Strong Fed Chairmen Confront Spending

By Thomas J. Sargent And William L. Silber

At the news conference following the Federal Reserve's policy meeting on June 14, a reporter asked Fed Chairman Jerome Powell, "At what point do you talk more firmly with lawmakers about fiscal responsibility?"

Mr. Powell answered, "I don't do that. That's really not my job. We hope and expect that other policy makers will respect our independence on monetary policy. And we don't see ourselves as, you know, the judges of appropriate fiscal policy."

These words would surprise Paul Volcker, the Fed chairman who brought down double-digit inflation, and his successor, Alan Greenspan, who solidified those gains. Both Volcker and Mr. Greenspan testified before Congress on the need to reduce the deficit to control inflation. They understood, as we've written in these pages, that government deficits promote inflation.

In September 1981, after two years on the job, Volcker appeared before the Senate Budget Committee and spoke about lowering inflation and interest rates: "What can be done—and done consistent with our short and longer-run objectives—is to provide assurance that the federal fiscal position is indeed clearly on track to balance." He followed up in 1984 by admitting during Senate Banking Committee hearings that "an inevitable consequence" of his tight monetary policy might help bring about the necessary crisis "so that we deal with the deficit."

Powell says it isn't his job. Greenspan and Volcker would differ.

In July 1987, Mr. Greenspan echoed his predecessor on the deficit during his confirmation hearings as Fed chairman, claiming there was no way to lower interest rates while there are ever-increasing government deficits. He said the deficit "is the most important economic policy variable."

Mr. Greenspan's preoccupation with the deficit reflected what he learned from former Fed Chairman Arthur Burns, his professor at Columbia University, who presided over the buildup of inflation in the 1970s. Burns knew the relationship between fiscal policy and inflation. Mr. Greenspan tells the story of Burns "asking his students 'What causes inflation?' " After no one could give him a satisfactory answer, Burns finally said, "Excess government spending causes inflation."

Though he certainly knew how to control inflation, Burns was reluctant to buck the political headwinds. He used that explanation of inflation's root cause to excuse his failure to tighten monetary policy as prices rose, saying during a lecture after he left the Fed that the Federal Reserve shouldn't "frustrate the will of Congress to which it is responsible—a Congress that was intent on providing additional services to the electorate." The result was a preventable inflationary spending explosion.

Mr. Powell has acknowledged that many of his "predecessors have said that we're on an unsustainable fiscal path," but he asserted that "trying to get into that with lawmakers would be kind of inappropriate." It's tempting to avoid political backlash, but Mr. Powell would be better served following in the footsteps of Paul Volcker and Alan Greenspan than Arthur Burns.

Mr. Sargent is a senior fellow at the Hoover Institution, a professor of economics at New York University and a 2011 Nobel laureate in economics. Mr. Silber is author of "Volcker: The Triumph of Persistence" and "The Power of Nothing to Lose: The Hail Mary Effect in Politics, War and Business."