sort of dead silence. Then Bill Martin’s squeaky voice came, “You should say *less*.” There’s a point there.

Then there’s another suggestion. You remember the great slugger Ted Williams from the Red Sox? He was the last major leaguer to hit .400. He never said much, and some reporter yelled to him once, “Hey, Ted. Why aren’t you talking?” He said, “I let my bat do the talking.” The Fed has a big bat, and of course it can say something. But I think it should take the advice of Bill Martin and Ted Williams, because sometimes the talk is confusing. And the

more you talk, the more you get drawn into politics, almost inevitably. It's better off to stay out of it.

My second point is a little different. And it is my worry in particular, not with the Fed so much as, generally, that people forget that classical, orthodox Milton Friedman-like policies have worked. When you analyze things and say, "Oh my gosh, everything's different, so we'll have to have new policies," watch out, because classical, orthodox policies work.

Here's an example. In the Kennedy administration, they wanted to get the economy moving again. They worried about inflation, so the Council of Economic Advisers put out a view in favor of what were called "guidelines" for wage and price changes, guidelines to steer companies and others on what they should do. I read this and I worried a little, because it's the conceptual underpinning of wage and price controls. So, I had a conference at the University of Chicago, where I was teaching on the subject, and Milton Friedman came and gave a terrific talk. Bob Solow came and talked about the case; its title was "The Case against the Case against the Guidelines." It was a very lively discussion, and then we published a book on it, so the subject was on my mind.

Then I was appointed secretary of labor under Richard Nixon, and that was a different atmosphere. I was worried about interfering in large labor disputes and discrimination in the workplace, and was working with Pat Moynihan on welfare reform and other things. And all of a sudden, I became the first director of the Office of Management and Budget. I found out that the chairman of the Fed, Arthur Burns, saw that a big financial company named Penn Central had mismanaged its affairs and was about to go bankrupt. He thought that would have a terrible impact on the financial markets and was considering a government bailout. I observed that Helmut Schmidt, former minister of finance and chancellor of Germany, thought Arthur was the "pope of economics." He called him infallible, but I thought he was wrong. So I found myself argu-

ing with Burns in the Oval Office, with half of me saying, “What am I doing, arguing with Arthur Burns about financial markets?”

In walked a guy named Bryce Harlow, who was a smart political adviser. He said, “Mr. President, in its infinite wisdom, the Penn Central has just hired your old law firm to represent them in this matter. Under the circumstances, you can’t touch this with a ten-foot pole.” So there was no bailout. And guess what? The financial markets were strengthened, because people saw that and avoided the bailout mentality, which is: we can get away with anything and they’ll bail us out. So, I thought, you know, Arthur could be fallible. He did one good thing: he flooded the market with liquidity, which is, it seems to me, what the Fed’s role should be. See that there’s plenty of liquidity, but don’t intervene.

Later, we were worried about inflation. As I said, I had the guidelines experience, so I could somehow smell wage and price controls coming, and I gave a speech called “Steady As You Go.” The argument was: we had the budget under control, we had sensible monetary policies, and if we were willing to stick with it, then inflation would come under control—steady as you go. Well, I lost, and wage and price controls were put into effect. I knew that Burns was in favor of them, but not too long ago I discovered in the Hoover archives a letter from Arthur Burns, chairman of the Fed, to President Richard Nixon. The argument of the letter was as follows: The economy has changed, and it’s much more rigid than it was before, partly due to trade unions; therefore, classical monetary policy won’t work. So what do you have to do? Wage and price controls.

I realized then why I lost so definitively. But what was produced was a failure of the US economy, a miserable decade, thanks, in part, to the chairman of the Fed. I resigned as secretary of the Treasury when Nixon reimposed the controls over my objections.

When I came back with Ronald Reagan in 1980, inflation was in the teens and the economy was going nowhere. That’s what this

innovative policy had produced. Paul Volcker was at the Fed at the time. He'd been my under secretary when I was secretary of the Treasury, and I knew him well. We talked, and I could see he was doing what needed to be done at that time. People kept running into the Oval Office saying, "Mr. President, Mr. President, it's going to cause a recession. We're going to lose seats in the midterm election." Reagan knew that we had to get rid of inflation if we were going to have a decent economy and that Paul Volcker was doing the right thing, so he basically put a political umbrella over him. Paul told me that he noticed on many occasions that the press would float up a question to the president, inviting him to take on the Fed, but the president always brushed off those questions.

By the time 1982 came to an end, we did have a recession and we did lose seats. But by that time, inflation was clearly under control, and it was obvious that it was going to stay that way. The tax changes that had been put into effect and the regulatory withdrawal kicked in, and the economy took off like a bird. So the lesson is that thinking you should have an unorthodox policy because everything has changed did not work. Paul Volcker proved that, despite Arthur's analysis, classical policy *did* work. So that's my message: be careful when you stray too far away from policies that work.