

# Volcker, Powell and the Price of Amnesia

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**I**s the Federal Reserve re-viewing the connection between high inflation and the past two years' U.S. monetary policy? A reporter asked Fed Chairman Jerome Powell that question at a June 15 news conference. After acknowledging that the Fed is doing so "very carefully," the chairman deflected. He said that for decades inflation was "dominated by disinflationary forces," but recent history has been plagued by "extraordinary shocks." Pointing to the pandemic, the war in Ukraine and shutdowns in China, he concluded: "We're aware that a different set of forces are driving the economy."

Yet Mr. Powell neglected to mention the expansionary monetary and fiscal policies of 2020 and 2021 that surely contributed to upward pressure

on prices. More important, he missed the main culprit: the Federal Reserve. The Fed lost control of inflation by abandoning its decadeslong strategy of pre-emptive restraint—that is, tightening before inflation takes hold. That policy, promoted by Fed Chairman Paul Volcker in the 1980s, has delivered price stability for nearly 40 years.

## The Fed should have heeded the lessons of 1980s inflation.

The mistake started in August 2020, when the Fed began to target "inflation moderately above 2% for some time" to make up for past shortfalls. This attitude encouraged the central bank to label the emerging inflation as "transitory." In June 2021

congressional testimony, Mr. Powell nailed the coffin on pre-emptive restraint precisely when it was most needed: "We will not raise interest rates pre-emptively because we think employment is too high, because we fear the possible onset of inflation. Instead, we will wait for actual evidence of actual inflation or other imbalances."

Volcker blamed the runaway inflation of the 1970s on this type of thinking. He told his Fed colleagues: "We have lost this game in the past by staying with an expansionary policy too long during a recovery period." He then followed through by raising rates early in the economic recovery of 1984—with the unemployment rate still at 7.8%—to avoid inflationary pressure. Alan Greenspan, Volcker's successor, continued pre-emptive restraint, most famously by surprising financial markets with a sharp rate increase in

mid-1994 while inflation during the first half of the year averaged 2.5%. The last pre-emptive rate increase occurred in December 2016 under Janet Yellen. That month, the Fed raised the federal-funds target by 25 basis points as inflation was running at 1.3% for the year.

We believe that the policy of pre-emptive restraint is what anchored inflationary expectations after the mid-1980s by preventing inflation from taking hold. The country is now paying for the Fed's amnesia.

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