What Jerome Powell Can Learn From Arthur Burns

By Thomas J. Sargent And William L. Silber

History, Federal Reserve Chairman Jerome Powell said last week in Jackson Hole, Wyo., warns against "prematurely loosening" Fed policy. Has he learned something from Arthur Burns? Burns, who led the Fed from 1970 to 1978, tightened credit to fight inflation early in the 1970s, but then failed to follow through. That contributed to the Great Inflation.

Burns, a respected economist who had been president of the National Bureau of Economic Research, had impeccable anti-inflation credentials when President Richard Nixon appointed him. He taught Milton Friedman when Friedman was an undergraduate at Rutgers University and trained future Fed Chairman Alan Greenspan, who did graduate work at Columbia. But Burns ultimately admitted that he failed to rein in the inflationary pressures when he had the opportunity to do so.

The 11% annual inflation of 1974 was the first installment of double-digit annual price increases of the decade. Some macroeconomists labeled that year's inflation transitory, citing shortages of food and energy as the main offenders. Ignoring those arguments, Burns tightened credit sharply to restrict demand, raising the overnight interest rate to more than 12% by mid-1974. That monetary restraint temporarily cut inflation in half, but subsequent Fed actions allowed it to grow again. The recession that developed in 1974 increased the unemployment rate to about 9% from 5%, and Burns responded by quickly cutting the short-term interest rate in half. But after that he never raised interest rates high enough to curb accelerating prices and regain the upper hand in battling inflation.

He did, however, convince Paul Volcker to become president of the Federal Reserve Bank of New York in 1975. Burns strong-armed Volcker, a known inflation hawk, into taking the job to place a voice of restraint on the Fed's policy-making committee. But in a public lecture after he left office in 1978, Burns admitted that under his leadership the Federal Reserve's "restrictive stance was not maintained long enough to end inflation."

Mr. Powell can avoid repeating those errors by restraining credit enough and for long enough. But figuring out what "long enough" means is challenging and depends on how inflation and the economy evolve. And unlike Burns in the 1970s, Mr. Powell has to contend with another challenge: the Fed's current policy of "forward guidance," the practice of releasing projections of each committee member's expected future path of the federal-funds rate after meetings of its rate-setting committee.

The Fed tries to explain forward guidance by saying that each member's projection is "based on information available at the time of the meeting, together with her or his assessment of appropriate monetary policy." But that description explains neither whether those projections are a forecast or a policy preference nor how they depend on inflation, economic growth and unemployment. Forward guidance is supposed to be informative but often fails to provide clarity and sometimes misleads. At the press conference following the Fed's July policy meeting, Mr. Powell announced a temporary suspension of forward guidance. He should make it permanent.

The 1970s Fed chairman choked when recession hit. Inflation persisted, and then he blamed Congress.

A prolonged battle against inflation won't be easy. Pressure to abandon tight money has already risen in Congress, even though real interest rates are still at historically low levels. And Congress holds the power to change the Fed's mandate. Sen. Elizabeth Warren recently wrote in these pages that "unfortunately, the Fed has seized on aggressive rate hikes—a big dose of the only medicine at its disposal—even though they are largely ineffective against many of the underlying causes of this inflationary spike." She asserted that high interest rates won't cure the current inflation, which comes from "skyrocketing energy prices caused by Vladimir Putin's war on Ukraine" and "won't fix supply chains still reeling from the pandemic." She neglected to mention that the purpose of the Fed's tight credit is to offset the inflationary effects of the expansionary monetary and fiscal actions of 2020 and 2021, which she and other members of Congress favored.

In the end, Burns blamed Congress for his failure to control inflation in the 1970s, saying in 1979 that if the Fed pursued a determined policy of monetary restraint, it "would be frustrating the will of Congress, to which it is responsible—a Congress that was intent on providing additional services to the electorate and assuring that jobs and incomes were maintained." America suffered a decade of inflation because Burns failed to do enough, soon enough and for long enough. Mr. Powell can avoid repeating those errors.

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THE WALL STREET JOURNAL.

PUBLISHED SINCE 1889 BY DOW JONES & COMPANY

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Notable & Quotable: Podcasts

From an Aug. 25 report by Dallas's WFAA-TV:

The world's largest podcast conference . . . apologized Thursday for the presence of a conservative podcaster. . . . The Podcast Movement apologized for Daily Wire co-founder . . . Ben Shapiro being at the conference, saying "we take full responsibility for the harm done by his presence."

The Daily Wire, which is a conservative news website and media company, did have a booth near the PM22 expo area. . . . The conference did not provide anymore details about what happened while Shapiro was there.

Podcast Movement provided a follow-up Tweet that said:

"There's no way around it: We agreed to sell The Daily Wire a first-time booth based on the company's large presence in podcasting. The weight of that decision is now painfully clear. Shapiro is a co-founder. A drop-in, however unlikely, should have been considered a possibility."

Later in the thread, Podcast Movement also tweeted, "The pain caused by this one will always stick with us. We promise that sponsors will be more carefully considered moving forward."