

# The Most Dangerous Idea in Federal Reserve History: Monetary Policy Doesn't Matter

By CHRISTINA D. ROMER AND DAVID H. ROMER\*

\* C. Romer: University of California, Berkeley, Berkeley, CA 94720-3880 (email: [crmer@econ.berkeley.edu](mailto:crmer@econ.berkeley.edu)); D. Romer: University of California, Berkeley, Berkeley, CA 94720-3880 (email: [dromer@econ.berkeley.edu](mailto:dromer@econ.berkeley.edu)).

Few would argue with the proposition that over the 100-year history of the Federal Reserve, there have been periods when—at least with the benefit of hindsight—policy could have been improved substantially. Our thesis in this paper is that overly pessimistic views about the power of monetary policy have been a more important source of these errors than have overly optimistic views.

There is little doubt that an overinflated belief in the power of monetary policy has contributed to some major policy errors. Most famously, policymakers in the mid-1960s believed that they faced an exploitable long-run inflation-unemployment tradeoff, and thus that monetary policy could move the economy to a sustained path of low unemployment and low inflation. This belief led them to pursue highly expansionary policy, starting the economy down the path to the inflation of the 1970s (for example, Romer and Romer 2002 and Primiceri 2006). The record of such errors has led many to argue that perhaps the most important attribute of a successful central banker is humility (for example, Booth 2012).

In this paper, we present evidence that the opposite belief—an unduly *pessimistic* view of what monetary policy can accomplish—has been a more important source of policy errors and poor outcomes over the history of the Federal Reserve. At various times in the 1930s, faced with the Great Depression, Federal Reserve officials believed that the power of monetary policy to combat the downturn or stimulate recovery was minimal. In both the mid- and late 1970s, faced with high inflation, policymakers believed that monetary policy could not reduce inflation at any reasonable cost. And there is evidence that in the past few years, faced with high unemployment and a weak recovery, monetary policymakers believed that policy was relatively weak and po-

tentially costly. In each episode, the belief that monetary policy was ineffective led to a marked passivity in policymaking.

The next three sections discuss the 1930s, the 1970s, and the past few years, respectively. The final section concludes by arguing that being a good central banker appears to require a balance of humility and hubris.

## I. The 1930s

The most significant error in the history of the Federal Reserve surely occurred in 1929–33, when the money stock fell 26 percent, the price level declined 25 percent, and output decreased 27 percent. We know of no evidence that the Federal Reserve's actions in this period were the result of an exaggerated sense of the power of monetary policy.

There is, however, vast evidence that an overly pessimistic assessment of the Federal Reserve's ability to combat the downturn was critical in this period (Friedman and Schwartz 1963, Meltzer 2003, and many others). Many monetary policymakers believed that expansionary monetary policy would not be effective and that it might involve substantial costs. The result was inaction in the face of the largest downturn in American history.

One early episode showing monetary policymakers' pessimism about what they could accomplish occurred in the summer of 1930. As described by Friedman and Schwartz (1963, pp. 369–75), Meltzer (2003, pp. 304–20), and Board of Governors (1956, pp. 432–517), the Federal Reserve Bank of New York proposed expansionary actions in this period. New York's proposal was opposed by most of the other Federal Reserve banks, and so little was done.

The opponents of New York's proposals proffered two main arguments that expansion would be ineffective. First, and crucially, the main indicators of the stance of policy that they used—nominal interest rates, banks' ex-

cess reserves, and their borrowing from the Federal Reserve—indicated that policy was already highly expansionary. They therefore thought that monetary policy had done all it could. For example, one opponent argued, “With credit cheap and redundant we do not believe that business recovery will be accelerated by making credit cheaper and more redundant.”<sup>1</sup> Another referred to “the fruitlessness and unwisdom of attempting to depress still further the abnormally low interest rates now prevailing.” Second, they believed that the cause of the downturn was not monetary but lay in excesses in the 1920s, and thus that the downturn could not be solved by monetary policy. One policymaker said,

The consequences of ... an economic debauch are inevitable. We are now suffering them.

Can they be corrected or removed by cheap money? We do not believe that they can. ... [T]here is no short cut or panacea for the rectification of existing conditions.

Policymakers also saw two costs to expansion, related to the two reasons they viewed expansion as unproductive. First, they believed that expansion that had little impact would damage their credibility, and so make later expansion less effective. As one put it,

[With] an abundance of funds in the market, ... it should be the policy of the Federal Reserve System to maintain a position of strength, in readiness to meet future demands, as and when they arise, rather than to put reserve funds into the market when not needed.

Second, they feared that expansion could trigger renewed speculation and inflation. For example, one opponent said, “Cheap money is a stimulant, ... but a headache will follow if the dose is large enough, and persisted in. It encourages over-borrowing.”

These concerns prevented significant action not just in 1930, but throughout the downturn. Consider, for example, the Federal Reserve’s decision to end a brief period of expansionary open-market operations in 1932. Hsieh and Romer (2006, pp. 169–72) document the reasons that George Harrison (head of the Federal

Reserve Bank of New York, and one of the architects of the program) gave for the decision:

When the figures of member bank reserves are sufficiently high ..., we shall probably have done our part. If the commercial banks can’t or don’t use the credit which we provide, that is another problem.

It was thought best ... not to use our ammunition until the chances of effective response from the banking and business community would favor the success of our undertaking.

There is no sense ... in our purchasing Government securities merely as an offset to currency hoarding. That is an impossible task and an inversion of our program, which was based on a revival of confidence in the banking and credit structure.

As described by Romer and Romer (2004), these ideas persisted into the recovery. For example, the expression that at some point further monetary easing is ineffective because “one cannot push a string” appears to have originated in Congressional testimony in 1935 by Marriner Eccles, the governor (that is, head) of the Federal Reserve Board. Similarly, in 1937, the Federal Open Market Committee (FOMC) believed that “the existing volume of excess reserves and of supplies of private capital is abundant at this time at low rates,” and therefore that “effective action to meet and overcome the present business recession should be taken outside the field of the System’s various monetary powers.”

In addition, the view that monetary expansion could lead to inflation even when the economy was operating well below capacity took on particular importance in the mid-1930s. Policymakers were concerned that monetary expansion “might well add unwise stimulus to the inflation of prices” and that “a further increase in excess reserves of member banks might give added impetus to existing inflationary tendencies.”

Consistent with its view that it could do little to stimulate the economy, the Federal Reserve was largely passive in the recovery, just as it had been during the downturn. The monetary base rose rapidly during much of this period, but the increases were almost entirely the result of gold inflows and the Treasury’s decision to not sterilize them, rather than of Federal Reserve actions.

The Federal Reserve’s major policy initia-

<sup>1</sup> The sources for all the quotations in the paper are given in the appendix.

tive in this period—the doubling of reserve requirements in 1936–37 and working with the Treasury to sterilize gold inflows at the same time—was motivated by fear of inflation in a still-depressed economy. Policymakers believed that banks’ excess reserves could “create an injurious credit expansion,” and therefore “decided to lock up this part of the present volume of member bank reserves as a measure of prevention.”<sup>2</sup>

## II. The 1970s

Another major failure of the Federal Reserve occurred in the late 1960s and the 1970s, when inflation rose erratically from low levels to near 10 percent before finally being conquered by the Volcker disinflation. Once the inflation was underway, overly pessimistic views about the power of monetary policy played a major role in policymakers’ decisions to not take strong steps to combat it.

This pessimism was especially important in two parts of this era. In both, Federal Reserve officials agreed that in principle, tight enough monetary policy, pursued for long enough, would bring inflation down. But they viewed the output costs as so large that such a policy was neither desirable nor politically feasible.<sup>3</sup>

The first period was roughly from 1971 to 1973. After inflation failed to fall in the mild recession of 1969–1970, Federal Reserve chairman Arthur Burns and other policymakers concluded not that the natural rate was higher than they had previously believed, but that inflation was almost impervious to economic slack.<sup>4</sup> Federal Reserve documents record that in June 1971, Burns expressed the view that:

[O]f late one found that at a time when unemployment was increasing prices continued to advance at an undiminished pace and wages rose at an increasing pace. ...

In his judgment a much higher rate of unemployment produced by monetary policy would not moderate [wage-cost] pressures appreciably.

In July, he testified that “even a long stretch of high and rising unemployment may not suffice to check the inflationary process.” In May 1971, the economist making the official staff presentation to the FOMC referred to “something like a 4 per cent floor on the rate of inflation.”

As discussed by Romer and Romer (2002), these views led the Federal Reserve to not use conventional monetary policy to combat inflation. For example, in the May 1971 presentation, the economist said,

The question is whether monetary policy could or should do anything to combat a persisting residual rate of inflation .... The answer, I think, is negative. ... It seems to me that we should regard continuing cost increases as a structural problem not amenable to macro-economic measures.

The belief that the costs of using monetary policy to control inflation were too high caused policymakers to advocate incomes policies instead. For example, in June 1971, Burns testified,

[A] substantial increase of unemployment has failed to check the rapidity of wage advances or to moderate appreciably the rise of the general price level.

With increasing conviction, I have therefore come to believe that our Nation must supplement monetary and fiscal policy with specific policies to moderate wage and price increases.

At the FOMC meeting the same month, one member asked Burns about the prospects of the administration proposing incomes policies. In response,

Chairman Burns said he wished he could give an encouraging response to that question but he could not. He thought the Administration had been much too slow to recognize the need for an effective incomes policy. He had urged that action be taken in that area and intended to continue doing so.

The second period when beliefs about the ineffectiveness of policy were prevalent oc-

<sup>2</sup> Of course, the pessimistic views we have described were not the only source of the policy failures in the 1930s. Meltzer and Friedman and Schwartz show how views about the proper role of monetary policy, including the importance of defending the gold standard and of meeting credit demand rather than promoting macroeconomic stability, had important effects on policy. In addition, Friedman and Schwartz document how the fractured power structure of the Federal Reserve in the first part of the decade favored inaction over action.

<sup>3</sup> Nelson (2005) documents similar beliefs in the United Kingdom in this era. Indeed, he argues that some policymakers held the stronger view that inflation was not a monetary phenomenon at all, and thus that monetary policy could play no role in ending it.

<sup>4</sup> Primiceri (2006) shows that such a belief could have arisen in this period as a result of endogenous learning.

curred under the chairmanship of G. William Miller in 1978 and 1979. Shortly after becoming chairman, Miller testified,

Our attempts to restrain inflation by using conventional stabilization techniques have been less than satisfactory. Three years of high unemployment and underutilized capital stock have been costly in terms both of lost production and of the denial to many of the dignity that comes from holding a productive job. Yet, despite this period of substantial slack in the economy, we still have a serious inflation problem.

Other policymakers expressed similar views throughout Miller's tenure. For example, in May 1979, Governor Henry Wallich, generally regarded as one of the most anti-inflationary members of the FOMC, said, "We also have evidence that inflation in the American economy is much less variable than it is in other countries and is, therefore, much harder to bring down." And at Miller's final meeting in July 1979, the staff presentation stated, "we expect that rising unemployment will do little to damp inflation," and that "[f]or monetary policy alone there seems to be little in the way of policy options which would yield substantially improved results during the next year or two." During the discussion, the economist in charge of the presentation listed several reasons that "we wouldn't expect to get the same price response from very weak markets" as had occurred just a few years before.

This humility about their powers again caused monetary policymakers to not pursue anti-inflationary policy, but instead to continue to stimulate the economy (Romer and Romer, 2002). Miller testified in March 1979, "Real interest rates ... still appear to remain low by historical standards and thus continue to facilitate an expansion of overall demands."

These views also led Miller and other FOMC members to again advocate nonmonetary steps to combat inflation. At his first FOMC meeting in March 1978, Miller argued that monetary policy was not the best way to fight inflation, saying that if the administration did not "take some more believable steps in fighting inflation ..., inflation is going to be left to the Federal Reserve and that's going to be bad news." The official summary of the meeting said, "It was noted that an effective program to reduce the rate of inflation had to extend beyond monetary policy." That same month, Miller testified that conventional poli-

cies "need to be complemented by programs designed to enhance competition and to correct structural problems."

### III. The Past Few Years

The last several years, like the 1930s and 1970s, have been a time of dismal macroeconomic performance. The economy suffered its largest postwar recession in 2007–09. Since then, unemployment has remained very high, and has consistently been projected to remain so for years. And in contrast to the periods of high unemployment in the 1970s and early 1980s—but similar to the 1930s—the high unemployment has occurred at a time of low inflation, with core inflation and the Federal Reserve's inflation forecasts generally below its inflation target.

It is clearly too soon to reach firm conclusions about monetary policy over this period. Much of the record of policymakers' thinking is not yet available. More importantly, there has not been enough time to confidently assess what monetary policy could and could not have accomplished.

Nonetheless, it seems hard to assign pessimism about the power of monetary policy a large role in the crisis itself. Prior to the crisis, monetary policymakers appear to have believed that they would be able to largely counteract the macroeconomic effects of a large fall in house prices. And during the crisis, they believed they had the ability to prevent a collapse of the financial system, and acted aggressively and creatively to do so.

There are, however, intriguing parallels between policymakers' beliefs in the period from roughly the end of the recession to the latter half of 2012 and beliefs in the 1930s and 1970s. Monetary policymakers in each period have to some extent believed that their tools were not very effective and were potentially costly.

In the recent period, strong views of this type among monetary policymakers have been largely confined to some of the presidents of the regional Federal Reserve banks. Indeed, at times some have expressed views similar to ones from the 1930s. For example, one argued against additional action on the grounds that, "Why would the Fed provision to shovel billions in additional liquidity into the economy's boiler when so much is presently lying

fallow?” Another argued that “a zero-rate policy increases the risk of misallocating real resources, creating a new set of imbalances or possibly a new set of bubbles.” And with regard to quantitative easing, he argued that “the purported benefits are small,” and that it risks “a further misallocation of resources, more imbalances and more volatility,” “undermining Federal Reserve independence,” and the possibility that “inflation expectations could become unanchored.” A third argued that “the supply of bank reserves is already large enough to support the economic recovery,” and that “further monetary stimulus runs the risk of raising inflation in a way that threatens the stability of inflation expectations.”

In addition, some bank presidents have attributed high unemployment to structural problems, and have therefore doubted the ability of monetary policy to reduce unemployment without triggering inflation. For example, one stated, “Most of the existing unemployment represents mismatch that is not readily amenable to monetary policy.” Another attributed the rise in unemployment largely to a need for sectoral reallocation that monetary policy could not address:

You can’t change the carpenter into a nurse easily .... Eventually ... [p]eople will be retrained and they’ll find jobs in other industries. But monetary policy can’t retrain people. Monetary policy can’t fix those problems.

Among the leading figures on the FOMC, the view that monetary policy tools are not very effective and potentially costly has been milder and more nuanced, both relative to the views described above and relative to those in the 1930s and 1970s. Nonetheless, there is evidence that it has been present. It appears to have had two key elements.

One is that the power of the available tools is limited. The language that key monetary policymakers have used to describe what their tools could accomplish has consistently been measured. In October 2012, for example, Federal Reserve chairman Ben Bernanke said that “we expect our policies to provide meaningful help to the economy,” but that “monetary policy is not a panacea” for “tackl[ing],” among other things, “the near-term shortfall in aggregate demand.” Similarly, in November 2011, after identifying “a dearth of aggregate demand,” Federal Reserve vice-chair Janet

Yellen also said that “monetary policy is not a panacea.” The same month, William Dudley, President of the Federal Reserve Bank of New York, said that “although a stimulative monetary policy is essential for recovery, it may not be sufficient.”

The second element of leading policymakers’ pessimism about their tools has been the view that there are costs associated with them. Probably the most explicit statement of this view was made by Bernanke in August 2012. He listed four potential costs to nontraditional policies: they “could impair the functioning of securities markets,” “reduce public confidence in the Fed’s ability to exit smoothly from its accommodative policies at the appropriate time,” create “risks to financial stability,” and cause “the possibility that the Federal Reserve could incur financial losses.”<sup>5</sup> Similarly, Yellen said in April 2012, “provid[ing] additional stimulus using [our] unconventional tools ... involves costs and risks.” And Dudley said in November 2011 that nontraditional tools entail “costs as well as ... benefits,” and went on to detail the costs he perceived.

Policymakers have been explicit that these considerations have muted their policy response. Bernanke in October 2012 said that “the Federal Reserve has generally employed a high hurdle for using” nontraditional tools. In April 2012, Yellen said, “The FOMC’s unconventional policy actions ..., in my judgment, have not entirely compensated for the zero-bound constraint.” These statements are consistent with the fact that Federal Reserve policy in recent years has been less aggressive than some analysts have suggested (see, for example, Gagnon 2009).

Another parallel between the recent experience and the earlier periods—particularly the 1970s—is that concern about the effectiveness of their tools has led monetary policymakers to advocate nonmonetary measures. In September 2012, after saying that monetary policy “is not a panacea” for addressing tight financial conditions and high unemployment,

<sup>5</sup> Bernanke’s conclusion was that “the costs of nontraditional tools, when considered carefully, appear manageable”; and, as we discuss below, his speech came shortly before a decision by the FOMC to use the tools more forcefully. Nonetheless, the speech provides an unusually clear discussion of the costs that policymakers perceived.

Bernanke said, “We’re looking for policymakers in other areas to do their part.” Using very similar language in November 2011, Yellen elaborated on her view that monetary policy alone could not solve an aggregate demand shortfall by saying that “it is essential for other policymakers to also do their part.” And in January 2012, the Federal Reserve sent Congressional leaders an unsolicited white paper discussing “current conditions and policy considerations” concerning the housing market and housing policy.

Whether the Federal Reserve’s decisions in the past few years have reflected unwarranted pessimism about the effectiveness of monetary policy or a wise assessment will not be known for many years, if ever. One suggestive piece of evidence that policymakers may now think they had been underestimating the effectiveness of the tools, or overestimating their costs, comes from the Federal Reserve’s decision in September 2012 that it was appropriate to use its tools more aggressively. Its policy statement said, “If the outlook for the labor market does not improve substantially, the Committee will ... employ its ... policy tools as appropriate until such improvement is achieved in a context of price stability.” But the Federal Reserve’s current judgments about the efficacy of its tools are unlikely to be the last word.<sup>6</sup>

#### IV. Conclusion

The view that hubris can cause central bankers to do great harm clearly has an important element of truth. A belief that monetary policy can achieve something it cannot—such as stable low inflation together with below-normal unemployment—can lead to the pursuit of reckless policies that do considerable damage.

<sup>6</sup> Some evidence consistent with the interpretation that the change in policy reflected a change in policymakers’ assessment of the efficacy of their tools (rather than a change in their assessment of the macroeconomic outlook) comes from the Federal Reserve’s projections of unemployment and inflation. Concretely, consider the projections in November 2011 and September 2012. The projections in September 2012, when it decided to make greater use of the tools, involved a considerably lower level of unemployment, and a similar rate of decline in unemployment and a similar path for inflation, than the projections in November 2011, when it decided to take no substantial new action.

But the hundred years of Federal Reserve history show that humility can also cause large harms. In the 1930s, excessive pessimism about the power of expansionary monetary policy and about its potential costs caused monetary policymakers to do little to combat the Great Depression or promote recovery. In critical periods in the 1970s, undue pessimism about the potential of contractionary monetary policy to reduce inflation led policymakers to do little to rein in the Great Inflation. We have stressed that it is too soon to reach conclusions about recent developments. But, faced with persistent high unemployment and below-target inflation, beliefs that the benefits of expansion are small and the costs potentially large appear to have led monetary policymakers to eschew more aggressive expansionary policy in much of 2010 and 2011. In hindsight, these beliefs may be judged too pessimistic.

The approaches of two largely successful Federal Reserve chairmen—William McChesney Martin and Paul Volcker—also suggest that the value of humility in a central banker may be overstated. Both came into office believing that monetary policy could accomplish a great deal. In his statement on being sworn in, Martin compared the importance of monetary policy to that of defending the country against foreign aggression:

Unless inflation is controlled, it could prove to be an even more serious threat to the vitality of our country than the more spectacular aggressions of enemies outside our borders. I pledge myself to support all reasonable measures to preserve the purchasing power of the dollar.

And Volcker had more faith than his predecessors in the ability of monetary policy to reduce inflation. At his confirmation hearings, for example, he said, “I don’t think we have any substitute for seeking an answer to our problems in the context of monetary discipline.”

One possible conclusion is that a central banker should have a balance of humility and hubris. A central banker needs to have a sound knowledge of both the limitations and the powers of monetary policy. Thus, the most important characteristic to look for in central bankers is not their inherent optimism or pessimism about the effectiveness of monetary policy, but rather their understanding of how

the economy works and the possible contributions of policy.

## REFERENCES

- Board of Governors of the Federal Reserve System.** 1956. "Open Market Investment Policy: Excerpts, 1929–Mid-1931."
- Booth, Philip.** 2012. "The Bank of England Needs a Humble Governor." Institute of Economic Analysis, October 17.
- Friedman, Milton, and Anna Jacobson Schwartz.** 1963. *A Monetary History of the United States, 1867–1960*. Princeton: Princeton University Press for NBER.
- Gagnon, Joseph E.** 2009. "The World Needs Further Monetary Ease, Not an Early Exit." Peterson Institute for International Economics Policy Brief No. PB09-22.
- Hsieh, Chang-Tai, and Christina D. Romer.** 2006. "Was the Federal Reserve Constrained by the Gold Standard During the Great Depression? Evidence from the 1932 Open Market Purchase Program." *Journal of Economic History* 66(1): 140–76.
- Meltzer, Allan H.** 2003. *A History of the Federal Reserve. Volume 1: 1913–1951*. Chicago: University of Chicago Press.
- Nelson, Edward.** 2005. "The Great Inflation of the Seventies: What Really Happened?" *Advances in Macroeconomics* 5(1), Article 3.
- Primiceri, Giorgio E.** 2006. "Why Inflation Rose and Fell: Policy-Makers' Beliefs and U.S. Postwar Stabilization Policy." *Quarterly Journal of Economics* 121(3): 867–901.
- Romer, Christina D., and David H. Romer.** 2002. "The Evolution of Economic Understanding and Postwar Stabilization Policy," in *Rethinking Stabilization Policy*. Kansas City: Federal Reserve Bank of Kansas City, 11–78.
- Romer, Christina D., and David H. Romer.** 2004. "Choosing the Federal Reserve Chair: Lessons from History." *Journal of Economic Perspectives* 18(1): 129–162.

## APPENDIX: SOURCES

This appendix documents the sources of the quotations and data in the paper. The structure of the appendix is that each relevant passage from the paper is followed by the associated documentation.

### I. The 1930s

in 1929–33, when the money stock fell 26 percent, the price level declined 25 percent, and output decreased 27 percent.

The data on the money stock are annual averages of monthly data on M1 from Friedman and Schwartz (1963, Table A-1, column 7, pp. 712–14). The data on the price level and real GDP are from the National Income and Product Accounts, Tables 1.1.4 and 1.1.3.

[http://www.bea.gov/iTable/index\\_nipa.cfm](http://www.bea.gov/iTable/index_nipa.cfm).

“With credit cheap and redundant we do not believe that business recovery will be accelerated by making credit cheaper and more redundant.”

Board of Governors (1956), p. 471.

[http://fraser.stlouisfed.org/docs/historical/openmarket/OMPC/OMIC1929\\_1931.pdf](http://fraser.stlouisfed.org/docs/historical/openmarket/OMPC/OMIC1929_1931.pdf).

“the fruitlessness and unwisdom of attempting to depress still further the abnormally low interest rates now prevailing.”

Quoted in Friedman and Schwartz (1963), p. 372.

“The consequences of ... an economic debauch are inevitable. We are now suffering them.

“Can they be corrected or removed by cheap money? We do not believe that they can. ... there is no short cut or panacea for the rectification of existing conditions.”

Board of Governors (1956), p. 503.

[http://fraser.stlouisfed.org/docs/historical/openmarket/OMPC/OMIC1929\\_1931.pdf](http://fraser.stlouisfed.org/docs/historical/openmarket/OMPC/OMIC1929_1931.pdf).

“[With] an abundance of funds in the market, ... it should be the policy of the Federal Reserve System to maintain a position of strength, in readiness to meet future demands, as and when they arise, rather than to put reserve funds into the market when not needed.”

Quoted in Friedman and Schwartz (1963), p. 371.

“Cheap money is a stimulant, ... but a headache will follow if the dose is large enough, and persisted in. It encourages over-borrowing.”



Board of Governors (1956), p. 504.

[http://fraser.stlouisfed.org/docs/historical/openmarket/OMPC/OMIC1929\\_1931.pdf](http://fraser.stlouisfed.org/docs/historical/openmarket/OMPC/OMIC1929_1931.pdf).

“When the figures of member bank reserves are sufficiently high ..., we shall probably have done our part. If the commercial banks can’t or don’t use the credit which we provide, that is another problem.”

Harrison Papers. Columbia University Rare Book and Manuscript Library. “Memorandum: Meeting of Board of Directors,” 5/12/1932, p. 218.

“It was thought best ... not to use our ammunition until the chances of effective response from the banking and business community would favor the success of our undertaking.”

Harrison Papers. Columbia University Rare Book and Manuscript Library. “Memorandum: Meeting of Board of Directors,” 6/30/1932, p. 246.

“There is no sense ... in our purchasing Government securities merely as an offset to currency hoarding. That is an impossible task and an inversion of our program, which was based on a revival of confidence in the banking and credit structure.”

Harrison Papers. Columbia University Rare Book and Manuscript Library. “Memorandum: Meeting of Board of Directors,” 7/7/1932, p. 264.

“one cannot push a string”

U.S. House of Representatives, Committee on Banking and Currency, *Banking Act of 1935*, Corrected Print (Washington, D.C.: Government Printing Office, 1935), p. 377.

[http://fraser.stlouisfed.org/docs/historical/congressional/1935hr\\_ba1935.pdf](http://fraser.stlouisfed.org/docs/historical/congressional/1935hr_ba1935.pdf).

the Federal Open Market Committee (FOMC) believed that “the existing volume of excess reserves and of supplies of private capital is abundant at this time at low rates,” and therefore that “effective action to meet and overcome the present business recession should be taken outside the field of the System’s various monetary powers.”

FOMC, Minutes, 12/1/1937, p. 2.

<http://www.federalreserve.gov/monetarypolicy/files/FOMChistmin19371201.pdf>.

“might well add unwise stimulus to the inflation of prices”

FOMC, Minutes, 3/15/1937, p. 9.

<http://www.federalreserve.gov/monetarypolicy/files/FOMChistmin19370315.pdf>.

“a further increase in excess reserves of member banks might give added impetus to existing inflationary tendencies.”

FOMC, Executive Committee, Minutes, 3/23/1937, pp. 3–4.

<http://www.federalreserve.gov/monetarypolicy/files/FOMChminec119370323.pdf>.

Policymakers believed that banks' excess reserves could "create an injurious credit expansion," and therefore "decided to lock up this part of the present volume of member bank reserves as a measure of prevention."

Record of Policy Actions—Board of Governors, 7/14/1936. In *Twenty-Third Annual Report of the Board of Governors of the Federal Reserve System, Covering Operations for the Year 1936* (Washington, D.C.: Board of Governors of the Federal Reserve System, 1937), p. 217.  
[http://fraser.stlouisfed.org/docs/publications/arfr/1930s/arfr\\_1936.pdf](http://fraser.stlouisfed.org/docs/publications/arfr/1930s/arfr_1936.pdf).

## II. The 1970s

"[O]f late one found that at a time when unemployment was increasing prices continued to advance at an undiminished pace and wages rose at an increasing pace. ...

In his judgment a much higher rate of unemployment produced by monetary policy would not moderate [wage-cost] pressures appreciably."

FOMC, Memorandum of Discussion, 6/8/1971, pp. 50–51.  
<http://www.federalreserve.gov/monetarypolicy/files/fomcm19710608.pdf>.

"even a long stretch of high and rising unemployment may not suffice to check the inflationary process."

Congressional testimony, 7/23/1971. In *Federal Reserve Bulletin* 57(8): 656.  
[http://fraser.stlouisfed.org/docs/publications/FRB/1970s/frb\\_081971.pdf](http://fraser.stlouisfed.org/docs/publications/FRB/1970s/frb_081971.pdf).

"something like a 4 per cent floor on the rate of inflation."

FOMC, Memorandum of Discussion, 5/11/1971, p. 28.  
<http://www.federalreserve.gov/monetarypolicy/files/fomcm19710511.pdf>.

"The question is whether monetary policy could or should do anything to combat a persisting residual rate of inflation .... The answer, I think, is negative. ... It seems to me that we should regard continuing cost increases as a structural problem not amenable to macro-economic measures, just as reducing the unemployment rate below 4 per cent or thereabouts has long been viewed as an objective requiring structural rather than macro solutions."

FOMC, Memorandum of Discussion, 5/11/1971, p. 29.  
<http://www.federalreserve.gov/monetarypolicy/files/fomcm19710511.pdf>.

"[A] substantial increase of unemployment has failed to check the rapidity of wage advances or to moderate appreciably the rise of the general price level.

With increasing conviction, I have therefore come to believe that our Nation must supplement monetary and fiscal policy with specific policies to moderate wage and price increases."

Congressional testimony, 6/30/1971. In *Federal Reserve Bulletin* 57(7): 596.  
[http://fraser.stlouisfed.org/docs/publications/FRB/1970s/frb\\_071971.pdf](http://fraser.stlouisfed.org/docs/publications/FRB/1970s/frb_071971.pdf).

“Chairman Burns said he wished he could give an encouraging response to that question but he could not. He thought the Administration had been much too slow to recognize the need for an effective incomes policy. He had urged that action be taken in that area and intended to continue doing so.”

FOMC, Memorandum of Discussion, 6/8/1971, p. 49.  
<http://www.federalreserve.gov/monetarypolicy/files/fomcmmod19710608.pdf>.

“Our attempts to restrain inflation by using conventional stabilization techniques have been less than satisfactory. Three years of high unemployment and underutilized capital stock have been costly in terms both of lost production and of the denial to many of the dignity that comes from holding a productive job. Yet, despite this period of substantial slack in the economy, we still have a serious inflation problem.”

Congressional testimony, 3/15/78. In *Federal Reserve Bulletin* 64(3): 193.  
[http://fraser.stlouisfed.org/docs/publications/FRB/1970s/frb\\_031978.pdf](http://fraser.stlouisfed.org/docs/publications/FRB/1970s/frb_031978.pdf).

“We also have evidence that inflation in the American economy is much less variable than it is in other countries and is, therefore, much harder to bring down.”

FOMC, Transcript, 5/22/1979, p. 21.  
<http://www.federalreserve.gov/monetarypolicy/files/FOMC19790522meeting.pdf>.

“we expect that rising unemployment will do little to damp inflation”

FOMC, Presentation Materials, 7/11/79, Zeisel presentation, p. 7.  
<http://www.federalreserve.gov/monetarypolicy/files/FOMC19790711material.pdf>.

“[f]or monetary policy alone there seems to be little in the way of policy options which would yield substantially improved results during the next year or two.”

FOMC, Presentation Materials, 7/11/79, second Kichline presentation, p. 3.  
<http://www.federalreserve.gov/monetarypolicy/files/FOMC19790711material.pdf>.

“we wouldn’t expect to get the same price response from very weak markets”

FOMC, Transcript, 7/11/1979, p. 7.  
<http://www.federalreserve.gov/monetarypolicy/files/FOMC19790711meeting.pdf>.

“Real interest rates ... still appear to remain low by historical standards and thus continue to facilitate an expansion of overall demands.”

Congressional testimony, 2/22/1979. In *Federal Reserve Bulletin* 65(3): 227.  
[http://fraser.stlouisfed.org/docs/publications/FRB/1970s/frb\\_031979.pdf](http://fraser.stlouisfed.org/docs/publications/FRB/1970s/frb_031979.pdf) .

“take some more believable steps in fighting inflation ..., inflation is going to be left to the Federal Reserve and that’s going to be bad news.”

FOMC, Transcript, 3/21/1978, p. 33.  
<http://www.federalreserve.gov/monetarypolicy/files/FOMC19780321meeting.pdf>.

“It was noted that an effective program to reduce the rate of inflation had to extend beyond monetary policy.”

FOMC, Record of Policy Actions, 3/21/1978, p. 16.  
<http://www.federalreserve.gov/monetarypolicy/files/fomcropa19780321.pdf>.

“need to be complemented by programs designed to enhance competition and to correct structural problems.”

Congressional testimony, 3/15/1978. In *Federal Reserve Bulletin* 64(3): 193.  
[http://fraser.stlouisfed.org/docs/publications/FRB/1970s/frb\\_031978.pdf](http://fraser.stlouisfed.org/docs/publications/FRB/1970s/frb_031978.pdf).

### III. The Past Few Years

Items referred to as “Speech” are ones listed on the “Speeches” page of the website of the Board of Governors of the Federal Reserve (<http://www.federalreserve.gov/newsevents/speech/2012speech.htm>) or the Federal Reserve Bank of New York (<http://www.newyorkfed.org/newsevents/speeches/index.html>).

“Why would the Fed provision to shovel billions in additional liquidity into the economy’s boiler when so much is presently lying fallow?”

Richard Fisher, “Comments to the Harvard Club of New York City on Monetary Policy (with Reference to Tommy Tune, Nicole Parent, the FOMC, Velcro, Drunken Sailors and Congress),” speech in New York, New York, 9/19/2012, p. 2.  
<http://www.dallasfed.org/news/speeches/fisher/2012/fs120919.cfm>.

“a zero-rate policy increases the risk of misallocating real resources, creating a new set of imbalances or possibly a new set of bubbles.”

Thomas M. Hoenig, “Statement before the House Subcommittee on Domestic Monetary Policy and Technology, United States House of Representatives, 7/26/2011, p. 1.”  
<http://www.kansascityfed.org/publicat/speeches/072611hoenig.pdf>.

“the purported benefits are small,” and that it risks “a further misallocation of resources, more imbalances and more volatility,” “undermining Federal Reserve independence,” and the possibility that “inflation expectations could become unanchored.”

Thomas M. Hoenig, “The Federal Reserve's Mandate: Long Run,” speech in Denver, Colorado, 10/12/2010, pp. 6-7. <http://www.kansascityfed.org/speechbio/hoenigpdf/nabe-hoenig-10-12-10.pdf>.

“the supply of bank reserves is already large enough to support the economic recovery”

Jeffrey M. Lacker, “Economic Outlook, December 2012,” speech in Charlotte, North Carolina, 12/17/2012, p. 3.  
[http://www.richmondfed.org/press\\_room/speeches/president\\_jeff\\_lacker/2012/pdf/lacker\\_speech\\_20121217.pdf](http://www.richmondfed.org/press_room/speeches/president_jeff_lacker/2012/pdf/lacker_speech_20121217.pdf).

“further monetary stimulus runs the risk of raising inflation in a way that threatens the stability of inflation expectations.”

Jeffrey M. Lacker, “Maximum Employment and Monetary Policy,” speech in New York, New York, 9/18/2012, p. 5.  
[http://www.richmondfed.org/press\\_room/speeches/president\\_jeff\\_lacker/2012/pdf/lacker\\_speech\\_20120918.pdf](http://www.richmondfed.org/press_room/speeches/president_jeff_lacker/2012/pdf/lacker_speech_20120918.pdf).

“Most of the existing unemployment represents mismatch that is not readily amenable to monetary policy.”

Narayana Kocherlakota, “Inside the FOMC,” speech in Marquette, Michigan, 8/17/2010, p. 6.  
[http://www.minneapolisfed.org/news\\_events/pres/kocherlakota\\_speech\\_08172010.pdf](http://www.minneapolisfed.org/news_events/pres/kocherlakota_speech_08172010.pdf).

“You can’t change the carpenter into a nurse easily .... Eventually ... [p]eople will be retrained and they’ll find jobs in other industries. But monetary policy can’t retrain people. Monetary policy can’t fix those problems.”

Charles Plosser, quoted in Mary Anastasia O’Grady, “The Fed’s Easy Money Skeptic,” *Wall Street Journal*, 2/12/2011.  
<http://online.wsj.com/article/SB10001424052748704709304576124132413782592.html>.

“we expect our policies to provide meaningful help to the economy,” but that “monetary policy is not a panacea” for “tackl[ing],” among other things, “the near-term shortfall in aggregate demand.”

Speech, 10/14/2012, pp. 3–4.  
<http://www.federalreserve.gov/newsevents/speech/bernanke20121014a.pdf>.

Speech, 2/25/2011, p. 3.  
<http://www.federalreserve.gov/newsevents/speech/yellen20110225a.pdf>.

after identifying “a dearth of aggregate demand,” Federal Reserve vice-chair Janet Yellen also said that “monetary policy is not a panacea.”

Speech, 11/29/2011, pp. 1, 11.

<http://www.federalreserve.gov/newsevents/speech/yellen20111129a1.pdf>.

“although a stimulative monetary policy is essential for recovery, it may not be sufficient.”

Speech, 11/17/2011, p. 2.

<http://www.newyorkfed.org/newsevents/speeches/2011/dud111117.html>.

“could impair the functioning of securities markets,” “reduce public confidence in the Fed’s ability to exit smoothly from its accommodative policies at the appropriate time,” create “risks to financial stability,” and cause “the possibility that the Federal Reserve could incur financial losses.”

Speech, 8/31/2012, pp. 12, 13, 14.

<http://www.federalreserve.gov/newsevents/speech/bernanke20120831a.htm>.

“the costs of nontraditional tools, when considered carefully, appear manageable”

Speech, 8/31/2012, p. 14.

<http://www.federalreserve.gov/newsevents/speech/bernanke20120831a.htm>.

“provid[ing] additional stimulus using [our] unconventional tools ... involves costs and risks”

Speech, 4/11/2012, p. 17.

<http://www.federalreserve.gov/newsevents/speech/yellen20120411a.pdf>.

Dudley said in November 2011 that nontraditional tools entail “costs as well as ... benefits,” and went on to detail the costs he perceived.

Speech, 11/17/2011, p. 5.

<http://www.newyorkfed.org/newsevents/speeches/2011/dud111117.html>.

“the Federal Reserve has generally employed a high hurdle for using”

Speech, 10/14/2012, p. 4.

<http://www.federalreserve.gov/newsevents/speech/bernanke20121014a.pdf>.

“The FOMC’s unconventional policy actions ..., in my judgment, have not entirely compensated for the zero-bound constraint.”

Speech, 4/11/2012, p. 17.

<http://www.federalreserve.gov/newsevents/speech/yellen20120411a.pdf>.

after saying that monetary policy “is not a panacea” for addressing tight financial conditions and high unemployment, Bernanke said, “We’re looking for policymakers in other areas to do their part.”

Transcript of press conference, 9/13/2012, pp. 7–8.

<http://www.federalreserve.gov/monetarypolicy/fomcpresconf20120913.htm>.

“it is essential for other policymakers to also do their part.”

Speech, 11/29/2011, p. 11.

<http://www.federalreserve.gov/newsevents/speech/yellen20111129a1.pdf>.

the Federal Reserve sent Congressional leaders a white paper discussing “current conditions and policy considerations” concerning the housing market and housing policy.

“The U.S. Housing Market: Current Conditions and Policy Considerations,” Board of Governors of the Federal Reserve, 1/4/2012.

<http://www.federalreserve.gov/publications/other-reports/files/housing-white-paper-20120104.pdf>.

“If the outlook for the labor market does not improve substantially, the Committee will ... employ its ... policy tools as appropriate until such improvement is achieved in a context of price stability.”

FOMC Statement, 9/13/2012.

<http://www.federalreserve.gov/newsevents/press/monetary/20120913a.htm>.

The projections in September 2012, when it decided to make greater use of the tools, involved a considerably lower level of unemployment, and a similar rate of decline in unemployment and a similar path for inflation, than the projections in November 2011

The projections are from the Federal Reserve’s “projection materials” for the FOMC meetings of 11/1–2/2011 and 9/12–13/2012.

<http://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20111102.pdf> and

<http://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20120913.pdf>.

#### IV. Conclusion

“Unless inflation is controlled, it could prove to be an even more serious threat to the vitality of our country than the more spectacular aggressions of enemies outside our borders. I pledge myself to support all reasonable measures to preserve the purchasing power of the dollar.”

“Statement by Chairman Martin on His Taking Oath of Office, April 2, 1951,” *Federal Reserve Bulletin* 37(4): 377. [http://fraser.stlouisfed.org/docs/publications/FRB/1950s/frb\\_041951.pdf](http://fraser.stlouisfed.org/docs/publications/FRB/1950s/frb_041951.pdf).

“I don’t think we have any substitute for seeking an answer to our problems in the context of monetary discipline.”

U.S. Senate, Committee on Banking, Housing, and Urban Affairs, *Nomination of Paul A. Volcker* (Washington, D.C.: U.S. Government Printing Office, 1979), 7/30/1979, p. 5.  
<http://hdl.handle.net/2027/mdp.39015083086606>.