

Under Pressure

POLITICS *and* THE FEDERAL RESERVE
DURING THE 1990 - 1991 RECESSION



Cartoon illustration by Mark Cullum of the "Economy Train." Originally appeared in *The Birmingham News*, 1991. Use courtesy of Mark Cullum, Abilene, Texas.

By: *Tim Todd*



Under Pressure

POLITICS *and* THE FEDERAL RESERVE
DURING THE 1990 - 1991 RECESSION

By: *Tim Edd*

Under Pressure:
POLITICS *and* THE FEDERAL RESERVE
DURING THE 1990 - 1991 RECESSION

PUBLISHED BY THE PUBLIC AFFAIRS DEPARTMENT *of*
THE FEDERAL RESERVE BANK *of* KANSAS CITY
1 MEMORIAL DRIVE • KANSAS CITY, MO 64198

Diane M. Raley, publisher
Kristina J. Young, associate publisher
Lowell C. Jones, executive editor

Tim Todd, author

Casey McKinley, designer
Cindy Edwards, archivist

All rights reserved, Copyright © 2011 Federal Reserve Bank of Kansas City

No part of this book may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior consent of the publisher.

FIRST EDITION

Contents

IX PREFACE

XIII FOMC MEMBERSHIP, 1988-1993

XV INTRODUCTION

1 'A KINGDOM DIVIDED'

January 1988 – October 1990

11 'WITH THE ECONOMY IN TROUBLE, MONETARY POLICY ... WAS PUT ON HOLD'

October 1990 – February 1991

17 'DEMOCRACY IS MESSIER THAN DICTATORSHIP'

February 1991 – May 1991

21 'MR. GREENSPAN'S FORECAST... COULD HARDLY HAVE BEEN SWEETER MUSIC TO A PRESIDENT'

May 1991 – September 1991

31 'THE ADMINISTRATION WAS TRYING TO PUSH A... PRO-GROWTH POLICY'

September 1991 – October 1991

37 'WITH THE DRUMBEAT *of* THE WHITE HOUSE IN OUR EARS'

October 1991 – November 1991

43 'I DON'T FIND ANYBODY ASKING *for* MONETARY POLICY TO DO MORE'

December 1991, Part I

Contents

- 49 'MERRY CHRISTMAS *and* HAPPY NEW YEAR *from* THE FED'
December 1991, Part II
-
- 55 'WELL, I SEE THEY CAVED IN AGAIN'
December 1991 – September 1992
-
- 61 'THE POLITICIZATION *of* MONETARY POLICY PROCEEDS IN A ... SUBTLE MANNER'
September 1992 – December 1992
-
- 65 'HIS TRACK RECORD IS HARD TO ARGUE WITH'
1993 and Beyond
-
- 75 ECONOMIC DATA, 1988-1994
-
- 82 CHANGES IN THE FED FUNDS RATE *and* THE DISCOUNT RATE, 1988-1994
-
- 87 BIBLIOGRAPHY
-
- 91 MONETARY POLICY *and* THE ROLE *of* DISSENT
By THOMAS M. HOENIG, PRESIDENT *and* CHIEF EXECUTIVE OFFICER,
FEDERAL RESERVE BANK *of* KANSAS CITY
-
- 100 PHOTO CREDITS
-
- 102 INDEX



© Lance Nelson/CORBIS

The Federal Reserve building on Constitution Avenue in Washington, D.C.

Preface

THE FEDERAL RESERVE, THE FEDERAL OPEN MARKET COMMITTEE *and* MONETARY POLICY

Congress designed the Federal Reserve's structure to carefully balance public and private interests in the oversight of the nation's central bank. The goal was to ensure broad representation in the bank's important policy deliberations with ample opportunity for discussion and disagreement while also providing insulation from those who might seek to influence policy decisions for short-term political gain. Under this structure, the Board of Governors in Washington, D.C., has broad oversight responsibility for the Federal Reserve. The Board is the government component of the Federal Reserve and comprises seven governors who are appointed by the president of the United States and confirmed by the Senate. Meanwhile, the regional Federal Reserve Banks operate under the leadership of local Boards of Directors. These boards are filled by individuals from throughout the respective Federal Reserve Districts and, among other responsibilities, select the president of their respective Federal Reserve Banks.

This blending of public and private is mirrored in the Federal Open Market Committee, (FOMC) which is responsible for setting the nation's monetary policy.

All seven governors are voting members of the FOMC, as is the president of the Federal Reserve Bank of New York. The other Federal Reserve Bank presidents vote on a rotating basis. All governors and Bank presidents participate in the FOMC policy deliberations and offer their views on current economic conditions, the outlook and the path they would recommend for monetary policy.

The Federal Reserve primarily conducts monetary policy through adjustments in a short-term interest rate known as the federal funds rate. Depository institutions, such as commercial banks, have accounts, called reserve accounts, at their respective regional Federal Reserve Bank. These funds are held to meet demand for loans or withdrawals and can be loaned to another institution needing cash. The interest rate on these short-term loans is the fed funds rate. Changes in the rate can set off a chain of events that influence other interest rates. The entire FOMC is responsible for setting a target for the fed funds rate.

The Federal Reserve Banks can also loan balances directly to sound financial institutions through what is known as the Fed's discount window. This is where the central bank meets its responsibility for acting as a lender of last resort. For these loans, the Fed charges borrowers an interest rate known as the discount rate. The discount rate is set by the Boards of Directors of the Federal Reserve Banks, subject to the review and determination of the Federal Reserve's Board of Governors. The rate is the same across the nation, and the Federal Reserve's governors vote on changes to the discount rate, not the entire FOMC. Because both rates involve bank borrowing, and the Fed lends at a higher rate than what is available on the market, the fed funds rate and the discount rate almost always move in tandem today. In recent years, discount window lending has changed and now includes both primary and secondary credit, which is available to financial institutions at different rates. In this environment, primary credit is the discount rate while secondary credit is a higher rate.

Current media coverage of Federal Reserve interest rate changes focuses almost exclusively on the fed funds rate. Previously, changes in the discount rate also received significant media attention, but even then, it was recognized that discount rate moves were seen as largely symbolic, and their actual influence on monetary policy was nominal.

FOMC Membership, 1988-1993

THE BOARD of GOVERNORS of THE FEDERAL RESERVE SYSTEM

ALAN GREENSPAN, *Chairman*

MANUEL H. JOHNSON, *Vice Chairman* (resigned Aug. 3, 1990)

MARTHA R. SEGER (resigned March 11, 1991)

WAYNE D. ANGELL

H. ROBERT HELLER (resigned July 31, 1989)

EDWARD W. KELLEY, JR.

JOHN P. LAWARE

DAVID W. MULLINS, JR. (oath of office: May 21, 1990;
became Vice Chairman July 24, 1991)

LAWRENCE B. LINDSEY (oath of office: Nov. 26, 1991)

SUSAN M. PHILLIPS (oath of office: Dec. 2, 1991)

PRESIDENTS of THE FEDERAL RESERVE BANKS

Atlanta.....Robert P. Forrestal

Boston.....Richard F. Syron

Chicago.....Silas Keehn

Cleveland.....W. Lee Hoskins (resigned Nov. 15, 1991);
Jerry L. Jordan (appointed March 10, 1992)

Dallas.....Robert H. Boykin (retired Jan. 31, 1991)
Robert D. McTeer Jr. (appointed Feb. 1, 1991)

Kansas City.....J. Roger Guffey (retired Oct. 1, 1991)
Thomas M. Hoenig (appointed Oct. 1, 1991)

Minneapolis.....Gary H. Stern

New York.....E. Gerald Corrigan (retired July 19, 1993)
William J. McDonough (appointed July 19, 1993)

Philadelphia.....Edward G. Boehne

Richmond.....Robert P. Black (retired Dec. 31, 1992);
J. Alfred Broaddus Jr. (appointed Jan. 1, 1993)

San Francisco.....Robert T. Parry

St. Louis.....Thomas C. Melzer



The role of political influence and the central bank have been an issue since well before the Federal Reserve's founding in 1913. The Second Bank of the United States, located in Philadelphia, was formed in 1816 as a central bank for the growing nation but was unable to overcome public distrust and a political attack mounted by President Andrew Jackson. Although Philadelphia visitors can still see the building, the Bank's charter expired in 1836.

Introduction

The financial crisis of the late 2000s will have numerous and far-reaching implications, bringing changes to components of our financial system, ranging from the documents borrowers sign when securing a loan, to the regulators that ensure consumers are treated fairly.

As Congress considered the massive financial reform legislation package in late 2009 and early 2010, one of the proposals that found support was the idea that the president of the Federal Reserve Bank of New York should be appointed by the White House instead of being selected by the New York Fed's Board of Directors.

That the proposal would be made was not at all surprising. In fact, in times of financial crisis, Congress frequently examines the nation's central bank and, in some cases, has made substantial changes to its structure and responsibilities. Most notable among these was during the Great Depression when legislation created the modern Federal Open Market Committee to handle the nation's monetary policy.

The idea of changing the method of filling the New York Fed position was eventually put aside in 2010 as lawmakers determined that such a move would have far-reaching and important consequences for the Federal Reserve's public/private structure.

Comments made throughout the debate on financial regulatory reform, however, indicated that there is support for revisiting the topic of possible changes to the Fed's structure with a much more thorough review in the future. The Fed's history suggests that even if the issue does not come up in 2011, it will be raised again at some point.

Given today's environment, Federal Reserve Bank of Kansas City directors asked for a historical perspective on the issue. Much has been written about the various battles between the political structure and the nation's central bank, from Andrew Jackson's famous declaration to "kill" the second Bank of the United States through the more recent efforts of Congressmen including Wright Patman, who battled the Fed from the late 1930s through the early 1970s, and Ron Paul, who launched an "End the Fed" campaign in the 2000s. I was involved in, and clearly recall, Rep. Henry Gonzalez's review of the Federal Reserve. However, while some events in the history of the nation's central bank have received significant attention, other, more recent, events have received a less thorough review.

Such a review can offer numerous benefits, not only by lending the heft of fact to arguments that may be largely hypothetical, but also by illustrating what control the nation's



© Najah Feanny/CORBIS SABA

President George Bush speaks to supporters at a New Jersey campaign stop during the 1992 election campaign. Although Bush was hounded by his apparent change of direction on a pledge about taxes, he was also faced with a mild recession and sluggish recovery.


political structure is currently able to exert over the central bank, in ways both direct and subtle.

A strong candidate for a more thorough exploration would be the interaction – and intersection – of monetary policy and politics during the recession of 1990-91 and the months leading up to the 1992 presidential election.

Although these events are now 20 years old, they may prove helpful to review in a couple of ways. First, from a monetary policy perspective, in addition to the political pressure, the recession presented policymakers with challenges that were then difficult to recognize – namely the idea of a “jobless recovery” where production was able to rebound while unemployment continued to swell. Since this is a relatively recent pattern associated with U.S. economic recoveries, reviewing this period may prove helpful in judging the best path for future policy actions. Second, those who started following the Federal Reserve in the last 10 to 15 years may be surprised to see that the Fed’s governors, who today seem almost constant in their agreement around policy, were once less so and vocal, even outspoken in some cases, in their opposing views about monetary policy. Even those who are more familiar with the Fed might benefit from a reminder that dissent within the FOMC was far more common than it has been in recent years.

From the political side, the implications of the example are obvious.

That the recession of 1990-91 is thought by some to have contributed to the defeat of a president who appeared unbeatable at the polls a year earlier illustrates all too well the incentive to control and to bring monetary policy more fully inside the “political” tent. These events show how tempting it can be for elected leaders to risk long-term damage for short-term political gains and the importance of the Federal Reserve’s decentralized structure.

A handwritten signature in black ink, reading "Thomas M. Hoenig". The signature is fluid and cursive, with a large, sweeping flourish at the end.

Thomas M. Hoenig,
President and Chief Executive Officer,
Federal Reserve Bank of Kansas City



© James Marshall/CORBIS

The 1987 stock market crash came only weeks after the start of Alan Greenspan's tenure at the Federal Reserve. The Fed's new chairman was later praised for his handling of the crisis.

A Kingdom Divided'

JANUARY 1988 – OCTOBER 1990

Two weeks before Christmas 1988, *The Wall Street Journal* subscribers picked up the paper and saw Gerald Corrigan's face smiling up at them from the front page.

Corrigan, drawn in the paper's iconic black and white style, could have been a retail executive pleased with holiday sales or a shopper who was finding great deals. The paper described him as looking "like a New York City cop."¹ What he definitely did not look like was president of the Federal Reserve Bank of New York.

Central banking isn't known for smiles. And the Dec. 13, 1988, article was a serious story about an important development at the nation's central bank – a divide among its top policymakers.

"For much of this year the Fed has been a kingdom divided," reporters Alan Murray and David Wessel wrote.² "The presidents of the 12 district Fed banks ... have been leading an effort to push up short-term interest rates and slow the economy. The seven Fed governors in Washington – all appointed by President Reagan – have been more reluctant to curb growth in the absence of other signs of accelerating inflation."

At that time, the factions were seen as having two leaders. On one side was Corrigan, who, regardless of the smile, was known to be "gruff" and "a central banker of the old school."³ On the other was the Fed's then-Vice Chairman Manuel Johnson, a supply-side economist who had been critical of the Fed's tight money policies before joining the Fed in 1986. Adding a layer of complexity to the relationship was the fact that both men had once been seen as possible successors to Chairman Paul Volcker before the appointment of economist Alan Greenspan.

Corrigan, in fact, had been the top choice in a poll of money managers published by *The Wall Street Journal* in early 1987.⁴ And while Greenspan's handling of the "Black Monday" stock market collapse later that year was seen as a pivotal moment in establishing his Wall Street credibility – and is in fact the focal point of the opening chapter in Bob Woodward's Greenspan profile "Maestro" – Corrigan played an equally critical role during the crisis, earning his own recognition as a skilled conductor.

1. *The Wall Street Journal*, Dec. 13, 1988.

2. *The Wall Street Journal*, Dec. 13, 1988.

3. *The Wall Street Journal*, Dec. 13, 1988.

4. *The Wall Street Journal*, Feb. 27, 1987.

“Drawing on his experience in earlier crises, Mr. Corrigan knew that his most essential tasks were to stay informed and to tally fears of the unknown,” wrote Michael Quint of *The New York Times*.⁵ “Working the telephone like a maestro, he kept Washington abreast of the latest developments and assured the financial community that the world was not coming to an end.”

Now, with Greenspan still a relative newcomer, Corrigan and Johnson were seemingly leading their own factions for control of monetary policy.

“They’re like a cork bobbing in turbulent seas,” economist Robert Brusca told a reporter about the Fed.⁶ “They are anchorless. You have a lot of new people, they are inexperienced, and everyone seems to be focusing on a different thing.”

Critics said that the Federal Reserve – specifically the policy-setting Federal Open Market Committee – had too many officials speaking publicly on policy and offering views that were too divergent. It was seen as a sharp contrast to the Fed under Paul Volcker’s “tightfisted rule.”⁷ The towering Volcker, although certainly facing his share of criticism in his time at the Fed’s helm, was seen as a leader. Now, critics said, the Fed seemed to be lacking clear leadership.

Within the Fed, however, the new environment of debate was seen as healthy, one Fed senior official told *The Wall Street Journal*.⁸

“Individual members who are economists in their own right are discussing their views of monetary theory. I see no danger, nor any particular problems in that, so long as they are all essentially together on policy.”

It is perhaps telling that the comment was attributed only to a “senior Fed official,” and that the somewhat odd syntax suggests that official may have been Greenspan himself trying to calm markets.

The split among Fed policymakers was rooted in a move Greenspan had made earlier in the year. In January, the Fed chairman had single-handedly cut the federal funds rate, which is the rate financial institutions pay to borrow funds overnight from each other, by 25 basis points. The rate is the Fed’s key monetary policy tool and has significant influence, although not direct control, over the rates that financial institutions charge borrowers. Greenspan’s decision to make the cut was in response to concerns about economic weakness in an environment still jittery from the 1987 stock market collapse only three months earlier.

Although Greenspan believed the cut, which put the fed funds rate at 6½ percent,

5. *The New York Times*, Oct. 2, 1988.

6. *The Wall Street Journal*, April 22, 1988.

7. *The Wall Street Journal*, April 22, 1988.

8. *The Wall Street Journal*, April 22, 1988.

was necessary, other Fed policymakers questioned both the need for the cut and the means through which it was executed.

Federal Reserve Bank of Kansas City President Roger Guffey raised the issue during the next FOMC meeting in February 1988. Guffey, an attorney who spent 10 years practicing law before joining the Kansas City Fed as its legal counsel, very carefully noted that although there were certain conditions under which Greenspan could make a cut without a FOMC vote, none of those conditions were met.

Additionally, Guffey said he was troubled by the move coming at a time when the Reagan administration was very publicly pressuring the Fed to ease monetary policy. That pressure was made extremely clear in a letter Assistant Treasury Secretary for Economic Policy Michael Darby had sent to Fed policymakers arguing that the economy was slowing and suggesting the need for easing monetary policy.

“In my view, it’s particularly important, given the background of the political pressure that had come from the Treasury people ... and so forth, that such a decision be a broader-based decision,” Guffey told Greenspan during the FOMC meeting.⁹

Greenspan responded to Guffey by saying he had already voiced concern to Treasury Secretary James Baker about Darby’s “most inappropriate” letter.¹⁰

Political concerns aside, the move turned out to be a monetary policy misstep. The Fed started raising rates only a month later.

The turn of events was troubling to the Fed’s longer-serving policymakers who were concerned about political influence over the central bank. Greenspan was a Republican political appointee who had chaired the Council of Economic Advisors under President Ford and had worked on the Nixon campaign. The Fed presidents, meanwhile, are appointed by the directors of their respective regional Federal Reserve Banks and make a very concerted effort to remain agnostic politically and focus only on monetary policy.

“The episode left some presidents more convinced than ever that they had to take the lead in the fight against inflation,” *The Wall Street Journal’s* Alan Murray later wrote.¹¹



Roger Guffey, president of the Federal Reserve Bank of Kansas City, was among those to voice concern after Fed Chairman Alan Greenspan utilized a provision to lower interest rates without consulting the Federal Open Market Committee in early 1988.

9. *Transcript of FOMC meeting, Feb. 9-10, 1988.*

10. *Transcript of FOMC meeting, Feb. 9-10, 1988.*

11. *The Wall Street Journal, April 5, 1991.*

If they needed any more convincing, it came over that summer when the regional Bank presidents led the charge to raise rates while the Republican-appointed governors, in the words of the *Journal's* Murray, were “reluctant participants”¹² in the rate hikes heading into the 1988 presidential election. Privately, the Reserve Bank presidents wondered about the reluctance and its connection to George H.W. Bush's bid for the White House. The matter came to a head during an August conference call where nine of the 12 regional Feds sought a rate hike. The governors finally signed off on the move, pushing the fed funds rate to 8¼ percent.¹³

It was an important turn of events for the FOMC.

“Reward to the boys”

A strong case can be made that 1988 was not a battle unto itself, but only part of a larger standoff between the Fed's governors and presidents.



President George Bush was joined by Republican party leaders during a Rose Garden press conference to discuss ongoing budget squabbling in October 1990. Gaining budget approval ended up taking weeks longer than the Bush team had hoped.

This division among Fed policymakers continued and became even more pronounced. There were multiple dissenting votes at three of the first four FOMC meetings in 1990. It took a war, literally, to bring consensus – the FOMC had its first unanimous vote of the year on Aug. 21, only a

few weeks after Iraq invaded Kuwait. For Fed policymakers, there were important economic questions about a rise in oil prices that accompanied the fighting, both how long it would last and how high prices might go.

The uncertainty only increased by the time of the next FOMC meeting on Oct. 2. Growth was slowing, consumer and business confidence was falling, oil prices and inflation were rising, credit was tightening, and it was becoming increasingly clear that the United States was in a recession. Against this backdrop was a monetary policy session that some later suggested was a “Fed revolt” while others said the division was overblown and

12. The Wall Street Journal, April 5, 1991.

13. The Wall Street Journal, April 5, 1991.

the whole situation was simply a “tempest in a teapot.”¹⁴

At the meeting, Greenspan recommended a 25-basis-point cut and then suggested that FOMC members be prepared to cut another 25 basis points in about 10 days if economic data set for release at that time showed weakness. In an unusual step, Greenspan suggested the first cut not be made immediately, but delayed until after congressional lawmakers reached an agreement on the 1991 federal budget, which was believed to be in the late stage of deliberations.

Although the suggested post-budget timing may have come as a shock, policymakers were likely not surprised by the idea of a cut. The Fed chairman had put down the groundwork at the FOMC’s August meeting, saying that the nation was in a period of “economic-political policy turmoil.”

“In that type of environment it is crucial that there be some stable anchor in the economic system. It’s clearly not going to be on the budget side; it has to be the central bank. It’s got to be we! [sic]”¹⁵

Greenspan told the FOMC that cutting the rate immediately before final budget approval would be “very confusing,” but some Fed policymakers told the chairman that they were concerned about linking the interest rate cut so directly to the political action¹⁶ – a move that some certainly saw as an affront to the very idea of an independent central bank. In creating the Federal Reserve in 1913, Congress had been very diligent in designing a structure that was supposed to insulate the central bank’s policy deliberations from just this type of politically driven pressure.

At worst, it seemed the central bank’s chairman was willing to blur the lines between monetary and fiscal policy. Even at best, it was likely to confuse the public.

“If you favor this move without the budget agreement because of economic considerations, wouldn’t it be wiser to link it more to those economic considerations so we don’t have this precedent of having acted because fiscal policy has acted?” asked Richmond Fed President Robert Black.¹⁷

Greenspan said he did not disagree with that view, but that he did not “see how we can get around not responding to a real budget agreement” that was going to have a significant impact on government spending.

“This is a real budget agreement. There is no question that there is a significant absorption of purchasing power coming out of the system,” Greenspan said.¹⁸

14. *The Washington Post*, April 18, 1991.

15. *Transcript of FOMC meeting*, Aug. 21, 1990.

16. *Transcript of FOMC meeting*, Oct. 2, 1990.

17. *Transcript of FOMC meeting*, Oct. 2, 1990.

18. *Transcript of FOMC meeting*, Oct. 2, 1990.

Some FOMC members argued that it was important to not only wait for the final approval, but to see how it was interpreted by the markets. Among other things, increased fiscal responsibility could, in fact, be viewed as an extremely positive step for the nation.

In addition to all of the political ramifications and possible outcomes, the timing of any Federal Reserve action related to the budget was complicated by the calendar. The following Monday, when Greenspan wanted to actually make the cut, was the Columbus Day holiday – the markets would still trade, but banks would be closed and, without banks, the Fed would be unable to implement policy. That meant that Greenspan was talking about policy action on Tuesday – a full week away and a very long time if a budget deal were reached, for example, late in the day the previous Friday.

In addition to having concerns about the apparent political arrangement, St. Louis Fed President Thomas Melzer told the committee that he was fearful about the impact of the possible second rate cut that Greenspan had mentioned might be necessary. In the public's mind, all of the Fed's actions would appear related.

"I don't think people will necessarily distinguish between the budget deal and fiscal restraint, and there's a lot more fiscal restraint promised down the road," Melzer said.¹⁹ "And I'd hate to see us get into a linkage where we sort of condition people to think that there is always going to be a monetary policy offset."

Cleveland Fed President W. Lee Hoskins argued that, with inflation rising, any cut in rates would look like the FOMC was "tossing in the towel on inflation."

"I think there is a danger of our losing sight of what the fundamental job of a central bank is, which, of course, is to bring down inflation over time," Hoskins told the rest of the committee.²⁰ "And this is the kind of period when I think we typically have lost sight of that in the past, so I'm very cautious about any wavering at this point in time."

When it came time for a vote, the measure passed 7 to 4 with the dissents coming from Fed governors Wayne Angell and Martha Seger and regional Fed presidents Robert Boykin from Dallas and Cleveland's Hoskins. There was one vacancy.

Although Boykin, Hoskins and Angell, along with some non-voters, opposed the softening, Seger took the opposite view, favoring a more robust easing of Fed policy. And she had no qualms about connecting it to the fiscal and political process.

"My preference would be ... an immediate 25 basis point cut reflecting those (economic) concerns and another 25," she said, "which would be the reward to the boys on the Hill for doing the budget."²¹

19. *Transcript of FOMC meeting, Oct. 2, 1990.*

20. *Transcript of FOMC meeting, Oct. 2, 1990.*

21. *Transcript of FOMC meeting, Oct. 2, 1990.*

“Credible”

The following day, with the rate cut in his pocket, Greenspan appeared before a House subcommittee and lent his support to an apparent budget compromise reached by congressional negotiators. Specifically, he described the budget as being a “credible” way to reduce the federal deficit.²² The word was a very clear signal for markets and the nation. For months, the chairman had been promising that interest rate cuts would follow any “credible” budget agreement.²³

Greenspan’s support quickly became a selling point for the Bush team.

“Administration officials are citing Mr. Greenspan’s view that interest rates will come down if the politicians enact a credible long-term plan to lower the deficit,” wrote David Rosenbaum of *The New York Times*.²⁴



One day after obtaining FOMC approval to cut the fed funds rate as soon as the Bush budget was approved, Greenspan testified before the House Government Operations Committee where he proclaimed the budget proposal “credible.” The word was a clear signal to the markets that a rate cut was in the offing.

“Lower rates would encourage companies and individuals to borrow and spend and thus stimulate the economy. Moreover, they would mean the Government would have to pay less on the money it borrows.”

The promise of lower rates, however, was not enough to get lawmakers on board.

The budget deal “had a face only a mother could love,” journalist Steven Beckner wrote, noting that it included tax hikes that threatened to only worsen the recession.²⁵ Those taxes, which were central to reducing the deficit, famously dealt a blow to the credibility of then-President George H.W. Bush and his oft-mentioned 1988 campaign vow of “no new taxes.”

As it turned out, the budget agreement was not as imminent as Greenspan thought.

Despite the enticement of a rate cut, the deal fell apart days later.

22. *The New York Times*, Oct. 4, 1990.

23. *The Wall Street Journal*, Sept. 14, 1990.

24. *The New York Times*, Oct. 4, 1990.

25. Back from the Brink, Beckner, Steven K.; John Wiley & Sons, Inc., New York, 1996.

The unexpected budget delay put the Federal Reserve in the odd and uncomfortable position of publicly holding a rate cut hostage when, on Oct. 11, *The Washington Post's* John Berry reported on the Oct. 2 FOMC action and the budget. With no agreement among lawmakers, Berry wrote, the rate cut “remains on hold.”²⁶

The budget was eventually finalized on Oct. 28 after a three-day government shut-down. The interest rate cut, approved on Oct. 2, was finally implemented the following day, Oct. 29.

Despite evidence from Fed transcripts and media coverage of the events, policymakers were later adamant that there was no quid pro quo on the rate cut and the budget.

Greenspan recounted the incident in his 2007 book, *“The Age of Turbulence,”* and maintained that view.

“(W)hen the budget was finally up for approval, I pronounced the plan ‘credible’ – which might sound like faint praise, but it was enough to make the stock market jump, as traders bet that the Fed would instantly cut interest rates,” Greenspan wrote.²⁷ “Of course, we had no such intention: Before easing credit, we needed to see first whether the budget cuts actually became law, and most important, whether they had any real economic effect.”

“Free-spirited rebel”

The Oct. 2 FOMC meeting marked 30 sessions under Greenspan’s leadership. There had been 32 dissents during that time, 16 from presidents and 16 from governors. And while the perception was that Volcker ruled with an iron fist, media accounts noted that during Volcker’s final 30 FOMC meetings, he had encountered 30 dissents with 20 from governors and 10 from the presidents.²⁸

Among the Greenspan Fed dissents, it should be pointed out that Seger accounted



During her tenure as a Federal Reserve governor, Martha Seger was a constant force for lower interest rates. A 2000 study ranked her as the most ease-oriented FOMC member since 1966.

26. *The Washington Post*, Oct. 11, 1990.

27. *The Age of Turbulence*, Greenspan, Alan; Penguin Press, New York, 2007.

28. *The Washington Post*, April 18, 1991.

for 11 of them.

Media accounts called Seger a “free-spirited rebel.”²⁹ During her seven-year tenure as a Fed governor, Seger participated in 54 policy votes and dissented 16 times, each time in favor of easier policy – an apparent record.³⁰ An analysis done in 2000 of FOMC voting behavior from 1966 to 1996 ranked Seger as the committee’s most ease-oriented member of any Fed voter over the 30-year span.

29. *The Wall Street Journal*, April 5, 1991.

30. *Committee Decisions on Monetary Policy: Evidence from Historical Records of the Federal Open Market Committee*; Chappell Jr., Henry W., Rob Roy McGregor, Todd A. Vermilyea; *Massachusetts Institute of Technology, Cambridge, Ma., 2005.*

Cartoon illustration by Clyde Wells of the "Recession Road." Originally appeared in *The Augusta Chronicle*, 1991. Use courtesy of *The Augusta Chronicle*, Augusta, Georgia.



The economic malaise of the 1990-91 recession and the jobless recovery that followed left many Americans unsure about where the economy was truly headed, creating challenges not only for monetary policymakers, but concerns for politicians seeking reelection.

‘With the Economy in Trouble, Monetary Policy... Was Put on Hold’

OCTOBER 1990 – FEBRUARY 1991

The Oct. 29, 1990 cut put the fed funds rate at 7¾ percent.³¹ The Fed continued lowering rates through the end of the year without dissent. As 1991 began, the rate was 7 percent. On Jan. 8, Greenspan dropped the fed funds rate another 25 basis points through authority to act under certain conditions under what was known as an “asymmetric directive” the FOMC had approved during its December meeting. The cut came prior to a large amount of bonds coming to the market from the Treasury and the Resolution Funding Corporation, which Congress created to raise funds for the thrift bailout. There was concern that if the Fed had waited to make the cut, it would have further steepened the yield curve by driving rates higher on the long end.³²

During a conference call to discuss Greenspan’s cut the following day, Fed Governor Wayne Angell questioned if Greenspan actually had the right to act based on the information available at that time.

Board of Governors staff on the call noted that the decision was based on only partial data that may have been clouded by seasonal activities around the holidays. Late in the call, Guffey said that it seemed the policy action was taken based on “pretty soft information.”

“...almost everything that was expressed this morning (on the call) ... was based upon uncertainty. And I don’t think we should be making policy on uncertainty,” Guffey said.³³

Greenspan acted again on Feb. 1, allowing a cut in the discount rate, which is dictated by the Board of Governors and is handled separately from the fed funds rate, to flow

31. Historical Changes to the Target Federal Funds and Discount Rates, www.NewYorkFed.org/markets/statistics/dlyrates/fedrate/html.

32. Back from the Brink, Beckner, Steven K.; John Wiley & Sons, Inc., New York, 1996.

33. Transcript of FOMC conference call, Jan. 9, 1991.

34. Historical Changes to the Target Federal Funds and Discount Rates, www.NewYorkFed.org/markets/statistics/dlyrates/fedrate/html.

through to the fed funds rate, putting it at 6¼ percent.³⁴ The cut came on a Friday, only four days before an FOMC meeting and, at 50 basis points, was

the largest policy move by the central bank since the days after the 1987 stock market collapse.³⁵

During a conference call prior to making the cut public, some FOMC members said they thought there should be a vote.

“I don’t have any problem at all with what is being done,” Boston Fed President Richard Syron said on the call.³⁶ “And I must say that I’m thinking about the perception in relation to the stories that were in the press ... which I thought were counterproductive, to the effect that there was a schism within the committee and that the presidents, at least, were dragging their feet in terms of moving (rates) down. In the sense of erasing any of that notion ... I’m just wondering if erasing that notion by having a vote might be worth considering.”

Greenspan responded that he did not want a vote. Taking one, he said, would “suggest that we think there’s more there than in fact we’re doing.”³⁷

It was another cut that, in the minds of many, linked the central bank’s monetary policy adjustments very closely with the desires of the White House. Three days earlier, Bush had publicly asked for the cut. The president had made the statement after Greenspan suggested to him that another drop in rates was on the horizon.³⁸

The issue of the chairman’s ability to independently move interest rates was raised by Greenspan himself at the opening of the February FOMC meeting, where he called for the creation of a task force. It was charged specifically with examining the chairman’s ability to act under the “asymmetric directive.” In its report at the FOMC’s next meeting on March 26, the task force suggested a method of “enhanced consultation” that would allow for discussion among FOMC members prior to action by the chairman.

Committee members, although generally voicing support for the idea, had some questions about what, exactly,



Bloomberg Contributor/Bloomberg via Getty Images

Boston Fed President Richard Syron, seen here in 2004, urged Fed Chairman Alan Greenspan during a conference call to conduct an FOMC vote prior to making a February 1991 interest rate cut. Greenspan said he did not think the vote was necessary. Later, some linked the interest rate move to political pressure Greenspan was under from the White House.

35. Historical Changes to the Target Federal Funds and Discount Rates, www.NewYorkFed.org/markets/statistics/dlyrates/fedrate/html.

36. Transcript of FOMC conference call, Feb. 1, 1991.

37. Transcript of FOMC conference call, Feb. 1, 1991.

38. Back from the Brink, Beckner, Steven K.; John Wiley & Sons, Inc., New York, 1996.

“enhanced consultation” entailed.

The asymmetric directive was designed to allow leeway to act on short notice. Even if some thought Greenspan was abusing that provision, adding additional steps to the process could reduce the central bank’s responsiveness at especially critical points.

“(W)ithin the framework of a so-called ‘enhanced consultation’ we have to be mindful that that process could become counterproductive if it deteriorated into people insisting upon a formal vote of the FOMC every time there was a consultation,” New York Fed President Corrigan said.³⁹ “I think we all have to have an open and flexible mind on that because if it degenerated into a process ... where we ended up with frequent recorded votes in intermeeting intervals, I think that would be potentially damaging and at the extreme could produce an inertia problem with the monetary policy process itself.”

Greenspan wrapped up the discussion by saying they would look at ways to implement the new process, vowing to revisit the issue, and make changes, if necessary.

The following week, the largely private debate of somewhat obscure central bank policy went public, first in a newsletter article authored by Manuel Johnson, the former Fed vice chairman who had left the central bank a few months earlier, and two days later in a lengthy *Wall Street Journal* examination of the Fed that had been in the works for some time. The *Journal* article went all the way back to the events of the late 1980s and shined a spotlight on the pre-budget agreement meeting in October 1990.⁴⁰

“With the economy in trouble, monetary policy, a potent stimulus, was put on hold for four critical weeks,” the *Journal’s* Murray wrote.⁴¹ “Credit remained costly. Layoffs mounted. Instead of combating the recession, the Fed’s lack of action exacerbated it.”

The article was headlined: “The New Fed: Democracy Comes to the Central Bank, Curbing Chief’s Power” and portrayed, essentially, a battle between the governors and the regional bank presidents over monetary policy.

“(T)he presidents of the district Fed banks have assumed a powerful new voice in policy,” Murray wrote.⁴² “These officials, based in outside-the-Beltway outposts such as Richmond, Minneapolis and Dallas, have become vanguards in the war on inflation. That frequently pits them against the Fed governors who tend to favor easier credit.”

Murray’s comment about the regional Fed presidents being more hawkish on inflation has been supported by research.

39. *Transcript of FOMC meeting, March 26, 1991.*

40. *Maestro: Greenspan’s Fed and the American Boom, Woodward, Bob; Simon and Schuster, New York, 2000.*

41. *The Wall Street Journal, April 5, 1991.*

42. *The Wall Street Journal, April 5, 1991.*

Of the 20 most ease-oriented policymakers identified in the 2000 survey of FOMC voting behavior, 15 were Fed governors. Conversely, the list of the 20 strongest advocates for tighter policy over the same period is dominated by regional bank presidents and includes only two Fed governors.⁴³ Additional research in this area has also shown that partisanship plays a role in policy votes among the politically appointed FOMC members in various ways. For example, governors appointed by Democrats tend to favor easier monetary policy than those appointed by Republicans, and in presidential election years, in-party appointees are more likely to favor stimulus, which would seem to support the sitting president, while out-party appointees are more likely to favor tight policy, which would potentially undermine the sitting president.⁴⁴

“The surprise is that ... the chairman is outvoted so seldom”

The split between the regional Reserve Bank presidents and the Fed governors is by no means exclusive to Greenspan’s early years at the central bank. In fact, a strong argument can be made that the division was even more substantial, and more closely aligned with political interests, in the final 18 months of Volcker’s tenure as Fed chairman.

Volcker, who had served as the New York Fed’s president for four years prior to being named Fed chairman, was strongly supported by the presidents of the 12 regional Federal Reserve Banks. Meanwhile, four of the seven Federal Reserve governors were appointees of President Reagan. Collectively, the Reagan appointees became known as the “Gang of Four.”⁴⁵ In late February 1986, the group outvoted Volcker by a 4 to 3 margin to make a 50-basis-point cut in the discount rate. Volcker reportedly stormed out of the room after the vote, but before the scheduled public announcement, the group reconvened and canceled the cut.

Volcker said that he had not opposed the cut, but was against the timing, wanting to wait first for foreign central banks to make similar moves. The cut eventually came on March 6, approved by the Fed governors without opposition.

The original vote, however, became public knowledge in mid-March.

Commenting on the vote, Governor Seger, one of the “Gang” who had voted against the chairman, was quoted as saying that the Fed “is not supposed to be a one-person show.”⁴⁶

43. A Long History of FOMC Voting Behavior; Chappell Jr., Henry W. and Rob Roy McGregor; *Southern Economic Journal*, Vol. 66, No. 4, April 2000.

44. Committee Decisions on Monetary Policy: Evidence from Historical Records of the Federal Open Market Committee; Chappell Jr., Henry W., Rob Roy McGregor, Todd A. Vermilyea; *Massachusetts Institute of Technology, Cambridge, Ma.*, 2005.

45. The Los Angeles Times, March 19, 1986.

46. The Wall Street Journal, April 4, 1986.

Seger's comment, as well as the messy way the vote was leaked to the press, were arguably as troubling – if not more – than the fact that the chairman had lost the vote.

Herbert Stein, a former chairman of the Council of Economic Advisors under Presidents Nixon and Ford, wrote a lengthy article for *The Wall Street Journal* defending the need for independence and dissent among Fed policymakers.

“I cannot understand the common feeling of shock at the spectacle of the chairman being outvoted,” Stein wrote.⁴⁷ “One must ask why Congress established a seven-member Board of Governors and a 12-member Federal Open Market Committee. The answer is that Congress gave the Federal Reserve much power but was unable or unwilling to give the Fed any guidance on how to use the power. So, it sought safety in numbers and diversity as protection against bias, idiosyncrasy and faddishness.”

He went on at some length about the Fed's structure, the terms of the governors and the fact that the regional Federal Reserve presidents serve as FOMC voters on a rotating basis – all of this, he wrote, was created out of the recognition that it was important to get diverse views into the policy deliberations.

“Congress intended diversity and the Federal Reserve establishment benefits from the appearance that diversity is at least possible,” Stein wrote.⁴⁸ “I doubt that any chairman would like to be rid of the board and bear sole responsibility for monetary policy. In these circumstances, to find the chairman outvoted should not be a surprise or a shock.

“The surprise is that, as far as outsiders know, the chairman is outvoted so seldom, and there are rarely even any close votes.”



Herbert Stein, who had served as head of the Council of Economic Advisors under Presidents Nixon and Ford, wrote a lengthy article for The Wall Street Journal in 1986 about the importance of the Federal Reserve's structure and the importance of diverse views in monetary policy deliberations.

47. *The Wall Street Journal*, April 4, 1986.

48. *The Wall Street Journal*, April 4, 1986.

Cartoon illustration by Ed Gamble of "And The Shorts Too." Originally appeared in *The Florida Times-Union*, 1991. Use courtesy of King Features Syndicate.



Although the fed funds rate was lowered 10 times in 1991, there were signs that impact on the economy was muted at least in part as banks that made bad real estate loans in the 1980s worked to tighten borrowing standards.

‘Democracy is Messier than Dictatorship’

FEBRUARY 1991 – MAY 1991

As was the case in 1986, the major national and financial media outlets ran stories in 1991 about dissent within the central bank that characterized it as everything from “a matter of procedure and not substance”⁴⁹ to Greenspan being “openly challenged.”⁵⁰

The truth was somewhere in between.

Even in interviews, including those where Fed officials were quoted and those where they remained anonymous, their views of the disagreement differed.

“Anytime people at the Fed become disgruntled with policy or uncertain about it, there is a tendency to focus on procedure,” Fed Governor Angell told a reporter.⁵¹

Meanwhile, Kansas City President Guffey said the real issue was around the delegation of authority that the chairman had exercised. Specifically, was it restricted to 25 basis points instead of the 50-point drop that had happened in February? Was there a need to first consult with the rest of the FOMC on what was clearly an unusual action?⁵²

Virtually all agreed, however, that the matter was being overblown by the press.

The reality may have been best described by Seger, who had recently resigned her post as a Fed governor: “Democracy is messier than dictatorship.”⁵³

It was only a couple of weeks before the new idea of enhanced consultation got its first test.

Early on the morning of April 12, Greenspan convened an FOMC conference call to discuss the release of the consumer price index later in the morning, which would show the first decrease in five years, indicating an ease in inflationary pressure. After a few minutes reviewing economic data, the chairman suggested a 50-basis-point drop in the discount rate that would flow through with a 25-basis-point drop in the fed funds rate.

In the course of a go-around to gauge the members’ opinions, it became apparent Greenspan had the support of four members, all of them presidents of the regional Federal Reserve Banks: New York Fed chief Corrigan, Richard Syron from the

49. *The Washington Post*, April 5, 1991.

50. *The New York Times*, April 8, 1991.

51. *The New York Times*, April 8, 1991.

52. *The New York Times*, April 8, 1991.

53. *The Wall Street Journal*, April 5, 1991.

Boston Fed, Silas Keehn from the Chicago Fed and Robert Forrester from Atlanta.

The tide turned when Angell spoke against the move.



Federal Reserve Governor Wayne Angell was concerned that the financial markets were having too much influence over policy actions.

“What we’re doing today is really in anticipation of where the economy will be in the third and fourth quarters,” said Angell, who was in Ottawa, Kan., at the time.⁵⁴ “And I’m somewhat troubled by the notion that we respond both in anticipation and then we also respond on an economic announcement. I find it to be somewhat disconcerting that we would in a sense let market expectations drive us on days of announcements. ... I don’t see how we can afford to time our moves ... based on when the markets expect us to move.”

After Angell, the remaining speakers, both presidents and governors were against the idea of a cut, although some more firmly than others.

“I find it almost embarrassing to seem to be reacting to market expectations unless we are truly convinced that the economy is on dead center,” Governor John LaWare said.

Recognizing his defeat, Greenspan adjourned the FOMC call without taking a vote but asked the governors to stay on the line. After the presidents had disconnected, the chairman again made a case to the governors to back a cut in the discount rate. The governors, noting the opinions that the regional Fed presidents voiced on the call, opposed the move.⁵⁵

On April 30, two and a half weeks after the April 12 discussion, Greenspan made the move he had proposed. The governors backed a 50-basis-point cut in the discount rate by a 4 to 1 margin with Angell dissenting. Greenspan allowed 25 basis points to flow through to the fed funds rate. In this case, the enhanced consultation of the April 12 call had been abandoned. There was no discussion. Greenspan opened a call with the FOMC by announcing the cut.⁵⁶

Details of the call became public in a *Wall Street Journal* article the following morning. Among other things, it noted that the Bush administration, which wanted lower rates, was considering whether to reappoint Greenspan, whose term would expire in August. Additionally, the article explained how during the call Greenspan had informed

54. Transcript of FOMC conference call, April 12, 1991.

55. Maestro: Greenspan’s Fed and the American Boom, Woodward, Bob; Simon and Schuster, New York, 2000.

56. Transcript of FOMC conference call, April 30, 1991.

the regional Fed presidents of the move rather than seeking their approval. In case anyone forgot, the reporter also reminded readers of the recent friction between the regional Fed banks and the chairman.⁵⁷

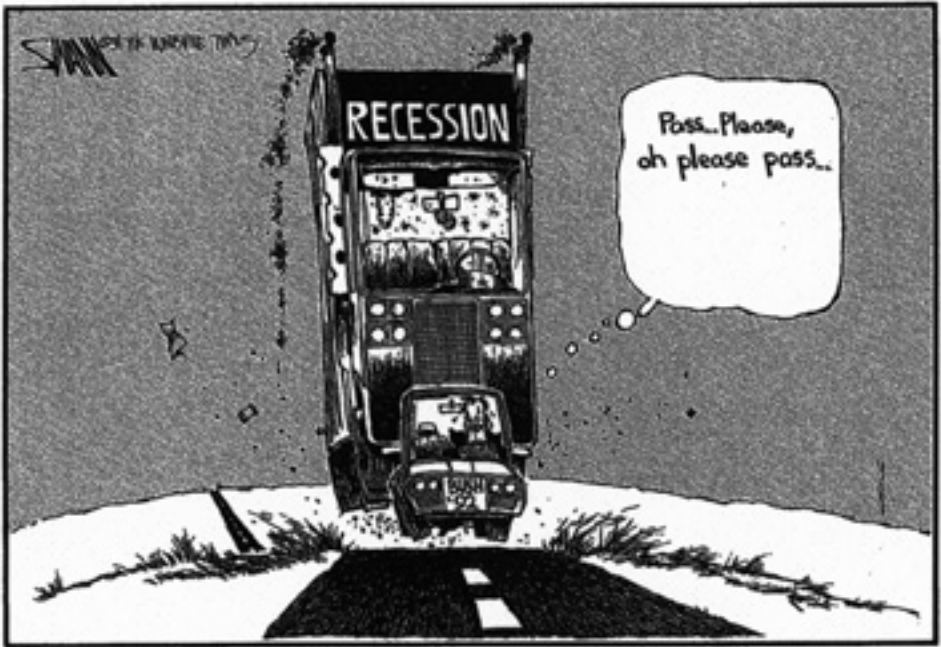
After reading the article that morning, Greenspan convened another scheduled FOMC conference call that was set up to discuss a recent G-7 meeting. He prefaced the discussion, and the sensitivity of the topic, with a comment about that morning's *Journal* article.

“If we can't keep it confidential, we're going to have to find another way to disseminate this sort of information in a more tightly held procedure,” Greenspan told the rest of the FOMC.⁵⁸ “I'd be most appreciative if everyone could keep that in mind.”

57. The Wall Street Journal, *May 1, 1991*.

58. *Transcript of FOMC conference call, May 1, 1991*.

Cartoon illustration by David Swann of the "Recession Semi." Originally appeared in *The Honolulu Times*, 1991. Use courtesy of David Swann, Honolulu, Hawaii.



With unemployment continuing to rise and the economy showing little improvement, it was becoming increasingly clear that the recession would have an influence on the 1992 elections.

‘Mr. Greenspan’s Forecast... Could Hardly Have Been Sweeter Music to a President’

MAY 1991 – SEPTEMBER 1991

By June, 1991, Greenspan appeared optimistic that the recession might be nearing an end.

In a June 18 appearance before the House Ways and Means Committee, the Fed chairman said though he saw no signs of expansion and that credit conditions remained tight, the most recent economic data “are strongly suggestive that the bottom is somewhere in the second quarter.”⁵⁹

A month later, he was even more optimistic, telling a House subcommittee on July 16 that the Fed was “well on the path of actually achieving the type of goals which we’ve set out to achieve: a solid economic recovery with the unemployment rate moving down to its lowest sustainable, long-term rate, with growth at or close to its maximum long-term sustainable pace, with inflation wholly under control.”⁶⁰

The comment came only days after President Bush announced he was appointing Greenspan to another term as Fed chairman. The question about Greenspan’s reappointment had hung over the Fed throughout the year and coverage of the Fed chairman’s House testimony referenced the connection to the White House’s concerns about the Fed and the recession.

“Mr. Greenspan’s (July 16) forecast and the tone of his comments could hardly have been sweeter music to a president gearing up for a run for re-election in 1992,” wrote David Rosenbaum of *The New York Times*.⁶¹

Although Greenspan was uncharacteristically optimistic about the economic outlook during his congressional testimony, concerns remained, especially related to the continuing credit crunch.

Despite those concerns, Greenspan told the rest of the FOMC during a July 3 meeting that the committee had “gone through the recession without blowing it.” Economic data

59. *The New York Times*, June 19, 1991.

60. *The New York Times*, July 17, 1991.

61. *The New York Times*, July 17, 1991.

over the last month, he told the committee, had all been positive with the exception of new-home sales.⁶²

Arguably the most significant debate during the meeting focused on money supply growth targets with some hawkish committee members, including Governor Angell, Richmond Fed President Black and Minneapolis Fed President Gary Stern voicing support for a cut in the supply target for 1992 as a way of showing the Fed was ready to fight inflation. The committee agreed to revisit the target later.⁶³

In terms of the fed funds rate, the committee members voted unanimously to hold steady with some committee members discussing the idea that the recovery might be even more robust than they were expecting.

There were two exceptions.

Black said that he was “a little concerned” by some weakness, but he thought there would be a good explanation. He voted in favor of holding steady.⁶⁴

The second concern was voiced by Stern. The Minneapolis Fed president told the committee he did not see anything in the data that went against the consensus of holding interest rates steady.

He then made a comment about the recovery that was at odds with what had been said by his counterparts around the massive meeting table in the Federal Reserve’s board room.

“I do have a little concern that things have worked out exceptionally neatly this time,” Stern said.

“You don’t trust it?” Greenspan interjected.

“I don’t trust it,” Stern responded.⁶⁵

Stern’s concerns were validated a month later when policymakers saw the “beige book.” Prepared by Fed staff prior to each FOMC meeting, the book includes an analysis of economic activity drawn from each Federal Reserve District through business contacts. In the August 1991 book, Fed officials saw that economic activity was uneven but was not strong in any part of the nation. The report noted that a pickup in housing sales had “moderated” and in some areas was losing momentum.⁶⁶ The latest jobs report, meanwhile, showed that the economy continued to shed workers.⁶⁷

In response, the Fed cut interest rates a quarter-point on Aug. 6, putting the fed funds rate at 5½ percent.

In an Aug. 5 conference call to discuss the outlook, the tone of FOMC policymakers

62. *Transcript of FOMC meeting, July 3, 1991.*

63. *Transcript of FOMC meeting, July 3, 1991.*

64. *Transcript of FOMC meeting, July 3, 1991.*

65. *Transcript of FOMC meeting, July 3, 1991.*

66. *The Washington Post, Aug. 8, 1991.*

67. *The New York Times, Aug. 7, 1991.*

was far different from that at their July meeting as the Fed presidents discussed the economy in their respective Districts.

In the southeast, Atlanta Fed President Forrester said that local business contacts were saying “they just don’t see any real recovery in their own businesses and in the businesses of their colleagues. True, they say there is not a continuing deterioration, but things are very, very flat.”⁶⁸



Questions about Fed Chairman Greenspan’s potential reappointment hovered over Fed decisions for the first half of 1991. In July, President Bush held a press conference announcing that he planned to nominate Greenspan to a second term.

In the west, San Francisco Fed President Bob Parry called the mood in the business sector “gloomy,” and his District’s banks, especially the larger institutions, were facing their own issues.

“(A)s I’m sure you know, they had some very disappointing results as far as their profits are concerned in the last quarter,” Parry said.⁶⁹ “And many of them are talking about the pressures they’ve received from the regulatory side; and they appear to be sitting on their hands in terms of what they think is likely to happen with regard to business over the next three to six months.”

Although the cause of the recession would eventually be shared among numerous contributing factors – the oil price shock, debt accumulation in the 1980s, the 1990 budget agreement that hampered the government’s ability to mount a fiscal response to the crisis and even a lingering hangover from the 1987 stock market crash – the collapse of

68. Transcript of FOMC conference call, Aug. 5, 1991.

69. Transcript of FOMC conference call, Aug. 5, 1991.

the nation's savings and loan industry and the related financial crisis was pivotal in creating uncertainty. Between 1988 and 1992 there was an average of one bank or savings and loan failure every day. The annual number of failures peaked at 533 in 1989, before a decline to 382 in 1990, 271 in 1991 and 181 in 1992.⁷⁰ Many institutions that remained solvent did it with bad real estate loans from the 1980s still on their books. The crisis was so severe that as August 1991 opened, Federal Deposit Insurance Corporation Chairman L. William Seidman was asking Congress for taxpayer money to keep the FDIC's bank failure insurance fund afloat.

Greenspan later elaborated on the banking environment.

"Commercial banks ... were in serious trouble," he wrote in 2007.⁷¹ "This was an even bigger headache than the S&Ls because banks represent a far larger and more important sector of the economy. The late 1980s was their worst period since the Depression; hundreds of small and medium-sized banks failed, and giants like Citibank and Chase Manhattan were in distress. Their problem, as with the S&Ls, was too much speculative lending."

Similar to the financial turmoil of the late 2000s, lawmakers scrambled to prevent a future crisis by revamping the nation's financial regulatory structure. Before the end of the year, President Bush would sign the Federal Deposit Insurance Corporation Improvement Act, which, among other things, created new capital requirements for financial institutions and strengthened the regulatory agency. The regulatory uncertainty also extended to the individuals involved in implementing the rules. On the same August day that the Fed lowered the fed funds rate, Seidman submitted his resignation to the White House. He would be succeeded by Bill Taylor, the Federal Reserve's long-time top regulator, who was highly respected.

As Wall Street followers know very well, in financial matters, uncertainty is often worse than even horrible news. And at this point, uncertainty was virtually the only thing that was certain.

"(I)n this part of the country among the bankers there is still a very strong fear factor, both in terms of growing pessimism about the robustness of the recovery and also of concern about the regulatory side," Boston Fed President Syron told his FOMC counterparts during the call.⁷²

Syron said lenders in his District were in "a bunker mentality."

"(They) hope that they can ride it out

70. *Managing the Crisis: The FDIC and RTC Experience, 1980-1994, the Federal Deposit Insurance Corporation, August 1998.*

71. *The Age of Turbulence, Greenspan, Alan; Penguin Press, New York, 2007.*

72. *Transcript of FOMC conference call, Aug. 5, 1991.*

with enough capital until things return to normal.”

A microcosm of the problems facing lenders was detailed in a Sept. 2, 1991, *Washington Post* article about a meeting organized by Virginia Congressman Frank Wolf involving business executives and top officials of the banking regulatory agencies.

“Bankers said a key part of the problem is that they are trying to do so many things at once: improve loan standards, reduce risk, raise profit and increase the ratio of capital to outstanding loans,” wrote reporter Susan Schmidt.⁷³

“Even banks awash in lendable deposits are having to shrink the size of their loan portfolios in order to improve their capital-to-asset ratios.”

Banks, Schmidt wrote, “are applying conservative standards they should have applied to risky development loans in the 1980s.”⁷⁴

Greenspan later said that the “inevitable” collapse of real estate “really shook the banks. “Uncertainty about the value of the real estate collateral in securing their loans made bankers unsure how much capital they actually had – leaving many of them paralyzed, frightened and reluctant to lend further.”⁷⁵

One banking executive told Schmidt, “The rules have simply changed. There’s a whole sea of change here. There is a slowdown of decisions, an exhaustive examination of every loan, much more paperwork.”⁷⁶

The weak anecdotal reports about the nation’s economy that Fed officials were hearing soon made their presence felt in the data. After believing the recession had ended, the Commerce Department released a revised gross national product (GNP) number for the second quarter of the year. After reporting a month earlier that GNP had grown by 0.4 percent in the April through June period, the Commerce Department said on Aug. 28 that the GNP had actually contracted at a 0.1 percent rate. Although a revision of 0.5 points is not especially earthshaking on its own, a turn from positive to negative in a delicate environment was a tough blow for consumer confidence.

When other negative data emerged in the weeks that followed, including a 0.7 percent drop in retail sales, only a minimal rise in prices and continuing concern in the Fed about the money supply, Greenspan convened an FOMC conference call on Sept. 13. After holding rates steady at their Aug. 20 meeting, FOMC members agreed with Greenspan’s proposal to allow 25 points of a 50-basis-point cut in the discount rate to flow through to the fed funds rate. The

move put fed funds at 5¼ percent – their lowest level since the 1970s.

73. The *Washington Post*, Sept. 2, 1991.

74. The *Washington Post*, Sept. 2, 1991.

75. *The Age of Turbulence, Greenspan, Alan; Penguin Press, New York, 2007.*

76. The *Washington Post*, Sept. 2, 1991.

All FOMC members were supportive of the move, although the St. Louis Fed's Melzer expressed some concern about continuing to react immediately to data reports that could expose policymakers to mistakes.

Melzer said he was particularly concerned about a move connected to the price report because “what we do with monetary policy right now, of course, won't be reflected in prices for another couple years. And just looking down the road, if we find in retrospect that we are overdoing it now, it seems to me that we're going to be in a very difficult environment over the next year to take the proper steps to reverse that.”⁷⁷

During the call, Melzer noted a market mentality that the data, in certain instances, was being seen as a signal for the Fed to lower rates.

The market saw that signal in the data very clearly. Stocks typically rallied on rate cuts, especially when they occurred outside of the Fed's regular meeting structure. That was not the case with this cut.

“The Federal Reserve's actions had been so widely anticipated in the financial markets ... that stock prices fell, apparently reflecting the adage that traders buy on rumor and sell on fact,” *The New York Times* reported.⁷⁸

“A coup d'état on monetary policy”

Throughout its nearly century-long history, the Federal Reserve has always had a uneasy balance with the nation's political structure. At times it has perhaps been comparable to a pair of angry children unhappily sharing the same teeter-totter – when things aren't working well, the easiest thing to do is blame the kid on the other side.

Along those lines, in times of financial crisis or economic turmoil, such as a recession, lawmakers in both the White House and Congress have undertaken various initiatives focused on altering the Fed's structure. For example, the Fed underwent significant structural changes during the Great Depression, and various members of Congress, from Wright Patman, who spent decades trying to restructure the Fed and at one point wanted to make it an arm of the Treasury, to Ron Paul, who today wants the Fed abolished, have pushed their own agendas.

“When the economy is sour ... (the Fed's) structure tends to become a focus of attention, a sponge that soaks up frustrations over the way the economy is going,” wrote journalist David Rosenbaum.⁷⁹

During the 1991 recession, a group of lawmakers led by Sen. Paul Sarbanes and Rep.

⁷⁷. Transcript of FOMC conference call, Sept. 13, 1991.

⁷⁸. *The New York Times*, Sept. 14, 1991.

⁷⁹. *The New York Times*, Nov. 14, 1991.

Lee Hamilton, began to raise serious questions about the Fed with an eye toward revamping the makeup of the FOMC, specifically targeting the Fed presidents, who generally favored tighter policy than the Fed governors.

“Frustrated senators knew they couldn’t boost spending or cut taxes to revive the economy – (the 1990) budget agreement between Congress and the Bush administration foreclosed those options,” wrote John Berry of *The Washington Post*.⁸⁰ “The only remedy (for the recession) has been a lowering of interest rates – a power that resides with Fed policy makers, not Congress or the administration.”

With the U.S. jobless rate around 7 percent, Sarbanes unloaded on Fed officials during a June 1991 hearing.

His criticisms did not appear to align with the environment inside the Fed – for example, he suggested there was conformity at work in the making of monetary policy, apparently oblivious to the recent headlines about a divided Fed – but his anger was very real and he was ready to take action.

Maybe it is time for Congress “to take a more careful look at this whole little world that exists there (at the Fed) where everyone ... apparently thinks the same way, sees things the same way, operates completely off of the same value framework, even though your decisions impact very broadly on the economy.”⁸¹



Presidents from 11 of the 12 regional Federal Reserve Banks went before the Senate Banking Committee in 1993 to face questioning about their role on the FOMC. The hearing was the result of efforts by some in Congress two years earlier to reduce the role of the regional Fed presidents in monetary policy decisions.

Less than two months later, Sarbanes and Hamilton introduced legislation to strip the regional Federal Reserve Bank presidents from having a vote on monetary policy and put it solely in the hands of the seven Federal Reserve governors in Washington. The Bank presidents would be bumped to an advisory-only role.

“The FOMC is the only monetary policy-making body in a major industrialized nation

80. *The Washington Post*, June 30, 1991.

81. *The Washington Post*, June 30, 1991.

on which we find bank presidents, private individuals, making government economic policies,” Hamilton said.⁸²

The pair also co-authored an opinion piece for *The Christian Science Monitor* in which they argued that the division among Fed officials was “not an ordinary split among government policymakers; rather, a handful of individuals representing private interests ... impeding efforts by public officials to conduct monetary policy in the best interests of the nation.”

They considered it “power without accountability.”⁸³

Economics writer Finlay Lewis, although seeming to support the idea of an FOMC shakeup in a 1991 column, spelled out the reasons why such legislation would likely not find sufficient support to gain approval.

“Since the (regional Fed) Bank presidents are generally regarded as hawks in the battle against inflation, opponents will argue that changing the present arrangement would upset the delicate balance between the advocates of tight and easy money,” he wrote.⁸⁴ “Political pressures would be more likely to color committee judgments, tilting the balance toward inflationary policies aimed at pleasing important constituencies.”

The proposal remained in a state of legislative limbo with too little interest to secure its passage but too much momentum to fade away. The idea of taking the presidents out of the policy role eventually resulted in 11 of the regional Federal Reserve Bank presidents appearing crammed together behind the Senate Banking Committee’s witness table to testify at a 1993 hearing. Some later referred to the image of the presidents behind the table facing the Senate Committee as being visually similar to Da Vinci’s famous painting of the Last Supper.

“On the surface, they were called to talk about the economy, which they said was slowly improving,” wrote Steven Greenhouse of *The New York Times*.⁸⁵ “But there were other reasons why Congress ... summoned the presidents of the Federal Reserve System’s 12 regional banks to testify: several senators wanted to show them who was boss.”

Sen. Connie Mack, a Republican from Florida, accused the Democrats, led by Sarbanes, of just that.

“This is a coup d’état on monetary policy,” Mack said.⁸⁶ “Exerting more Congressional rule over monetary policy would be a horrible mistake.”

82. Associated Press, *Aug. 2, 1991*.

83. *The Christian Science Monitor*, *Sept. 27, 1991*.

84. *The San Diego Union*, *Dec. 3, 1991*.

85. *The New York Times*, *March 11, 1993*.

86. *The New York Times*, *March 11, 1993*.

Caroon illustration by Jim McCloskey of "U.S. Economy Flying Level." Originally appeared in *The Staunton Daily News Leader*, 1991. Use courtesy of Jim McCloskey, Staunton, Virginia.



Questions about which way the economy was headed provided editorial cartoonists with ample opportunity to ridicule those who suggested conditions were improving.

'The Administration was Trying to Push a... Pro-Growth Policy'

SEPTEMBER 1991 – OCTOBER 1991

In late September, Greenspan said publicly that the recovery was struggling to make gains against “the face of a 50-mile-an-hour headwind.” In his 1996 book, journalist Steven Beckner writes that the Fed chairman may have first used the phrase during a Sept. 27 meeting at the White House with Bush and his top economic advisers. Beckner writes that Bush’s team was taken aback by the comment.

“Greenspan had, in effect, handed the president a death warrant on his reelection chances,” Beckner wrote.⁸⁷

Greenspan talked about the differences between the political and economic perspectives of a recession and recovery during the FOMC’s Oct. 1 meeting.

“An economist’s view is that a recession is over when the economy stops receding; and that by definition is the low point of a cycle, the worst point of a cycle,” Greenspan said.⁸⁸ “Politicians believe the recession is over when the economy has recovered fully.”

The FOMC did not move rates at the meeting, but the “headwinds” continued. And although Greenspan continued using the phrase to describe the economy, at the end of October he was a tad less elegant inside the privacy of the FOMC.

“(T)he recovery is clearly petering out at a fairly pronounced pace,” Greenspan told the FOMC during an Oct. 30 conference call.⁸⁹

After discussing the economic data, including poor home sales, the chairman talked about how the economy was struggling to overcome hangover from the “very substantial debt buildup and speculative binge of the 1980s.

“In the process our financial intermediaries have been undermined to a very considerable extent. The savings and loan industry is pretty much incapable of lending at anywhere near the (volume) it did in the past. Commercial banking has been significantly debilitated and even the insurance (sector) is creating problems for intermediary lending of the type

that usually finances recoveries of the nature we’re looking (toward) now.”⁹⁰

87. Back from the Brink, Beckner, Steven K.; John Wiley & Sons, Inc., New York, 1996.

88. Transcript of FOMC meeting, Oct. 1, 1991.

89. Transcript of FOMC conference call, Oct. 30, 1991.

90. Transcript of FOMC conference call, Oct. 30, 1991.

He said that a decline in property values had created a “fear element” in the public. That element was apparent in reports from the regional Fed Bank presidents.

“We’ve had recent meetings with our directors and also the (San Francisco Fed’s) Small Business and Agricultural Advisory Committee and they have been as pessimistic in their reports as I’ve seen,” Parry, president of the San Francisco Fed, told his counterparts.⁹¹

In Chicago, Fed President Keehn echoed Parry.

“(T)here has been a perceptible change in attitudes among the people that I’ve talked to,” Keehn said. “They just are feeling much more concerned than they were before. The sentiment has turned to the very negative side.”⁹²

The psychological side of it was a difficult issue, as illustrated by additional comments from Parry.

“The other thing I’m finding from the business people we talk to is that they just don’t seem to have an understanding that we’re not going to have, at least in the foreseeable future, the kinds of growth rates that we had in the U.S. economy over the past decade,” he said.⁹³ “They do not yet

have it in their mindset, it seems to me, that our potential for growth is lower than it was; they’re looking for the kinds of returns that they had before.”

But the problems went much deeper than a downturn in sentiment. Comments from the Fed presidents focus on discussions with a wide range of business industry contacts in their specific Districts and touched on issues such as those in the auto industry, where executives were beginning to talk about production cutbacks and relaying disappointing reports that they were getting from their individual dealerships. In the Dallas Fed District, President Robert McTeer referenced the credit crunch: “It feels very real down here.”⁹⁴

When it came to the Fed policy, however, the FOMC was once again divided, with the presidents on one side and the governors on the other. In this instance, however, it was



In late October 1991, San Francisco Fed President Robert Parry was among the regional Fed presidents explaining to the rest of the FOMC the pessimism coming from business contacts.

91. Transcript of FOMC conference call, Oct. 30, 1991.

92. Transcript of FOMC conference call, Oct. 30, 1991.

93. Transcript of FOMC conference call, Oct. 30, 1991.

94. Transcript of FOMC conference call, Oct. 30, 1991.

the Fed governors who wanted to stand pat, as the FOMC had done with a unanimous vote to hold rates steady at the Oct. 1 meeting. The Fed presidents, drawing on what they were hearing from contacts nationwide, were seeking a rate cut.

And it happened. The fed funds rate was lowered by 25 basis points to 5 percent on Oct. 31.

The swapping of traditional policy views between the governors and presidents was not lost on those well aware of the battle in Congress to remove the Fed presidents from policy considerations because they felt the presidents were too eager to raise interest rates.

The Oct. 30 session had clearly refuted that idea. The problem was that it would be years before the division was publicly known.

Governor Angell jokingly offered a suggestion at the end of the call:

“(M)aybe we ought to have a leak of this so that Messrs. Sarbanes and Hamilton and so forth would want to get the number of presidents voting up from five to 12.”⁹⁵

“We’ve just been absolutely swamped”

Angell’s joke aside, politics were having an impact on Fed policy in another way.

As Fed policymakers were considering their next move to fight the recession, the White House was fighting against congressional Democrats who the Administration felt were purposefully delaying action on two Bush nominees to fill vacancies on the Fed’s Board of Governors. Individuals who, the Democrats likely thought, would help a struggling president right a listing economy before reaching the election now on the horizon.

Bush had appointed David Mullins, Jr. to the Fed’s Board of Governors the previous year to fill a vacancy left by the departure of H. Robert Heller. After Fed Vice Chairman Johnson resigned, Bush nominated Mullins to move into the vice chairman’s seat in January 1991 and nominated White House economist Lawrence Lindsey to fill the vacant seat. Additionally, after Seger left the Board in March, Bush had settled on nominating former Commodity Futures Trading Commission Chair Susan Phillips, but didn’t actually make the nomination until late September. The delay might have been due, in part, to the fact that the Senate Banking Committee didn’t begin hearings on Lindsey until May and, as of mid-July, the Senate had approved only Mullins’ move to the vice chairman’s seat. Meanwhile the Senate Banking Committee had not yet taken a vote on Lindsey.

When asked about the delay, Committee Chairman and Michigan Democrat Sen. Don Riegle said it was more of a scheduling issue: “We’ve just been absolutely swamped.”⁹⁶

95. Transcript of FOMC conference call, Oct. 30, 1991.

96. The New York Times, July 2, 1991.

Regardless of the reasoning, the delay meant that, despite it being an exceptionally delicate period for monetary policy, the Fed's key policy-making body was playing without a full roster. Unfortunately, that's not necessarily a unique situation. For a more recent example, one need only look at the economic and financial turmoil of the late 2000s and realize that as of early 2011, it had been six years since the FOMC had a meeting where all seven governors' seats were filled.⁹⁷

As it turned out in 1991, Lindsey would not join the Fed until Nov. 26. He was followed by Phillips a week later on Dec. 2.

Of the two, Lindsey's approval process was the most difficult. Democrats had little reason to add Lindsey – often described as “an outspoken advocate of supply-side economics”⁹⁸ – to the Fed Board. A strong supporter of the Reagan tax cuts, Lindsey was expected by most to be a strong proponent of dropping interest rates and a key Bush ally when he got to the FOMC table.

Beckner noted that some of the most strident opponents of the Fed's monetary easing policies, specifically Sen. Sarbanes and Democrat Sen. James Sasser of Tennessee, were Lindsey's biggest critics. Riegle, meanwhile, did what he could by joining the minority voting against Lindsey on the Senate Banking Committee.



Ted Hlaif/TIME & LIFE PICTURES/GETTY IMAGES

Amid expectations that Lawrence Lindsey would be a strong Bush ally at the central bank, Lindsey saw his confirmation process linger in the Senate for months.

“They knew the administration was trying to push a more pro-growth policy,” a Bush aide said, “and they (congressional Democrats) were moving very slowly on it. It certainly looked deliberate.”⁹⁹

Although the political connotations are obvious, one of the concerns about Lindsey related not specifically to his likely policy positions, but to his residence.

In addition to the regional presidents, the Fed's designers also sought to ensure that the nation's interests were broadly represented in policy deliberations

97. Historical Analysis of FOMC Tenures, *Tim Todd, Federal Reserve Bank of Kansas City, April 2009.*

98. *The New York Times, Jan. 3, 1991.*

99. *Back from the Brink, Beckner, Steven K.; John Wiley & Sons, Inc., New York, 1996.*

by making sure that each of the Federal Reserve's governors came from different regions of the country. Section 10, paragraph 1 of the Federal Reserve Act says that not more than one governor "shall be selected from any one Federal Reserve District." As such, Fed governors are assigned as being "from" specific Fed Districts.

In a development that some might consider unfortunate, at the modern-day Fed, the connections between the governor and where they are "from" can be tenuous.

Lindsey faced opposition from some southeastern U.S. senators who were angered that he was going to be assigned as representing the Richmond Federal Reserve District – a region that spans south from Maryland through South Carolina. Lindsey, meanwhile, was born in New York, did his undergrad work in Maine and did his postgraduate work through his Ph.D. at Harvard. Lindsey had moved into the District three years earlier, taking up residence in one of Washington's Virginia suburbs when he took a job at the White House.¹⁰⁰

For some, that was not good enough.

"The people of the South deserve a representative who has been a participant and has been able to develop a clear understanding of their economic needs," North Carolina Sen. Terry Sanford said during floor debate on Lindsey's nomination.¹⁰¹

Sarbanes argued that, at the very least, the spirit of the statute was being violated.

"I do not think that geographic requirement is something to be ignored or laughed at or brushed off," he said.¹⁰²

Despite the discussion, Lindsey was one of several presidential appointees confirmed by unanimous consent.

Phillips, meanwhile, sailed through the confirmation process. She said later that the process might have been made a bit easier by following the drama of the Clarence Thomas Supreme Court hearings.¹⁰³

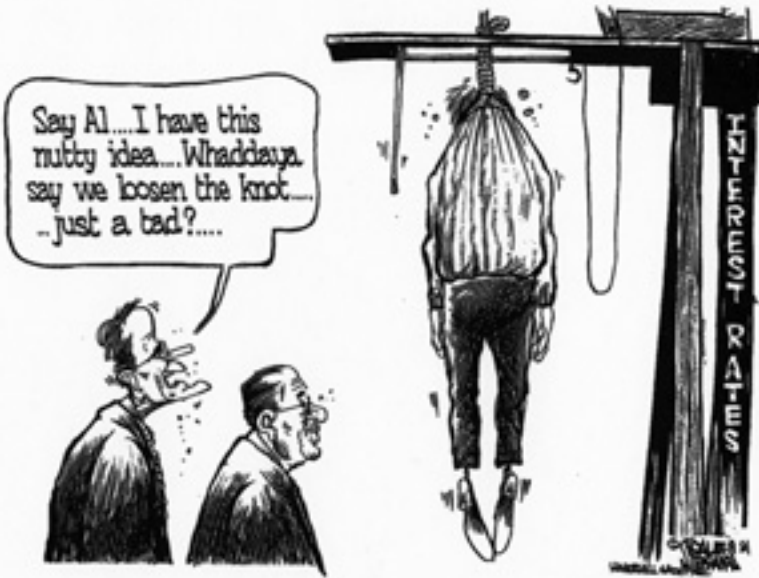
100. *The Wall Street Journal*, Dec. 23, 1991.

101. *The New York Times*, Nov. 25, 1991.

102. *The New York Times*, Nov. 25, 1991.

103. *The Region*, *Federal Reserve Bank of Minneapolis*, March 1992.

Cartoon illustration by Dale Stephanos of the "Interest Rates Gallows," © 2001. Originally appeared in *The Haverhill Gazette*, 1991. Use courtesy of Dale Stephanos, Foxboro, Massachusetts.



While the FOMC continued to push rates lower, it was clear to the nation that President Bush wanted even more aggressive action taken with the nation's monetary policy.

‘With the Drumbeat of the White House in our Ears’

OCTOBER 1991 – NOVEMBER 1991

A week after the Oct. 31 move, the FOMC held its scheduled meeting on Nov. 5 in Washington where policymakers dropped rates again, lowering the fed funds rate by 25 basis points (on Nov. 6) to 4¾ percent. The discount rate, meanwhile, was lowered by 50 basis points to 4½ percent.

The moves were not unanimous. Governors Angell and Edward Kelley opposed the fed funds rate cut, and Angell also voted against the cut in the discount rate.

Taking the closely watched fed funds rate down 50 basis points over a six-day span had echoes of Greenspan’s decision to allow a 50-basis-point drop in a single move nine months earlier. Now, there was increasing talk that 50 basis points was not enough.¹⁰⁴

And though Fed officials told reporters that the size of individual cuts was not as important as the overall loosening of credit conditions – the fed funds rate had been slashed in half over a 30-month span, down from 9½ percent in the summer of 1989 and at its lowest point since 1977 – the markets hardly responded to the news.

“This will help, but it’s not going to be anything dramatic,” Richard Peterson, chief economist at Chicago’s Continental Bank, told a reporter.¹⁰⁵

His comment was only one of many in stories focused on explaining why interest rate cuts were not saving the economy.

In one article, economist Allen Sinai explained to a journalist the lag between a policy move and the time its response becomes apparent.

“Research studies show that as much as two years can elapse before easier money really takes hold in the economy,” he said. “In the current circumstance, the biggest effect of easier money over the past year could be expected to occur in 1992 rather than 1991.”¹⁰⁶

The Washington Post talked with a wide range of sources for a similar story.

“(E)conomic experts, consumers and business executives interviewed yesterday said that the latest reduction is not likely to trigger much more spending or investing,” wrote

104. *The New York Times*, Nov. 7, 1991.

105. *The Christian Science Monitor*, Nov. 8, 1991.

106. *The Washington Post*, Nov. 2, 1991.

reporter Anne Swardson.¹⁰⁷ “It is not that rates are not low enough, it is that rates are not the issue.”

As the article noted, in addition to the credit crunch and the problems in the banking sector, consumers were simply afraid: They lacked confidence in the economy, were fearful about losing their jobs and were already laden with debt.

“People are very concerned about their jobs,” Fabian Linden, executive director of the Conference Board, told the paper.¹⁰⁸ “There is a whopping amount of stuff you don’t have to buy ... there isn’t a car around that can’t run for another six months.”

And, as if consumer confidence could withstand another negative hit, *The New York Times* published an analysis only days before Thanksgiving and the start of the critical holiday shopping season with the troubling headline of “Will the Aura of Recession Always Be With Us?”¹⁰⁹

One way to possibly restore confidence, some suggested, was a bigger rate cut. Supporters of this idea believed that, perhaps most importantly, it would show very clearly that policymakers understood the scope of the challenge presented by an economic recovery.

“We have a very precarious fiscal situation because of the enormous amount of debt,” economist Walter Joelson said to a reporter.¹¹⁰ “It’s very clear to me that under these circumstances a cut in interest rates is the only game in town, if it’s done on a sufficient scale.”

Although unknown to the public, there had in fact been comments during the FOMC meeting about the idea of a larger cut and its potential for addressing the nation’s confidence issue.

“One thing that I think is in everybody’s mind is: How do we improve confidence?” Fed Governor Kelley asked his counterparts.¹¹¹ “I think it may be a little more complex than meets the eye. If we make another small move, it probably will have a small impact. We’ve made 10 small moves in the last 12 months. And we can each make our own assessment of what the effect on confidence has been from all of that.”

However, a large rate cut also presented its own issues, including, among others, the political concerns connected with an angry White House and a Congress that was threatening the central bank’s structure.

“(P)eople would wonder what the Fed knows that they don’t or what the Fed thinks that they don’t think,” Kelley said.¹¹² “And particularly right here with the drumbeat of the White House in our ears, I think the Fed could come off looking politically dominated.”

107. *The Washington Post*, Nov. 7, 1991.

108. *The Washington Post*, Nov. 7, 1991.

109. *The New York Times*, Nov. 24, 1991.

110. *The Washington Post*, Nov. 2, 1991.

111. *Transcript of FOMC meeting*, Nov. 5, 1991.

112. *Transcript of FOMC meeting*, Nov. 5, 1991.

That, he said, would destroy the central bank's credibility and potentially do long-term damage.

“The Funny Coincidence Department”

As far as the Fed's credibility is connected to its political independence, the November 1991 rate cut shows how closely the actions of the FOMC are linked to the nation's political landscape.

As the FOMC was meeting in Washington, voters were heading to the polls to decide a number of state and local issues, with one national seat up for election in Pennsylvania. A special election was held to elect the successor to Republican Sen. John Heinz, who was among the victims killed when a helicopter collided with his plane above a Pennsylvania elementary school earlier in the year. Now, with the special election one year before the presidential election, strategists from both parties looked to the Keystone State as a trial run.



The 1991 victory of Pennsylvania Democrat Harris Wofford in a special Senate election to fill an unexpired term sent shockwaves through the Republican party looking toward the 1992 presidential vote. The victory was important for not only Wofford but also made a national name for his campaign manager: James Carville.

In the election, Harris Wofford, a little-known Democrat, scored an overwhelming victory over Dick Thornburgh, who had served as U.S. Attorney General under Presidents Reagan and Bush. To the Bush administration, which had heavily backed Thornburgh, it was a stunning, and troubling outcome.

“President Bush, who only months ago seemed headed for a steady stroll toward re-election, discovered this week that there are mine fields strewn across the political landscape,” wrote Robin Toner from *The New York Times*.¹¹³

In his victory speech, Wofford said his victory was about more than one Senate seat: “The people of Pennsylvania have used the power of the ballot to send a wake up call to the president and the Congress.”¹¹⁴

Bush clearly heard the call. One Republican strategist told a reporter that the White House’s attitude in the defeat seemed disproportionately large.

“You would have thought we had lost 26 House seats,” the strategist said.¹¹⁵

As it turned out, the Pennsylvania election would end up being more directly connected to the 1992 presidential race than either the strategist or even the Bush White House might have imagined. Wofford’s campaign was managed by James Carville. The election made Carville, who *The Washington Post* called “the bulldozer behind Wofford’s landslide,”¹¹⁶ a national figure.

Commentators noted that Carville’s strategy focused on turning the Republican Thornburgh “into a surrogate for the White House and a target for middle-class unease over the economic recession.”¹¹⁷ At least one political analyst noted that Wofford’s message of “middle class populism” was very similar to the message from one of the Democrat party’s presidential hopefuls: Arkansas Gov. Bill Clinton.

Although the FOMC was meeting on the afternoon of Election Day, the 25-basis-point cut that put the fed funds rate at 4¾ percent was announced the day after the election, which was in line with Fed policy at the time. Although Fed officials noted that they voted on the cut before the election results were known, in the minds of many, the cut was seen as a direct response to the stunning Republican defeat in Pennsylvania.¹¹⁸

Leonard Silk, a long-time economics writer who was highly respected and had a Ph.D. in economics, wrote that, after the election, the task of making sure the recession did not cost the Republicans the White House was “being handed to the Federal Reserve.

“The Fed said the move had nothing to do with the election. True, President Bush, Treasury Secretary Nicholas Brady and other Administration figures have been loud in their urgings to the Fed to cut rates. And Democrats had joined in urging the Fed to ease further. Nevertheless, the Fed’s move this week was filed at the central bank under the Funny

113. *The New York Times*, Nov. 7, 1991.

114. *The Washington Post*, Nov. 5, 1991.

115. *The New York Times*, Nov. 7, 1991.

116. *The Washington Post*, Nov. 7, 1991.

117. *The Washington Post*, Nov. 7, 1991.

118. *The New York Times*, Nov. 7, 1991.

Coincidence Department.”¹¹⁹

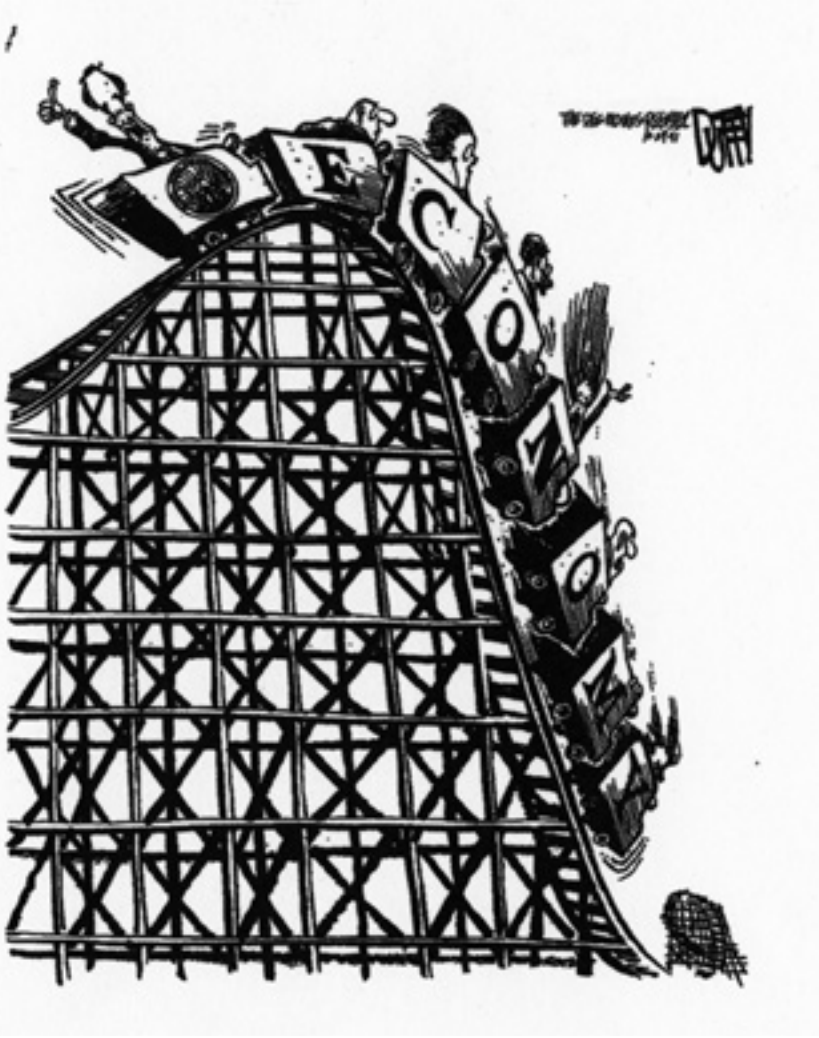
Market watchers saw more than a coincidence.

“The perception in the market was that this move was a result of extreme political pressure from the Bush Administration,” economist David Jones told *The New York Times*.¹²⁰ “The Fed may not have intended it that way, but that is the result.”

119. *The New York Times*, Nov. 8, 1991.

120. *The New York Times*, Nov. 7, 1991.

Cartoon illustration by Brian Duffy of the "Economy Roller Coaster." Originally appeared in *The De Moines Register*, 1991. Use courtesy of King Features Syndicate.



For President Bush, the nation's economy was not the only roller coaster ride. The President also saw his approval ratings, extremely high earlier in his term, take a fall.

‘I Don’t Find Anybody Asking for Monetary Policy to do More’

DECEMBER 1991, PART I

Fed policymakers convened a conference call to review the economic conditions on Dec. 2, 1991. The call was dominated by the regional Reserve Bank presidents providing reports on their regional economies. Other than Greenspan, only Governor LaWare asked a single question, and at the end of the call, Governor Angell referenced how the governors had been silent.¹²¹

The individual District reports showed a still-struggling economy.

From Boston, President Syron noted that his conversations with New England retailers indicated that sales were a bit better than they expected. However, he also noted that those expectations were “very, very negative.”¹²²

From Atlanta, President Forrestal said “optimistic” reports from his contacts were only “optimistic in the sense that they were so bad before that anything sounds better.”¹²³

From Minneapolis, First Vice President Tom Gainor talked about a recent meeting of that Fed’s Economic Advisory Council. About half the members of the group of business leaders from across the Ninth Federal Reserve District reported flat activity.

Ed Boehne, President of the Federal Reserve Bank of Philadelphia, referenced discussions with a number of groups representing businesses and credit unions.

“They were really quite negative, quite sour,” Boehne said.¹²⁴ “I was surprised by the number of times I heard the word ‘fear’ used to describe members of their credit unions and employees or companies that they represent.”

Several members also commented about how business contacts believed extensive press coverage of the recession was only compounding the fears of jittery consumers during the holiday season.¹²⁵

Overall, Greenspan characterized the reports from most participants as “negative and

121. *Transcript of FOMC conference call, Dec. 2, 1991.*

122. *Transcript of FOMC conference call, Dec. 2, 1991.*

123. *Transcript of FOMC conference call, Dec. 2, 1991.*

124. *Transcript of FOMC conference call, Dec. 2, 1991.*

125. *Transcript of FOMC conference call, Dec. 2, 1991.*

increasingly so.”¹²⁶

As far as a solution, St. Louis Fed President Melzer noted that contacts in the St. Louis Fed District had begun to voice concerns about monetary policy.

“It is interesting that, among people I’ve talked to in this context and other contexts, I don’t find anybody asking for monetary policy to do more,” he said. “If anything, a concern is evolving among business people that monetary policy is going to be asked (to do) too much and that in the process it will lose sight of longer-term goals. There was no pressure for further ease in any of these conversations.”

Economic data in the following days painted a picture that was negative.

On Dec. 5, the Commerce Department reported that 471,000 people had filed jobless claims for the week ending Nov. 23, up 57,000 from the previous week.¹²⁷ The Fed also released its beige book survey that suggested “flagging momentum in the economic recovery.”

Perhaps the most enlightening data, however, came from the Commerce Department, which had revised the method for measuring the nation’s output, switching from gross national product, which includes goods and services produced by labor and property supplied by U.S. residents, to gross domestic product (GDP), which covers only goods and services produced by labor and property in the United States. Among other things, GDP, which remains the key measure today, does not include interest receipts from abroad and is considered a more accurate gauge by economists.

Media accounts said the new measurement put the recession “in a harsher light,” showing the dip had been deeper than previously thought and that the economy was recovering far more slowly.¹²⁸

For the fourth quarter of 1990, GDP declined by 3.9 percent instead of the 2.1 percent previously reported. The new data presented a slightly better view of the first half of 1991, with GDP declining at an annual rate of 2.5 percent instead of the previously reported 3 percent decline in the first quarter. GDP grew at a rate of 1.4 percent during the second quarter, ahead of the initially reported 0.3 percent growth. However, between July and September, the economy expanded at a 1.7 percent pace, down from the initial estimate of 2.3 percent.¹²⁹

On Dec. 6, rates were cut again. Greenspan, using the latitude granted by the FOMC during the Nov. 5 meeting, lowered the fed funds rate 25 basis points to 4½ percent. The move was linked in the press to the jobs picture – one analyst called the most recent

126. *Transcript of FOMC conference call, Dec. 2, 1991.*

127. *The New York Times, Dec. 6, 1991.*

128. *The New York Times, Dec. 5, 1991.*

129. *The New York Times, Dec. 5, 1991.*

employment data “devastatingly weak”¹³⁰ – and public comments Greenspan had made about the recovery showing “signs of faltering.”¹³¹

It was the ninth fed funds rate cut of 1991. Eight of those cuts, with the exception of the somewhat controversial February move, had taken the fed funds rate down by 25 basis points. Meanwhile, there had been five cuts of the Fed’s discount rate – all of them by 50 basis points or a half a percentage point. Critics were saying that was not enough.

“The demand for credit is not driven by half-point changes in interest costs; it is driven by businesses’ expectations of future demand for their products,” one Jacksonville, Fla., banker told *The New York Times* after the early November rate cut.¹³² “Right now, that demand is just not there. I don’t expect any line around the bank tomorrow.”

In regard to the quarter-point cuts, one Fed staffer said later that there was a realization among policymakers “that we’ll take this step today, but more will be needed in the future, because this just isn’t enough, and when we meet again we’ll do more.”¹³³

And, with the economic news continuing to disappoint, the cuts were widely expected, as evidenced by the muted reaction from the markets. In the days ahead of the FOMC’s Dec. 17 meeting, markets were trading on the assumption that the Fed would announce another 50 basis points off of the discount rate and 25 points off of the fed funds rate.

The regional Fed presidents continued to paint a picture of a lackluster economy at the FOMC’s Dec. 17 meeting, although some reports were more along the lines of a stalling economy, not one in further decline. There were a couple of exceptions. In the St. Louis District, President Melzer noted some regional signs of improvement, including in employment while in Minneapolis, President Stern said there was “at least a glimmer of hope” coming from busy shopping malls and auto dealers who were seeing increased traffic.¹³⁴

When it came to policy actions, a couple of FOMC participants expressed caution at the idea of another rate cut, regardless of what the markets expected.

130. *The New York Times*, Dec. 7, 1991.

131. *The New York Times*, Dec. 7, 1991.

132. *The New York Times*, Nov. 7, 1991.

133. *Back from the Brink*, Beckner, Steven K.; John Wiley & Sons, Inc., New York, 1996.

134. *Transcript of FOMC meeting*, Dec. 17, 1991.



Bloomberg Contributor/Bloomberg via Getty Images

Gary Stern, president of the Federal Reserve Bank of Minneapolis, said he was seeing “at least a glimmer of hope” in the Ninth Federal Reserve District’s shopping malls and auto dealers late in 1991.

Melzer said he believed there was “a limit to what monetary policy can do.”

“The permanent effect of our actions is really only on inflation,” he told the rest of the FOMC; any immediate boost to the economy from a rate cut, he said, was only temporary.¹³⁵

He said he was worried about creating a future of “stop-and-go” policy where the Fed would have to dramatically raise rates to counter inflation. Fighting inflation, he said, required stable policy over the long term.¹³⁶

Among the governors, LaWare said that the economy could actually benefit if it was clear that the Fed was done making moves.

“We creep down ¼ point in the funds rate and then we creep down another ¼ point and we change the discount rate,” LaWare said.¹³⁷ “If we follow that same pattern, it seems to me that we are creating the expectation that ... pattern is going to continue almost indefinitely. I think there’s a lot to be said for turning it off, at least for a while, and seeing what happens. I’m still not convinced that all of the effects of our previous easing have come through.”

The FOMC ended up voting to hold policy steady, but gave Greenspan leeway to take rates lower if conditions warranted. Governor LaWare dissented.

135. *Transcript of FOMC meeting, Dec. 17, 1991.*

136. *Transcript of FOMC meeting, Dec. 17, 1991.*

137. *Transcript of FOMC meeting, Dec. 17, 1991.*

Cartoon illustration by Joe Hoffecker of "For Cryin' Out Loud." Originally appeared in *The Business Courier of Cincinnati*, Ohio.



President Bush had wanted the FOMC to make a cut larger than the usual 25 basis points in the fed funds rate to fight the recession. By the end of 1991, the pieces were finally in place to make that cut happen.

‘Merry Christmas and Happy New Year from the Fed’

DECEMBER 1991, PART II

The individuals taking part in the FOMC meetings underwent some significant changes in 1991.

In Kansas City, Thomas M. Hoenig started what would be a 20-year tenure as Bank president, attending the Oct. 1 FOMC meeting. Hoenig, a Ph.D. economist who had been the Bank’s head of supervision, succeeded Guffey, who had been the Bank’s president since 1976.

Meanwhile, in Dallas, Robert McTeer took over from the retiring Boykin early in the year, starting his FOMC involvement with the February conference call. McTeer, who began his Fed career as an economist with the Richmond Fed in the 1970s and later managed that Fed’s Baltimore Branch, would go on to serve as president of the Dallas Fed for 14 years. Boykin had held the job for 10.

In addition to the two new Reserve Bank presidents, there were the two Fed governors appointed by President Bush. After being nominated by the president earlier in the year, Lindsey and Phillips had finally made it through the political approval process and participated in an FOMC meeting for the first time at the Dec. 17 session.

Lindsey made light of the Senate debate about his residency, wearing a tie featuring photos of arguably Virginia’s most famous native – Thomas Jefferson – to his first FOMC session. He also spoke with a pronounced southern drawl when he was called upon, referencing his upbringing in the northeastern U.S. as being “temporarily domiciled.”¹³⁸

The joking aside, later media accounts would say that Lindsey and Phillips’ arrival at the policy table, where they joined Mullins, was the critical element in a significant Fed policy move.

In the days after the Dec. 17 FOMC meeting, and at a time when the FOMC did not issue immediate announcements on its policy directives, the markets waited for a rate cut that never came.

The Wall Street Journal’s coverage of Dec. 18 market activity notes the “conspicuous

¹³⁸. *Transcript of FOMC meeting, Dec. 17, 1991.*

absence of a move by the Federal Reserve to ease interest rates.” Stocks, in fact, slid early in the session when it became clear no Fed announcement was forthcoming.¹³⁹

The same day, Greenspan told the House Ways and Means Committee that the economy was “struggling” and added that tax cuts then under consideration by both Congress and the administration would be counterproductive.¹⁴⁰

The comments were sharply at odds with remarks made only a week earlier by Vice Chairman Mullins during a speech at the National Economics Club in Washington.

In that speech, Mullins said it was “promising” that the economy could be back to expanding at a 2½ to 3 percent pace by the following spring or summer.

“It looks promising, certainly by midyear we should be back squarely in the positive growth category,” he told the standing-room-only audience.¹⁴¹

He said that, compared against the late 1970s and early 1980s, “there doesn’t seem to be all that much to be pessimistic about.”¹⁴²

The public comments suggest that Mullins was already at work on a strategy that some might suggest was closely aligned to trying to help conclusively restore the economy as early as possible in the coming election year.

After a comparatively chipper public presentation, Mullins was at the other extreme in the FOMC’s Dec. 17 meeting. While a few suggested minor signs of improvement and many talked about conditions holding steady or the economy moving “sideways,” Mullins was without question the most pessimistic participant in the meeting.

“I think the economy is dead in the water with no forward momentum, or maybe drifting back a little,” he told the rest of the FOMC.¹⁴³

Although he said he believed that there was “not a unanimous consensus on this,” he presented an extensive case for a rate cut more substantial than was typical for the Fed.

“My feeling is that it may be time to reconsider the pattern of moving in an incremental approach and making the smallest moves possible. I’m concerned that this may dissipate the impact of our actions and not have the signaling effect. I’m also getting a bit concerned about the way the market is responding to the easing pattern rather than perhaps to the economic fundamentals. They think we ease on employment reports and before (congressional) testimony. They’re predicting policy easing rather than focusing on the fundamentals, it seems to me. And I wonder how much benefit there is to making another fully anticipated minimum size policy move. We

had academic consultants in the other day

^{139.} *The Wall Street Journal, Dec. 19, 1991.*

^{140.} *The New York Times, Dec. 19, 1991.*

^{141.} *The New York Times, Dec. 11, 1991.*

^{142.} *The New York Times, Dec. 11, 1991.*

^{143.} *Transcript of FOMC meeting, Dec. 17, 1991.*

and one of them said, in effect: 'It's time to get this mule's attention.' I doubt another ¼ percentage point tap on the mule's head is likely to do much. It may be time to figure out where we want to be and get there and make a stand."¹⁴⁴

He said that he wanted to move in such a way that there would not be an expectation that any rate cuts would be necessary in 1992 and that the central bank would be "ahead of the uncertainties."¹⁴⁵

Of all the Fed governors, Mullins had the tightest political ties. Initially a Harvard professor, Mullins participated in a Treasury commission examining the 1987 stock market crash. Bush appointed Mullins assistant Treasury secretary in 1989, made him a Fed governor a year later and elevated him to vice chairman a year after that. He was also known to be close with Treasury Secretary Nicholas Brady.

A lengthy *Wall Street Journal* article published later went into an unusually high level of detail about how Mullins worked "aggressively" to convince his Fed counterparts to take a bolder step with policy.¹⁴⁶ Woodward's 2000 book about Greenspan also portrays Mullins as the driving force behind the Fed's eventual action, with Corrigan at the New York Fed also playing an important role.¹⁴⁷

According to the article, Greenspan and Mullins "were already working behind the scenes to engineer (a) ... large discount rate cut" when Greenspan went before the House committee and painted a dreary picture of the nation's economy.

While changes in the Fed's discount rate are made by the Fed's Board of Governors, they must first be requested by one of the 12 regional Federal Reserve Banks. Although the Board had several requests for half-point cuts in the discount rate, Greenspan and Mullins wanted a request for a full-point cut, of which 50 basis points would flow through to the fed funds rate. Greenspan had flown to Chicago for a meeting after his House appearance, and when he got back to Washington the following evening he had with him a request from the Chicago Fed for a 1 percent cut in the discount rate. In the interim, New York had also filed the same request with the Board.¹⁴⁸

The seven Fed governors met at 7 p.m. They had hurriedly scheduled the session for only a couple of hours after Greenspan returned to D.C. to accommodate Fed officials leaving town for the holidays the following day.¹⁴⁹ At the evening session, they approved a

1 percent cut in the discount rate by a 6 to 1 margin, with Angell dissenting. As expected, 50 basis points flowed

144. *Transcript of FOMC meeting, Dec. 17, 1991.*

145. *Transcript of FOMC meeting, Dec. 17, 1991.*

146. *The Wall Street Journal, Dec. 23, 1991.*

147. *Maestro: Greenspan's Fed and the American Boom, Woodward, Bob; Simon and Schuster, New York, 2000.*

148. *The Wall Street Journal, Dec. 23, 1991.*

149. *The Wall Street Journal, Dec. 23, 1991.*

through to the fed funds rate, putting it at 4 percent. The discount rate fell to 3½ percent – its lowest level since 1964. It was the biggest rate cut in 10 years.

The cuts were announced the following day and welcomed by the market.

“It’s sort of Merry Christmas and Happy New Year from the Fed,” one finance executive told *The Washington Post*.¹⁵⁰

Some Fed watchers thought the cut was unusual in both its size and in its timing, coming only a couple of days after an FOMC meeting where no action had been taken.

The New York Times wrote that the cut “may have been a desperate attempt to wrest control of the economy back from the politicians.”¹⁵¹

Others saw political fingerprints all over the move.

“(I)t was Mr. Bush’s quiet reshaping of the seven-member Federal Reserve Board that made Friday’s (rate cut) possible,” wrote reporters Murray and Wessel in *The Wall Street Journal*.¹⁵²

Mullins had been working for some time to shore up support among the governors for a substantial rate cut rather than the piecemeal steps the central bank had taken throughout the year. Governors Angell opposed while LaWare and Kelley were reluctant. Mullins had two solid votes of support from the Fed’s new governors.¹⁵³ The newcomers now meant that Bush appointees, including Greenspan who had been reappointed Fed chairman, outnumbered the Reagan appointees 4 to 3 for the first time.

Woodward notes that the same *Journal* article portrayed Mullins as a “hero”¹⁵⁴ because he “laid the intellectual groundwork”¹⁵⁵ for the cut. Beckner’s 1996 book about the Fed portrays Corrigan as the originator of the cut, but it is clear that Mullins was the salesman.

Phillips later talked about the vice chairman laying the groundwork prior to the meeting.

“I remember David Mullins came down here and we sat in this very office, and we talked about it and I said, ‘You know we need to move.’ So he said, ‘What would you think about a one percent move?’ And I said, ‘If we can do it that would be great, but I don’t think it can be done. I don’t think the votes are there.’ And he said, ‘Well, we’ll see.’”¹⁵⁶

Beckner recounts a story about Lindsey at an airport the following day waiting for a flight and seeing that the Dow was up 100 points, or about 3 percent, at that time.

150. *The Washington Post*, Dec. 21, 1991.

151. *The New York Times*, Dec. 21, 1991.

152. *The Wall Street Journal*, Dec. 23, 1991.

153. *The Wall Street Journal*, Dec. 23, 1991.

154. *Maestro: Greenspan’s Fed and the American Boom*, Woodward, Bob; Simon and Schuster, New York, 2000.

155. *The Wall Street Journal*, Dec. 23, 1991.

156. Back from the Brink, Beckner, Steven K.; John Wiley & Sons, Inc., New York, 1996.

“I felt like I had done what I was supposed to do,” Lindsey later said.¹⁵⁷ “It was an exhilarating feeling.”

For his part, if Mullins was feeling good about the cut, the emotion might have been relatively short-lived. When he arrived in Florida to spend the holidays with his mother, she and her friends were outraged because the cut meant they were earning less on their savings.¹⁵⁸

The markets, however, clearly felt otherwise.

Exactly a week later, the Dow closed above 3,100 for the first time. It closed above 3,200 for the first time a week after that.

“It was great. It was great,” Phillips later said of the rate cut.¹⁵⁹ “And it was quite a break (from past Fed strategy) because the Fed had been moving in smaller increments. . . . The economy had shown positive growth, but it was very paltry.”

One of the Fed governors appointed by Reagan later told Beckner that the cut would have come without the Bush appointees taking the majority, but Lindsey and Phillips did not agree with that conclusion.¹⁶⁰

“It was obvious that Mullins had worked very hard to try to get rates down, but it was dragging,” Lindsey said.¹⁶¹ “There was a lot of inertia . . . (in) what had been a very cautious Board with LaWare, Kelley, Greenspan and Angell. Phillips and I were anxious to cut rates, as was Mullins.”

157. Back from the Brink, *Beckner, Steven K.; John Wiley & Sons, Inc., New York, 1996.*

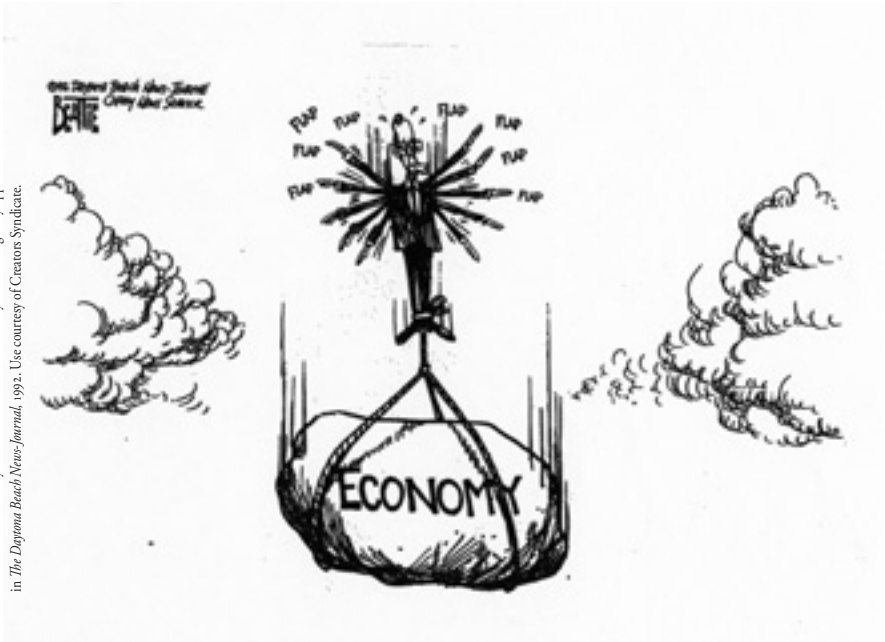
158. The Wall Street Journal, Oct. 6, 1992.

159. Back from the Brink, *Beckner, Steven K.; John Wiley & Sons, Inc., New York, 1996.*

160. Back from the Brink, *Beckner, Steven K.; John Wiley & Sons, Inc., New York, 1996.*

161. Back from the Brink, *Beckner, Steven K.; John Wiley & Sons, Inc., New York, 1996.*

Cartoon illustration by Bruce Beattie of the "Economy Rock." Originally appeared in *The Daytona Beach News-Journal*, 1992. Use courtesy of Creators Syndicate.



Although Bush may have finally gotten the rate cut he wanted, his reelection bid could not overcome the economic issues the nation faced during his presidency.

‘Well, I See They Caved in Again’

DECEMBER 1991 – SEPTEMBER 1992

Although the markets, and certainly the administration, welcomed the dramatic Fed action, others believed that the central bank had relented in the face of political pressure.

“Well, I see they caved in again,” respected economist and preeminent Fed historian Allan Meltzer told friends a few days after the cut.¹⁶²

Meltzer, whose lengthy written Federal Reserve histories are the most comprehensive analysis of the nation’s central bank ever published, went on to write a newspaper column about the cut.

“I regret to say, I believe that ... after months of resistance and a four-year effort to restore price stability, the Federal Reserve caved in to pressures to reflate in advance of the election.

“By acting as it did, the allegedly independent Fed gave as clear a signal as can be expected that it will do all it can to assure that it will not be blamed for the defeat of President Bush or any congressional incumbents who seek re-election.”¹⁶³

Other economists indicated they felt like much of the hand-wringing about the recession was fueled by political interests and not economic realities.

“It’s hard to see what all the shouting is about,” Harvard professor Benjamin Friedman told *The New York Times* for a story about the Fed move and the recession.¹⁶⁴

Taken in a more historical perspective, the 1990-91 downturn was a mild recession and remains among the most mild of the postwar era. GDP fell 1.3 percent, a much less severe decline than in the vast majority of U.S. recessions, and half of the decline experienced in the first five quarters of the late-2000s recession.¹⁶⁵ Meanwhile, unemployment climbed

1.3 percentage points during the 1990-91 recession, about half the average increase in postwar recessions.¹⁶⁶

But the economic picture was

162. *The Washington Post*, May 9, 1992.

163. *The Washington Post*, May 9, 1992.

164. *The New York Times*, Dec. 21, 1991.

165. “How Will Unemployment Fare Following the Recession,” Knotek, Edward S. II, and Stephen Terry, *The Economic Review*, Federal Reserve Bank of Kansas City, Third Quarter 2009.

166. “How Will Unemployment Fare Following the Recession,” Knotek, Edward S. II, and Stephen Terry, *The Economic Review*, Federal Reserve Bank of Kansas City, Third Quarter 2009.

clouded by a couple of issues. First, the nation had come through a long period of economic growth spanning eight years. As suggested by San Francisco Fed President Parry's comments in the October FOMC conference call, the nation had become conditioned to a strong economy after nearly a decade of growth. Perhaps more importantly – certainly from a political perspective – was that unemployment continued to rise long after the “recession” was over.

Officially, the National Bureau of Economic Research (NBER) later concluded that the recession lasted from July 1990 through March 1991.¹⁶⁷ At the end, joblessness was at 6.8 percent – its high point for the recession – but it continued to climb. Nine months later in December 1991, the unemployment rate was 7.3 percent and it hit 7.8 percent in June 1992. Unemployment did not fall below its pre-recession levels until August 1996 when it slipped to 4.1 percent.¹⁶⁸

This “jobless recovery,” which, combined with other mixed data and the fact that a mild recession is followed by a mild recovery, meant that many Americans did not feel like they were experiencing a “recovery.” Even the NBER waited until the end of 1992 before it was officially able to say that the recession had ended in the spring of 1991.

“(I)t is hard to find evidence that (the recession) is ending,” NBER member Geoffrey Moore told a reporter in a late-April 1992 interview that, it turned out, was actually conducted after the recession was over.¹⁶⁹

For the Federal Reserve, that meant while it was later determined the economy was growing in the last half of 1991, it was not entirely apparent at the time. For Bush, it was a grave concern with the clock ticking down toward the 1992 election.

The president issued a statement calling the December rate cut “a significant step” and commending the Fed for its action. Democrats in Congress, meanwhile, criticized the Fed for not acting sooner.¹⁷⁰

Others were critical for different reasons.

“The whole thing stinks,” one senior Fed staffer told writer Beckner about the Dec. 19, 1991, rate cut. He said Greenspan had bowed to political pressure after both the chairman and Mullins had publicly suggested a rate cut was not imminent.¹⁷¹

Beckner also says that two days prior to the late-December rate cut, a senior administration official told him “the pressure on the Fed is just about irresistible at this point,” and that others bragged about having convinced the Fed to move more aggressively. Beckner, however, wrote that he has

167. National Bureau of Economic Research press release issued Dec. 22, 1992.

168. Author analysis of U.S. Bureau of Labor Statistics data.

169. The New York Times, April 26, 1991.

170. The New York Times, Dec. 21, 1991.

171. Back from the Brink, Beckner, Steven K.; John Wiley & Sons, Inc., New York, 1996.



While it was later determined that the recession officially ended in March 1991, for many Americans, including this Chicago business, the pain continued to linger more than a year later.

no reason to believe that Greenspan caved to White House pressure, noting that New York Fed President Corrigan, who said he was the originator of the big cut, was a Democrat.

The December move was not the final rate cut, but the reductions slowed dramatically the following year. The Fed lowered the fed funds rate three times in 1992: quarter-point cuts in April and September, and a half-point cut in July. The discount rate was lowered only once, by a half-point in July. After the September cut, both the discount rate and the fed funds rate stood at 3 percent.

Meanwhile, in the eyes of some, the connection between the Bush reelection effort and the Fed's monetary policy responsibilities grew.

Prior to the July 1992 meeting, *The Wall Street Journal* made the meeting seem more like a wrestling battle royal:

“The dispute pits Bush appointees against Reagan holdovers, Fed officials in Washington against Fed officials in the heartland, economists against bankers. The immediate issue: Has the Fed cut short-term interest rates enough to get the economy on track?”¹⁷²

In the weeks prior to the meeting, some Fed officials had started to say they feared further cuts in short-term rates would drive long-term rates higher by stoking investor fears of inflation.¹⁷³ Keeping long-term rates low is critical to economic growth because loans such as home mortgages are influenced by long-term rates.

Bush had already weighed in on the topic.

In a June 23, 1992, interview with *The New York Times*, the president said inflation was “pretty well under control” and that the argument that lowering short-term rates would

172. *The Wall Street Journal*, June 26, 1992.

173. *The New York Times*, June 24, 1992.

drive long-term rates higher was no longer valid.¹⁷⁴

“I can understand people worrying about inflation. But I don’t think that’s the big problem now,” Bush said.¹⁷⁵

Fed watchers said Bush’s public pressure on the Fed had likely worked against the president and the central bank.

“If a President in an election year, who is looking bad in the polls, tells you to ease, and you ease immediately, then you will be perceived as easing for political purposes,” one Fed watcher told *The New York Times*.¹⁷⁶ “Then long-term bondholders might give up on the Fed as a credible inflation fighter, and that might push up long-term rates.”

In the weeks prior to the July FOMC session, the regular Monday morning meetings of the seven Fed governors, typically uneventful sessions where economic data was shared, had turned into debates with Mullins, Lindsey and Angell challenging the analysis and forecasts of Fed staff. One media account referred to them as skirmishes.¹⁷⁷

As it turned out, the Fed did not lower rates at the mid-week meeting, but acted the following day in the aftermath of the Labor Department’s reporting the jump in the jobless rate during June 1992. The Fed’s Board of Governors approved a 50-basis-point cut in the discount rate, putting it at 3 percent. The fed funds rate followed with a 50 percent cut to 3¼ percent.

At 7.8 percent, the jobless rate was the highest it had been since March 1984. It would not see that level again until February 2009.¹⁷⁸

The New York Times called the report “a stunning grim set of figures that challenged assumptions of continued economic recovery.”¹⁷⁹

John Berry at *The Washington Post* compared it to “a 16-inch shell fired from a battleship beyond the horizon.”¹⁸⁰

174. *The New York Times*, June 24, 1992.

175. *The New York Times*, June 24, 1992.

176. *The New York Times*, June 29, 1992.

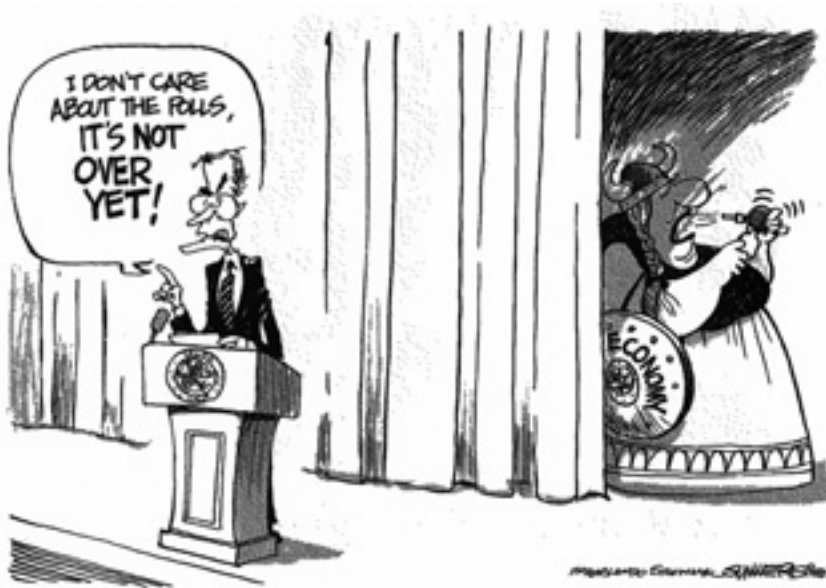
177. *The Wall Street Journal*, June 26, 1992.

178. Author analysis of U.S. Bureau of Labor Statistics data.

179. *The New York Times*, July 3, 1992.

180. *The Washington Post*, July 4, 1992.

Cartoon illustration by Dana Summers of "It's Not Over Yet." Originally appeared in *The Orlando Sentinel*, 1992. Use courtesy of Dana Summers, Orlando, Florida.



As the 1992 election drew near it was apparent that the economy would be one of the most important, if not the most important, issues for voters.

‘The Politicization of Monetary Policy Proceeds in a... Subtle Manner’

SEPTEMBER 1992 – DECEMBER 1992

A few weeks after the third cut in the fed funds rate, and about a month before the 1992 presidential election, *The Wall Street Journal* published a lengthy front page article about Mullins, portraying him as the driving force behind rate cuts and doing Bush’s work at the central bank.

“George Bush couldn’t have asked for more,” wrote *The Wall Street Journal’s* Wessel, adding that Mullins “has fought tirelessly” to lower rates.¹⁸¹

“More than some other Treasury officials who have moved to the officially independent central bank ... Mr. Mullins maintains close ties to the administration,” Wessel wrote.¹⁸²

One unnamed government source told Wessel that Mullins was “a wave washing against the shore. He’s constantly pounding against Greenspan.”¹⁸³

A 1993 research article by Duke University Professor Thomas Havrilesky pointed to Mullins as one example of an ongoing politicization of monetary policy. Specifically, the article noted a string of individuals appointed to serve as the Fed’s vice chairman going back to 1976 who were tied more closely with political interests than those who held the position previously. The article compared those moves against more overt political initiatives, such as those introduced by Sarbanes and others.

“In some cases the politicization of monetary policy proceeds in a more subtle manner. It does not feature acts of Congress,” Havrilesky wrote.¹⁸⁴ “It is not even marked by legislative discussion, overt executive branch initiatives or discernable external pressure on the Federal Reserve.”

For his part, Mullins told Wessel he was surprised that he hadn’t been accused more

often of doing the work of the administration. The lower rates, he said, were needed to help borrowers pay

181. *The Wall Street Journal*, Oct. 6, 1992.

182. *The Wall Street Journal*, Oct. 6, 1992.

183. *The Wall Street Journal*, Oct. 6, 1992.

184. “The Politicization of Monetary Policy: The Vice Chairman as the Administration’s Point Man;” Havrilesky, Thomas, *The Cato Journal*, *The Cato Institute*, Spring/Summer 1993.

off the debts they accumulated in the 1980s when central banks around the world held rates at too low of a level.¹⁸⁵

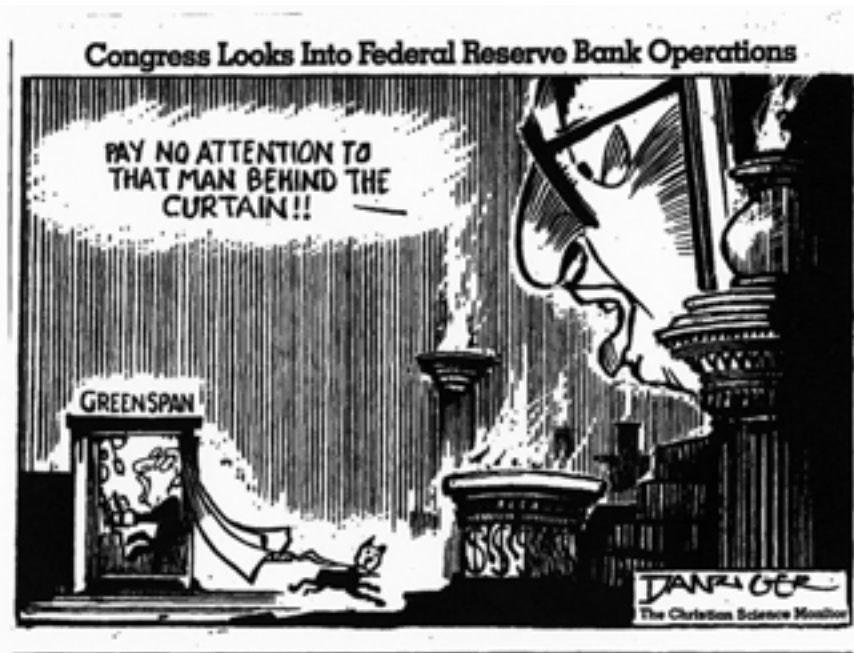
In that regard, Mullins said he would fight as hard to raise rates when the time was right. Not everyone believed his promise.

“Mullins generally talks tougher on inflation than he votes,” a New York banker told Wessel.¹⁸⁶

185. The Wall Street Journal, Oct. 6, 1992.

186. The Wall Street Journal, Oct. 6, 1992.

Reproduced with permission from the March 28, 1996 issue of *The Christian Science Monitor*
(www.CSMonitor.com) © 1996 *The Christian Science Monitor*.



In 1996, Congress took a close look at the Federal Reserve, prompting at least one comparison between the central bank and the classic film "The Wizard of Oz."

‘His Track Record is Hard to Argue With’

1993 AND BEYOND

The Fed held rates steady in 1993 and started to move them higher in 1994.

As it turned out, the New York banker who doubted Mullins’ willingness to tighten policy had his opinion validated – when Mullins left the Federal Reserve on Feb. 1, 1994, he had completed his time on the FOMC without ever voting for a rate increase. His entire tenure spanned the recession and recovery where the Fed only moved rates lower.

In what can only be an ironic coincidence, the first FOMC meeting in which Mullins did not take part, in February 1994, was the first post-recession rate hike by the Fed in the aftermath of the 1990-91 recession. That meeting had its own dissention, with members divided on how to best remove policy accommodation put in place during the recession. Numerous FOMC members – both governors and presidents – supported a 50-basis-point increase of the fed funds rate, with some pointing out it would expedite the return to a more normal rate.

Greenspan, however, was convinced that a 50-basis-point increase would be a mistake. As support for the move became apparent, Greenspan strongly made his case to the rest of the committee. He had been involved in economic forecasting and connected to Wall Street, he said, since 1948, and he was convinced the bigger rate hike was simply too risky in terms of the response it might receive in the markets.¹⁸⁷

“I have a pain in the pit of my stomach,” he said, and then elaborated to the rest of the FOMC about the importance of them unanimously backing his proposed quarter-point increase.

“I ... would be concerned if this committee were not in concert because at this stage we as a committee are going to have to do things which the rest of the world is not going to like,” Greenspan said. “We have to do them because that’s our job. If we are perceived to be split on an issue as significant as this, I think we’re risking some very serious problems for this organization.”¹⁸⁸

The rate was increased by 25 basis points to 3¼ percent. The vote was unanimous.

187. *Transcript of FOMC meeting, Feb. 2-3, 1994.*

188. *Transcript of FOMC meeting, Feb. 2-3, 1994.*

In what was then an unusual step, for the first time the Federal Reserve announced the move immediately. Many Fed watchers connected the announcement to political pressure the Fed was facing in Congress related to its responsibilities for bank supervision.

The New York Times noted that, with Americans growing concerned about possible inflation, and the Fed not only facing opposition in Congress but also having to take the politically unpopular step of a rate hike, it was able to make a “modest” quarter-point increase “without antagonizing Congress much or the Administration at all.”¹⁸⁹

Economist John Lipsky told the paper that the 25-basis-point increase, along with the unexpected addition of the public announcement, had the same effect on markets as a half-point increase done through what was then the more traditional method without an announcement.

“They were able to get the markets’ attention in a rapt way, with the most modest move they could have considered,” he said.¹⁹⁰

The fed funds rate would be increased five more times before the end of the year, concluding with a 75-basis-point increase on Nov. 15.

It was the largest rate hike since May 1981 when the Volcker-led Fed was fighting to break the back of inflation. The increase, which was supported unanimously, put the fed funds rate at 5½ percent, up from 3 percent at the start of the year.

With the recession past, the U.S. economy then moved into a decade-long span that became the longest period of growth in U.S. history, ending with the bursting of the dot-com bubble and the rise in uncertainty after the terrorist attacks of Sept. 11, 2001. After recovering from the brief and comparatively mild recession, the financial crisis of the late 2000s prompted the start of what has become known as “the Great Recession” in the fourth quarter of 2007.

“Individual members often do not vote their true preference”

Greenspan served as Federal Reserve chairman until Jan. 31, 2006. He was the second-longest-serving chairman in the Fed’s 100-year history, trailing only William McChesney Martin, Jr., who held the post from April 1951 through January 1970.

Late in his tenure, he received numerous honors, including the Presidential Medal of Freedom in 2005 and the Department of Defense Medal for Distinguished Public Service in 2006. He was even granted the honorary title of Knight Commander of the British

Empire in 2002. And, of course, he was famously lauded as the “Maestro,” a reference to the title of the Woodward book profiling a portion of his tenure as Fed chairman.

Although the nation’s monetary policy was determined by the Fed committee, Greenspan had become its personification, especially to the financial press and those on Wall Street. As the end of his term drew near, many fretted over the thought of his imminent departure. In the minds of many – perhaps even most – Greenspan was the decision maker of monetary policy, with the “committee” seemingly reduced to little more than its letter at the end of the “FOMC.” That viewpoint, by the way, is sharply at odds with the early days of Greenspan’s tenure, which often noted the “collegial” way the Fed was determining monetary policy.¹⁹¹

“To be sure, Alan Greenspan ... is the dominant figure at the institution, but the Fed is far from the monolith it sometimes appears and Mr. Greenspan, more than most chairmen in the past, encourages other FOMC members to air their views,” *The New York Times* wrote in 1991.¹⁹²

Certainly, the public disagreement among the Fed’s governors, as evidenced by their policy votes, ended after the early 1990s.

Over a 15-year span from January 1995 through January 2010 – a period that covers more than 120 separate FOMC policy votes and a wide range of economic conditions including the tech bubble and housing collapse – there were only three instances where a Federal Reserve governor cast a dissenting vote. Conversely, over that same period, Reserve Bank presidents dissented 35 times.¹⁹³

One measure of how much policymakers were relying on Greenspan’s direction was the FOMC’s behavior around the turn of the century. From the fall of 1999 through the spring of 2001, the FOMC voted 15 times and moved rates eight times, including a string of 50-basis-point cuts in early 2001. There were no dissents.

“Alan has been right so often now that some of us trust his judgment more than our own,” one FOMC member said.¹⁹⁴ “He’s the guy who gets new meaning out of old numbers so when we’re unsure we decide to trust him and vote with him. His track record is hard to argue with.”

The string was broken at the FOMC’s May 2001 meeting when Hoenig from the Kansas City Fed dissented against

another 50-basis-point cut, favoring instead a 25 percent drop.

191. *The New York Times*, July 11, 1991; numerous others.

192. *The New York Times*, June 9, 1991.

193. *Federal Reserve records, policy analysis by RDQ Economics, author analysis.*

194. *The International Economy, Sept.-Oct. 2001, reprinted at www.entrepreneur.com.*

Media coverage of the dissent offers some indication on how much the world of monetary policy had changed over the years. Although Hoenig's dissent – the sole dissenting vote among the 12 FOMC voters at the meeting – was only about the depth of the cut and not the direction of policy, it was seen as a major event, with headlines blaring “rebellion in the ranks”¹⁹⁵ and “discord on rate policy.”¹⁹⁶

There was later another even longer streak without dissent spanning 17 meetings from late 2003 through much of 2005.

In a Jan. 4, 2008, speech, then-Fed Vice Chairman Don Kohn credited the lack of dissent among Fed policymakers to the leadership of the central bank's chairman and his ability to achieve consensus, which is obviously critical in policymaking. However, he also acknowledged that there could be other reasons for voting with the majority. For example, policymakers might vote with the majority because they are concerned that “a series of close votes could create uncertainty about policy and the direction of the institution.”¹⁹⁷

Others have connected the decline in dissenting votes by Fed governors with the 1993 discovery that Fed staff had been maintaining FOMC meeting transcripts for nearly 20 years. It was a development that surprised Fed policymakers. Since the revelation of the transcripts, which are now released to the public annually after a five-year lag, there have been only four dissents by Fed governors.

In the eyes of at least some Fed policymakers, it is apparent that a dissenting vote is not specifically a question about if they might prefer an alternative policy approach.

“(I)t is widely known that individual members often do not vote their true preference. Instead, each committee member decides whether to support or oppose the chairman's policy recommendation, which is almost always made first,” reads a 2001 report authored by former Federal Reserve Vice Chairman Alan Blinder and others.¹⁹⁸ “... Fed traditions dictate that a member should ‘dissent’ only if they find the majority's (that is the chairman's) opinion unacceptable.”

A comment that President Melzer made during a 1994 FOMC meeting where officials were discussing details related to the public release of individual votes on Fed policy moves, explains that line of thinking.

“(T)he effect of that is to place the minority rather than the majority in the limelight in terms of who the press might be interested in talking to, which might not be

195. *The International Economy, Sept.-Oct. 2001, reprinted at www.entrepreneur.com.*

196. *The Wall Street Journal, June 29, 2001.*

197. *Text of comments by Vice Chairman Donald L. Kohn at the American Economic Association Session, Allied Social Science Associations Annual Meeting, New Orleans, La., Jan. 4, 2008.*

198. *How Do Central Banks Talk? Alan Blinder, Charles Goodhart, Phillip Hildebrand, David Lipton, Charles Wyplosz.*

optimal,” Melzer said.¹⁹⁹

Certainly, the absence of a dissenting vote does not mean that there are not disagreements at the policy table; however, in this regard, the record very clearly shows a difference between the presidents and the governors.

“Presidents have tended to dissent a little more than governors (which) ... might reflect a number of factors. For one, presidents have their own staffs, which can help support alternative views in preparing for a meeting,” Kohn said.²⁰⁰ “Board members share a common staff with the chairman, and, being in the same building, perhaps have a greater opportunity to influence and be influenced by the chairman.”

As far as the presidents – their views might have been best expressed by Boykin in a 1991 conversation with a reporter.

“There’s a lot of institutional memory among the (regional Federal Reserve Bank) presidents,” the then-retired Dallas Fed President told a reporter in 1991.²⁰¹ “Not to put Washington down ... but I don’t think we’re totally dumb. We damn sure know what’s going on in the hinterlands and I think it’s important somebody can go to Washington and say, ‘Hey, here’s what’s going on in the boondocks.’”

Even those who closely follow the Federal Reserve might be surprised to realize that no Federal Reserve governor has cast a dissenting vote since former Fed Governor Mark Olson dissented against a 25-basis-point increase in the fed funds rate in September 2005. To find the last time a Fed governor dissented in favor of tighter monetary policy, one would have to go back another decade to December 1994 when the late John LaWare wanted to raise interest rates.

“Legacy”

On Greenspan’s last day at his office in the Federal Reserve’s headquarters building along Washington’s Constitution Avenue in 2006, his accomplishments as Fed chairman were praised by numerous Fed watchers and media outlets, including a *Los Angeles Times* editorial that called him “the world’s banker.”²⁰²

A few days later, a letter to the editor from a Santa Barbara, Calif., resident named Sridhar Subramanian, suggested that while Greenspan may have done all he could at the

helm of the Fed, it was premature to “gush over his legacy,” noting several issues facing the economy, including

199. *Transcript of FOMC meeting, Feb. 2-3, 1994.*

200. *Text of comments by Vice Chairman Donald L. Kohn at the American Economic Association Session, Allied Social Science Associations Annual Meeting, New Orleans, La., Jan. 4, 2008.*

201. *The Wall Street Journal, April 5, 1991.*

202. *The Los Angeles Times, Jan. 30, 2006.*



Alan Greenspan, center, talks with Federal Reserve Vice Chairman Roger Ferguson, Jr. and other Federal Reserve officials on Greenspan's final day as Federal Reserve Chairman. Although he was widely praised at the time of his departure, questions about the Fed during his tenure became more frequent as the nation faced a financial crisis only a few years later.

the housing bubble.

“Will *The Times* still stand by its assessment if the dollar drops precipitously or if we’re facing a depression in a few years?”²⁰³

The comment seemed prescient as the nation drifted further into the depths of The Great Recession, and the man who had once been lauded as providing an omniscient guiding hand to the U.S. economy started defending his record as Fed chairman with numerous media appearances.

It “looks like a desperate attempt to buff up his legacy in the face of rather compelling evidence that ... well, that he screwed up big time,” Steven Pearlstein wrote in *The Washington Post*.²⁰⁴

In a late 2008 appearance before a congressional committee examining the decisions that created the financial crisis, Greenspan was called on the carpet.

“The tough talk reflected a widening sense that some of Greenspan’s apparent successes in managing the economy from 1987 to 2006 were in fact illusory, that they came at the cost of building the biggest credit bubble in world history,” *The Washington Post* reported.²⁰⁵

203. *The Los Angeles Times*, Feb. 2, 2006.

204. *The Washington Post*, Aug. 15, 2008.

205. *The Washington Post*, Oct. 24, 2008.

Steve Goldstein, London bureau chief for *MarketWatch.com*, compared the former Fed chairman's comments to the congressional committee to Capt. Renault, the character in the 1942 film classic *Casablanca*, who said he was "shocked" to find gambling in the casino.²⁰⁶

Some would suggest that Greenspan had, in fact, ignored the comments by former Fed Chairman Martin – the most famous statement ever made about central banking: The job of the central banker is "to take away the punch bowl just as the party gets going."

Comparatively, Woodward described Greenspan this way late in his glowing 2000 portrait of the man: "Greenspan is one of the elders who allows the economic party to continue. In *The Wizard of Oz*, when the man behind the curtain emerges, we are let down. With Greenspan, we find comfort."²⁰⁷

"It's the economy, stupid"

Given the outcome of the 1992 election, with Clinton getting 370 electoral votes to 168 for Bush, it is easy to forget that in early 1991 newspapers described Bush as "unbeatable"²⁰⁸ and having "an aura of invincibility."²⁰⁹ In the aftermath of a quick war in Iraq, his approval rating soared to an almost unfathomable 90 percent.

But the lesson that all politicians draw from that election is the focus on the economy. One of the most memorable line from the election was crafted by Clinton advisor Carville, the force behind the Democrats' 1991 victory in Pennsylvania: "It's the economy, stupid."



President-elect Bill Clinton visited the White House on Nov. 18, 1992, to begin working on the transition to the new administration. President Bush shook Clinton's hand as he left the meeting.

206. *Marketwatch.com*, Oct. 23, 2008.

207. *Maestro: Greenspan's Fed and the American Boom*, Woodward, Bob; *Simon and Schuster, New York, 2000.*

208. *The Christian Science Monitor*, Aug. 2, 1991.

209. *The New York Times*, Feb. 27, 1991.

Supporters of an independent central bank, meanwhile, can point to it as making an extremely strong case to keep the central bank as protected from political influence as possible.

As the reporter David Rosenbaum explained it in an article he wrote for *The New York Times* in the midst of the 1991 turmoil:

“Using its power to raise or lower interest rates, the Federal Reserve has much more influence over the state of the economy than any other government agency. That is especially true ... when the large budget deficit has caused the White House and Congress to relinquish much of their grip on economic policy.”

Rosenbaum and many others have suggested that the Fed’s independence is protected, to some degree, by a couple of points recognized by politicians:

- An independent Fed is an easy and popular target for political venom in a rough economy;
- Politicians know that they can talk about the need for lower interest rates, but recognize that higher rates are necessary to keep inflation at bay.

Although both of those points sound reasonable, it is not at all clear that they would hold up under extreme political pressure.

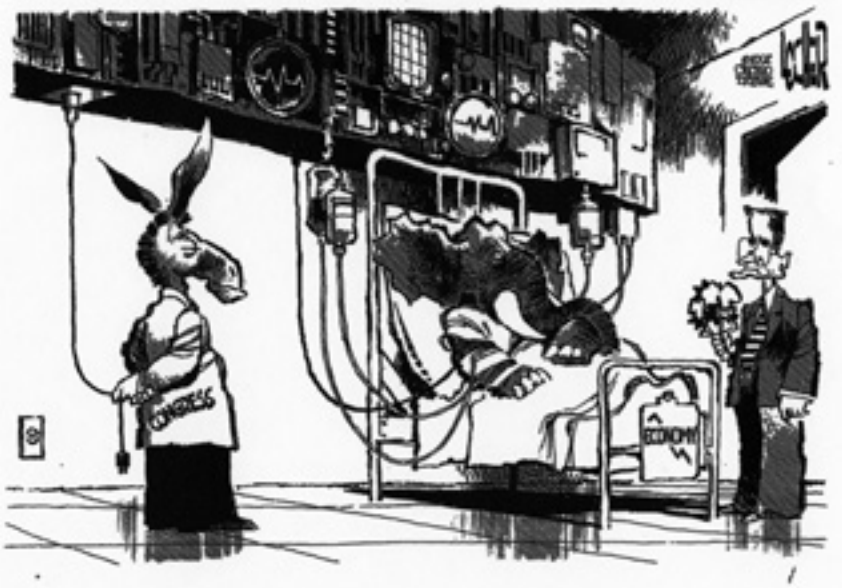
For example, it seems apparent that, with the benefit of hindsight, Bush might have done things very differently and worried about the long-term issues after the 1992 election had passed. He made no secret that he felt like the Fed cost him a second term.

Regardless of how much water Mullins may or may not have been carrying for Bush to the Fed’s policy table, it seems apparent that Bush would have exerted greater control over the policy-making body if the avenues had been available to him.

As it was, the administration continued to talk up the idea of more rate cuts. Meanwhile, Bush told *The New York Times* during the summer 1992 interview that he wanted to be careful that he was not “Fed bashing.”

He then added: “I don’t know of any President that would like to advocate higher interest rates, and certainly I’m not one.”²¹⁰

© Tribune Media Services, Inc. All Rights Reserved. Reprinted with permission.



President Bush may have felt Congress was working against him, but it did not matter, at the end the result was the same – the struggling economy had affected his reelection bid.

Economic Data, 1988-1994

REAL GROSS DOMESTIC PRODUCT (GDP) CHANGE

from PRECEEDING PERIOD²¹¹

SEASONALLY ADJUSTED ANNUAL RATES

1988

Q1	2.1 percent
Q2	5.2 percent
Q3	2.1 percent
Q4	5.5 percent

1992

Q1	4.5 percent
Q2	4.3 percent
Q3	4.2 percent
Q4	4.3 percent

1989

Q1	3.8 percent
Q2	3.0 percent
Q3	3.2 percent
Q4	0.9 percent

1993

Q1	0.7 percent
Q2	2.6 percent
Q3	2.1 percent
Q4	5.4 percent

1990

Q1	4.2 percent
Q2	1.6 percent
Q3	0.0 percent
Q4	-3.5 percent

1994

Q1	4.0 percent
Q2	5.6 percent
Q3	2.6 percent
Q4	4.5 percent

1991

Q1	-1.9 percent
Q2	2.7 percent
Q3	1.7 percent
Q4	1.6 percent

211. Department of Commerce, Bureau of Economic Analysis, data run July 27, 2010.

CONSUMER PRICE INDEX²¹² *Seasonally Adjusted*

<i>1988</i>	<i>1-month change</i>	<i>12-month change</i>
Jan.	0.3 percent	4.1 percent
Feb.	0.2 percent	3.9 percent
Mar.	0.3 percent	3.8 percent
Apr.	0.6 percent	4.0 percent
May	0.3 percent	4.0 percent
Jun.	0.4 percent	4.0 percent
Jul.	0.4 percent	4.1 percent
Aug.	0.4 percent	4.1 percent
Sep.	0.4 percent	4.2 percent
Oct.	0.3 percent	4.3 percent
Nov.	0.3 percent	4.2 percent
Dec.	0.3 percent	4.4 percent

<i>1989</i>	<i>1-month change</i>	<i>12-month change</i>
Jan.	0.4 percent	4.5 percent
Feb.	0.3 percent	4.6 percent
Mar.	0.5 percent	4.9 percent
Apr.	0.7 percent	5.0 percent
May	0.5 percent	5.3 percent
Jun.	0.3 percent	5.2 percent
Jul.	0.3 percent	5.1 percent
Aug.	0.0 percent	4.6 percent
Sep.	0.2 percent	4.4 percent
Oct.	0.5 percent	4.6 percent
Nov.	0.4 percent	4.7 percent
Dec.	0.3 percent	4.6 percent

CONSUMER PRICE INDEX

Seasonally Adjusted

<i>1990</i>	<i>1-month change</i>	<i>12-month change</i>
Jan.	1.0 percent	5.2 percent
Feb.	0.4 percent	5.3 percent
Mar.	0.5 percent	5.2 percent
Apr.	0.2 percent	4.7 percent
May	0.2 percent	4.4 percent
Jun.	0.6 percent	4.7 percent
Jul.	0.5 percent	4.8 percent
Aug.	0.8 percent	5.7 percent
Sep.	0.7 percent	6.2 percent
Oct.	0.7 percent	6.4 percent
Nov.	0.2 percent	6.2 percent
Dec.	0.4 percent	6.3 percent

<i>1991</i>	<i>1-month change</i>	<i>12-month change</i>
Jan.	0.4 percent	5.6 percent
Feb.	0.1 percent	5.3 percent
Mar.	0.0 percent	4.8 percent
Apr.	0.2 percent	4.8 percent
May	0.4 percent	5.0 percent
Jun.	0.3 percent	4.7 percent
Jul.	0.1 percent	4.4 percent
Aug.	0.3 percent	3.8 percent
Sep.	0.3 percent	3.4 percent
Oct.	0.1 percent	2.8 percent
Nov.	0.4 percent	3.1 percent
Dec.	0.3 percent	3.0 percent

CONSUMER PRICE INDEX

Seasonally Adjusted

<i>1992</i>	<i>1-month change</i>	<i>12-month change</i>
Jan.	0.1 percent	2.7 percent
Feb.	0.2 percent	2.8 percent
Mar.	0.4 percent	3.2 percent
Apr.	0.2 percent	3.2 percent
May	0.2 percent	3.0 percent
Jun.	0.3 percent	3.0 percent
Jul.	0.3 percent	3.2 percent
Aug.	0.2 percent	3.1 percent
Sep.	0.2 percent	3.0 percent
Oct.	0.4 percent	3.3 percent
Nov.	0.3 percent	3.1 percent
Dec.	0.1 percent	3.0 percent

<i>1993</i>	<i>1-month change</i>	<i>12-month change</i>
Jan.	0.4 percent	3.3 percent
Feb.	0.2 percent	3.2 percent
Mar.	0.1 percent	3.0 percent
Apr.	0.3 percent	3.2 percent
May	0.3 percent	3.2 percent
Jun.	0.1 percent	3.0 percent
Jul.	0.1 percent	2.8 percent
Aug.	0.2 percent	2.8 percent
Sep.	0.1 percent	2.8 percent
Oct.	0.4 percent	2.8 percent
Nov.	0.3 percent	2.7 percent
Dec.	0.2 percent	2.8 percent

CONSUMER PRICE INDEX

Seasonally Adjusted

<i>1994</i>	<i>1-month change</i>	<i>12-month change</i>
Jan.	0.0 percent	2.5 percent
Feb.	0.3 percent	2.5 percent
Mar.	0.3 percent	2.7 percent
Apr.	0.1 percent	2.4 percent
May	0.2 percent	2.3 percent
Jun.	0.3 percent	2.5 percent
Jul.	0.3 percent	2.7 percent
Aug.	0.4 percent	2.9 percent
Sep.	0.2 percent	3.0 percent
Oct.	0.1 percent	2.6 percent
Nov.	0.3 percent	2.6 percent
Dec.	0.2 percent	2.6 percent

UNEMPLOYMENT RATE²¹³

Percent unemployment of individuals age 16 years and older

1988

Jan.	5.7 percent
Feb.	5.7 percent
Mar.	5.7 percent
Apr.	5.4 percent
May	5.6 percent
Jun.	5.4 percent
Jul.	5.4 percent
Aug.	5.6 percent
Sep.	5.4 percent
Oct.	5.4 percent
Nov.	5.3 percent
Dec.	5.3 percent

1990

Jan.	5.4 percent
Feb.	5.3 percent
Mar.	5.2 percent
Apr.	5.4 percent
May	5.4 percent
Jun.	5.2 percent
Jul.	5.5 percent
Aug.	5.7 percent
Sep.	5.9 percent
Oct.	5.9 percent
Nov.	6.2 percent
Dec.	6.3 percent

1989

Jan.	5.4 percent
Feb.	5.2 percent
Mar.	5.0 percent
Apr.	5.2 percent
May	5.2 percent
Jun.	5.3 percent
Jul.	5.2 percent
Aug.	5.2 percent
Sep.	5.3 percent
Oct.	5.3 percent
Nov.	5.3 percent
Dec.	5.4 percent

1991

Jan.	6.4 percent
Feb.	6.6 percent
Mar.	6.8 percent
Apr.	6.7 percent
May	6.9 percent
Jun.	6.9 percent
Jul.	6.8 percent
Aug.	6.9 percent
Sep.	6.9 percent
Oct.	7.0 percent
Nov.	7.0 percent
Dec.	7.3 percent

UNEMPLOYMENT RATE

Percent unemployment of individuals age 16 years and older

1992

Jan.	7.3 percent
Feb.	7.4 percent
Mar.	7.4 percent
Apr.	7.4 percent
May	7.6 percent
Jun.	7.8 percent
Jul.	7.7 percent
Aug.	7.6 percent
Sep.	7.6 percent
Oct.	7.3 percent
Nov.	7.4 percent
Dec.	7.4 percent

1994

Jan.	6.6 percent
Feb.	6.6 percent
Mar.	6.5 percent
Apr.	6.4 percent
May	6.1 percent
Jun.	6.1 percent
Jul.	6.1 percent
Aug.	6.0 percent
Sep.	5.9 percent
Oct.	5.8 percent
Nov.	5.6 percent
Dec.	5.5 percent

1993

Jan.	7.3 percent
Feb.	7.1 percent
Mar.	7.0 percent
Apr.	7.1 percent
May	7.1 percent
Jun.	7.0 percent
Jul.	6.9 percent
Aug.	6.8 percent
Sep.	6.7 percent
Oct.	6.8 percent
Nov.	6.6 percent
Dec.	6.5 percent

CHANGES IN THE FED FUNDS RATE
and THE DISCOUNT RATE,²¹⁴
 1988-1994

<i>Date</i>	<i>Discount rate</i>		<i>Federal funds rate</i>	
	CHANGE	NEW LEVEL	CHANGE	NEW LEVEL
<i>1988</i>				
Late Jan. to Early Feb.	NA	6	grad. decrease	6 1/2
Late Mar to Late Jun			grad. increase	7 1/2
Mid Jul.			+ 1/8 to 1/4	7 5/8 to 7 3/4
Aug. 5			+1/8 to 0	7 3/4
Aug. 9	+1/2	6 1/2	+1/4 to 1/2	8 to 8 1/4
Mid Nov.			+ 3/8 to 1/8	8 3/8
Early Dec.			+1/4 to 3/8	8 5/8 to 9 3/4

CHANGES IN THE FED FUNDS RATE
and THE DISCOUNT RATE,
 1988-1994

<i>Date</i>	<i>Discount rate</i>		<i>Federal funds rate</i>	
	CHANGE	NEW LEVEL	CHANGE	NEW LEVEL
<i>1989</i>				
Early Jan. to Early Feb.			grad. increase	9 1/4 to 9 3/8
Feb. 23			+ 1/4	9 1/2 to 9 5/8
Feb. 24	+1/2	7	+ 1/4 to 1/8	9 3/4
Early Jun.			- 1/4 to 1/8	9 1/2 to 9 5/8
Early Jul. to Mid Dec			grad. decrease	8 1/4

CHANGES IN THE FED FUNDS RATE
and THE DISCOUNT RATE,
 1988-1994

<i>Date</i>	<i>Discount rate</i>		<i>Federal funds rate</i>	
	CHANGE	NEW LEVEL	CHANGE	NEW LEVEL
<i>1990</i>				
Jul. 13			-1/4	8
Oct. 29			-1/4	7 3/4
Nov. 13			-1/4	7 1/2
Dec. 7			-1/4	7 1/4
Dec. 18-19	-1/2	6 1/2	-1/4	7
<i>1991</i>				
Jan. 9			-1/4	6 3/4
Feb. 1	-1/2	6	-1/2	6 1/4
Mar. 8			-1/4	6
Apr. 30	-1/2	5 1/2	-1/4	5 3/4
Aug. 6			-1/4	5 1/2
Sep. 13	-1/2	5	-1/4	5 1/4

CHANGES IN THE FED FUNDS RATE
and THE DISCOUNT RATE,
 1988-1994

<i>Date</i>	<i>Discount rate</i>		<i>Federal funds rate</i>	
	CHANGE	NEW LEVEL	CHANGE	NEW LEVEL
<i>1991</i>				
<i>Continued</i>				
Oct. 31			-1/4	5
Nov. 6	-1/2	4 1/2	-1/4	4 3/4
Dec. 6			-1/4	4 1/2
Dec. 20	-1	3 1/2	-1/2	4
<i>1992</i>				
Apr. 9			-1/4	3 3/4
Jul. 2	-1/2	3	-1/2	3 1/4
Sep. 4			-1/4	3

CHANGES IN THE FED FUNDS RATE
and THE DISCOUNT RATE,
 1988-1994

<i>Date</i>	<i>Discount rate</i>		<i>Federal funds rate</i>	
	CHANGE	NEW LEVEL	CHANGE	NEW LEVEL
<i>1993</i>	No changes		No changes	
<i>1994</i>				
Feb. 4			+1/4	3 1/4
Mar. 22			+1/4	3 1/2
Apr. 18			+1/4	3 3/4
May 17	+1/2	3 1/2	+1/2	4 1/4
Aug. 16	+1/2	4	+1/2	4 3/4
Nov. 15	+3/4	4 3/4	+3/4	5 1/2

Bibliography

WORKS REFERENCED IN THE TEXT AND USED *for* RESEARCH:

Beckner, Steven K. *Back from the Brink: The Greenspan Years*. New York: John Wiley & Sons, Inc., 1996.

Belden, Susan. "Policy Preferences of FOMC Members as Revealed by Dissenting Votes." *Journal of Money, Credit and Banking*, Vol. 21, No. 4, Ohio State University Press, November 1989.

Blinder, Alan; Goodhart, Charles; Hildebrand, Philipp; Lipton, David; Wyplosz, Charles. How Do Central Banks Talk? *Geneva Reports on the World Economy*, Number 3, London: Centre for Economic Policy Research, 2001.

Bullard, James B. "The FOMC in 1990: The Onset of Recession," The Federal Reserve Bank of St. Louis Review, The Federal Reserve Bank of St. Louis, May/June 1991.

Bullard, James B. "The FOMC in 1991: An Elusive Recovery." The Federal Reserve Bank of St. Louis Review, The Federal Reserve Bank of St. Louis, March/April 1992.

Chappell, Henry W. Jr; McGregor, Rob Roy; Vermilyea, Todd A. *Committee Decisions on Monetary Policy: Evidence from Historical Records of the Federal Open Market Committee*. Cambridge, Mass: The MIT Press, 2005.

Chappell, Henry W. Jr; McGregor, Rob Roy. A Long History of FOMC Voting Behavior. *Southern Economic Journal*, Vol. 66, No. 4, April 2000.

Gildea, John A. "The Regional Representation of the Federal Reserve Bank Presidents." *Journal of Money, Credit and Banking*, Vol. 24, No. 2, Ohio State University Press, May 1992.

Greenspan, Alan. *The Age of Turbulence: Adventures in a New World*. New York: The Penguin Press, 2007.

Havrilesky, Thomas. "The Politicization of Monetary Policy: The Vice Chairman as the Administration's Point Man," *The Cato Journal*, The Cato Institute, Spring/Summer 1993.

Knotek, Edward S. II and Terry, Stephen. "How Will Unemployment Fare Following the Recession," *The Economic Review*, Federal Reserve Bank of Kansas City, third quarter 2009.

Lowenstein, Roger. *When Genius Failed: The Rise and Fall of Long Term Capital Management*. New York: Random House, 2000.

Managing the Crisis: The FDIC and RT Experience, 1980-1994, the Federal Deposit Insurance Corporation, August 1998.

Meade, Ellen E. "The FOMC: Preferences, Voting and Consensus," The Federal Reserve Bank of St. Louis Review; The Federal Reserve Bank of St. Louis, March/April 2005.

Ritter, Joseph A. "The FOMC in 1992: A Monetary Conundrum." The Federal Reserve Bank of St. Louis Review: The Federal Reserve Bank of St. Louis, May/June 1993.

Todd, Tim. *Historical Analysis of FOMC Tenures*. The Federal Reserve Bank of Kansas City, April 2009.

Tootell, Geoffrey M. B. "Appointment Procedures and FOMC Voting Behavior," *Southern Economic Journal*: Southern Economic Association, July 1996.

Walsh, Carl E. "What Caused the 1990-1991 Recession?" *Economic Review*: The Federal Reserve Bank of San Francisco, 1993 number 2.

Woodward, Bob. *Maestro: Greenspan's Fed and the American Boom*. New York: Simon and Schuster, 2000.

Woolley, John T. “*The Politics of Monetary Policy: A Critical Review*,” *Journal of Public Policy*, Vol. 14, No. 1: Cambridge University Press. Jan.-Mar. 1994.

Transcripts of Federal Open Market Committee meetings and conference calls are available at www.FederalReserve.gov.

MATERIAL WAS ALSO PULLED *from* NUMEROUS EDITIONS *of* THE FOLLOWING PUBLICATIONS *and* SERVICES:

The Associated Press

The Christian Science Monitor

The International Economy

The Los Angeles Times

MarketWatch.com

The New York Times

The Region

The San Diego Union

The Wall Street Journal

The Washington Post



Thomas M. Hoenig

PRESIDENT *and* CHIEF EXECUTIVE OFFICER

FEDERAL RESERVE BANK *of* KANSAS CITY

THE CENTRAL EXCHANGE
KANSAS CITY, MO. • JAN. 5, 2011



© Ho/Renters/CORBIS

Presidents all 12 Federal Reserve Banks and the Federal Reserve's governors all participate at meetings of the Federal Open Market Committee. While the presidents serve as voting FOMC members on a rotating basis, all have an opportunity to share their views on the economic outlook and Federal Reserve policy during the meetings.

Monetary Policy

and THE ROLE of DISSENT

My January presentation at the Central Exchange, greater Kansas City's business women's association, has become an annual event and an opportunity that I have enjoyed immensely.

In particular, I want to recognize the WIN/WIN program initiated by the Central Exchange. I am personally a supporter of this campaign to increase the number of women on boards of directors and in executive positions in greater Kansas City to a level of 20 percent by 2015. More importantly, I am a believer in the business case for gender diversity and am fortunate to have an outstanding leadership team at the Federal Reserve Bank of Kansas City. It happens that 50 percent of those positions are filled by women. Currently the immediate past chairman and current deputy chairman of our Board is Lu Cordova, an entrepreneur's entrepreneur from Boulder, Colo. She was an outstanding chair during difficult economic and financial times. The Tenth Federal Reserve District, and the entire Federal Reserve System, benefitted from her outstanding leadership. Lu will be speaking here at the Central Exchange in March, and I encourage you to attend that program as well. Today I want to discuss two related topics. First, I will outline my economic outlook for 2011. And since it is because of my outlook for the economy during this past year that I have found myself in the minority view among my colleagues at the Federal Reserve, I will spend just a few minutes discussing the monetary policy process.

The Economic Outlook

As we begin 2011, recent economic data indicate a firmer tone in the outlook, and I am increasingly confident that the recovery is both sustainable and likely to gain strength over the next several quarters. That said, I expect the recovery to be moderate, with real GDP growing about 3½ to 4 percent a year over the next couple years.

To put this outlook into perspective, it is important to remember that a major and necessary rebalancing – including the deleveraging of consumers, businesses, and financial institutions – is taking place within our economy. Moreover, this is occurring while state

and local governments are struggling with budgets and mounting debt loads. With these adjustments, growth necessarily will be more modest than in past recoveries. Under such circumstances, the fact that we can talk about the likelihood of a sustainable recovery is highly encouraging.

Before turning to the outlook for this year, let me begin with a brief look back at economic events in 2010. Last year began with solid gains in the first quarter. The nation's real GDP grew at an annual rate of 3.7 percent and employment rose 261,000. Then the economy hit a soft patch in the middle of the year with growth in output and employment slowing. Fortunately, though, we appear to be coming out of that soft patch with the economy growing at a 2.6 percent rate in the third quarter and expected to accelerate to about a 3 percent rate in the fourth quarter.

Over the last few months, we have seen clear signs of improvement. Consumer spending has steadily trended up and is likely to gain further strength as confidence rebounds, personal incomes continue to rise, and the labor market gradually improves.

The trend in business spending has been supportive of growth. For example, over the last year, spending on equipment and software increased almost 20 percent. And I expect that strong corporate profits – they grew 26 percent last year – and sales growth will keep business investment a key source of strength going forward.

Also, the recently passed fiscal actions, in which Congress and the president extended the Bush-era tax cuts and unemployment insurance, and then also temporarily reduced payroll taxes, will provide a further boost to aggregate demand next year, although not without longer-run risks to the economy.

While the consumer and business sectors of the economy are rebounding, the same cannot be said for housing. As you know, housing lost momentum after the end of the homebuyer tax credit, and house prices continue to decline. Moreover, the inventory of unsold homes is exerting downward pressure on house prices and housing activity. As the broader economy continues to grow, though, I expect that we will see a turnaround in housing this year. However, there are many issues tied to the housing crisis that could impede recovery, and much depends on how these issues are addressed in the next several months.

Employment is the other issue that seems difficult to understand and solve. Unfortunately, while private jobs are being added to the economy, the pace of job gains is not strong enough to bring unemployment down to where we would all like. In fact, although the United States added over 1 million net new jobs through November, the unemployment

rate remained at 9.8 percent. Forward-looking surveys, including our Bank's manufacturing survey, point to gains in employment over the next six months, and if history is any guide, we should see these increases accelerate over the course of the year. I would also note that our manufacturing survey points to expected gains in production and capital spending, which will contribute to improving job growth. Even so, with the number of people out of work and the growing numbers of new job entrants, it will be some time before we see the unemployment rate well below 9 percent.

Given the immediate levels of slack in the economy, core inflation will remain modest in the near term. However, given the degree of monetary and fiscal stimulus in place in the economy currently, inflation should move higher over the medium and longer term, depending on what further steps are taken in these policy areas. Also, the risk of further disinflation or outright deflation is small and, with an improving economy, should only decline further in the coming months. It is also noteworthy that long-run inflation expectations even now remain above 2 percent and should exert upward pressure on inflation during the course of the recovery.

There are, of course, risks to the outlook. First, I am concerned about what might happen to the economy if we fail to deal successfully with our long-run fiscal challenges. The budget deficit is the largest we have seen, as a share of GDP, since World War II. With these large budget deficits, total federal debt outstanding is almost \$14 trillion, or about 94 percent of GDP. Moreover, projections of deficits and debt show the federal debt will continue to increase, suggesting that fiscal policy is unsustainable and must be changed soon. As we have seen elsewhere, the reaction of interest rates and exchange rates to unsustainable fiscal policy can be sharp and disruptive. While specific recommendations on fiscal policy are not the purview of the Federal Reserve, I would urge serious consideration of proposals that have been offered by several groups, including the Simpson-Bowles deficit reduction plan. These are reasonable starting points for addressing the intractable problem that may have very serious ramifications for future monetary policy.

A second concern I have is the consequences that will follow when we combine our current fiscal projections with a highly accommodative monetary policy. In essence, the Federal Open Market Committee (FOMC) has maintained an emergency monetary policy stance in a recovering economy and has continued to ease into the recovery. I believe these actions risk creating a new set of imbalances, or bubbles. Importantly, such actions as they continue are demanding the saving public and those on fixed incomes subsidize the

borrowing public.

To summarize, I am pleased to be able to say that in my view the economy is in recovery, although at a moderate pace. Over time, barring unexpected surprises, the recovery should gain momentum, which will encourage hiring and slowly bring down the unemployment rate. While we would all like to see the unemployment rate come down more quickly, and in fact should gain momentum, we must also acknowledge that our economy is adjusting to decades of excess consumption, high government debt and spending, and a low domestic savings level. These factors must also adjust, and this will take time as well. The very fact that we are in what appears to be a sustained recovery speaks well of our economy and its flexibility to adjust and regain strength over time.

Dissent and Monetary Policy Deliberations

My view of the economy's prospects and the appropriate stance of monetary policy differ from the majority view among my Federal Reserve colleagues.

Last year, I was a voting member of the Federal Open Market Committee. Reserve Bank presidents vote in rotation, so I will be a participant rather than a voting member this year. It is a matter of public record that I dissented, or cast a "no" vote in all eight meetings in 2010. Based on audience questions, news coverage and pundit columns throughout the year, it has become obvious to me that the role of dissent in the FOMC is misunderstood and viewed without context. The idea that a dissenting vote is confusing, counterproductive, and generally undesirable is unhealthy. It is also historically inaccurate.

In my remaining time today, I will discuss why dissenting views at the FOMC are critical to the success of the Federal Reserve System and that public debate was the intent of its congressional founders.

I will also describe how open debate and dissent are fundamental to achieving transparency of FOMC deliberations and to supporting the credibility of the committee in difficult economic times.

History

When the Congress created the Federal Reserve nearly a century ago, it believed very strongly that the best policy is not made in isolation, but encompasses a wide range of views from all affected interests. A Federal Reserve Bank was established in Kansas City, as well as 11 other major cities across the United States, to make sure the views of communities

nationwide had a voice in Federal Reserve policy. The founders knew that such broad-based participation would lead to better decision making.

This structure is replicated on the Federal Open Market Committee, which is the body that makes decisions about our nation's monetary policy through changes in an interest rate known as the federal funds rate, and, over the last couple of years, changes in the size of the Federal Reserve's balance sheet and the interest rate it pays on excess reserves. The FOMC is made up of 12 members: Seven of them are the Federal Reserve governors who have been appointed by the president and confirmed by the Senate. Governors always have a vote at the FOMC. The other five members are presidents of the regional Federal Reserve Banks who are appointed by their local boards of directors. The New York Bank's president always has a vote, and the other 11 presidents share the remaining four votes in a set rotation. As a result, while all 12 Reserve Bank presidents are active participants in the FOMC debate, the seven politically appointed governors always have a majority of votes over the five voting Reserve Bank presidents.

The regional Bank presidents fill a critical role at the Fed's policy table. They have the responsibility of representing their respective Federal Reserve Districts in providing their unique perspective on national policy issues. As dictated by the FOMC's structure, Washington and Wall Street not only participate in all discussions but have a permanent vote. Therefore, it is crucial to have independent voices at the table that regularly interact with Main Street business and community leaders in the rest of the country.

In this structure, it is a key point to remember that each member was given a vote, not an advisory role. In FOMC policy votes since 1995 – which is essentially the current era of Fed policy – there was a dissenting vote about one-third of the time. Going back a bit earlier in the 1990s to the '90-91 recession, there were far more significant levels of dissent for both tighter and less restrictive monetary policy. During the Paul Volcker era, the chairman nearly lost one policy vote. In addition, there were 30 dissenting votes cast in Volcker's final 30 meetings as Fed chairman.

Transparency

There are, of course, commonalities between the end of the Volcker era, the 1990-91 recession and today: In each of these periods the economy was poised at a critical juncture and broad disagreement prevailed about the appropriate policy course – and not just around the Fed policy table. By the very nature of our political system, these were also periods of

extreme political pressure to provide increased stimulus with an eye toward short-term gains and with a promise to take appropriate steps at some later point to remove that stimulus before inflationary pressures could become a problem.

Leaving those issues aside, last year some suggested that dissenting votes confuse the market and that public disagreement among members reduced the effectiveness of Fed policy, including the second round of quantitative easing, known as QE2.

As an economist, I cannot be certain that my views are correct. Certainly, a majority of my counterparts on the FOMC last year did not agree with my views. But it is important to recognize that in the face of uncertainty, arriving at the best policy decision is built on divergent opinions and vigorous debate.

Because of this, the role of open dissent is at least as critical to FOMC monetary policy decisions as it is to deliberations by the Supreme Court, the United States Congress or any other body with important public responsibilities from the local through the federal level. If you find it unusual to consider the FOMC as being similar to these other deliberative bodies, it is perhaps because many—including some former Federal Reserve officials—tend to speak of Fed policy as being done by a single actor.

In 2004, then-Fed Governor Ben Bernanke talked about this issue in a speech where he noted the “diversity of views and opinions likely to exist among the members of a large committee create further challenges of effective communication.”¹

Despite these challenges, he went on to talk about the importance of making these divergent views broadly known: “Although at times it feels cacophonous, the willingness of FOMC members to present their individual perspectives in speeches and other public forums provides the public with useful information about the diversity of views and the balance of opinion on the Committee.”

Credibility

Some would suggest, of course, that monetary policy is not like a Supreme Court ruling. This line of reasoning comes from an idea that a unanimous FOMC is more likely to foster the confidence that is so critical to the functioning of our economy and financial system. To this line of thinking, dissent becomes even more dangerous in periods of high uncertainty.

A deliberative body does not gain credibility by concealing dissent when decision making is most difficult. In fact, credibility is sacrificed as those on the outside realize that

unanimity – difficult in any environment – simply may not be a reasonable expectation when the path ahead is the most confounding. The question then becomes: Should the debate that is happening privately remain hidden from the public eye until the meeting minutes or transcripts are later released? And in the interim, is the nation somehow better served by giving the public the impression that the entire body is in agreement to the prescribed approach even when that is not the case?

In the mid-1980s, after the vote Chairman Volcker nearly lost created a bit of a media circus, Herbert Stein wrote a very interesting column about the issue for *The Wall Street Journal*. Mr. Stein, who had been chairman of the Council of Economic Advisers under two presidents, wrote that divergent views at the policy table should not be worrisome. It is more important, he wrote, that there are visible principles at work in shaping these views.

Stein wrote that in creating the central bank of the United States, “Congress intended diversity (of views) and the Federal Reserve ... benefits from the appearance that diversity is at least possible.”²

To suggest that public support is somehow encouraged by unanimous decisions suggests little appreciation for the public and their understanding about the challenges we face. To me, that fosters a loss of confidence that can be difficult to recover. As a result, the body becomes less able to respond to a crisis and is left more vulnerable to its critics.

The Federal Reserve’s founders recognized this a century ago. I hope we continue to recognize its critical importance in the years to come. As for me, I recognize that the committee’s majority might be correct. In fact, I hope that it is. However, I have come to my policy position based on my experience, current data and economic history. If I had failed to express my views with my vote, I would have failed in my duty to you and to the committee.

2. *The Wall Street Journal*, April 4, 1986

Photo Credits

PHOTOGRAPHS AND ILLUSTRATIONS ARE *from* THE FOLLOWING SOURCES.

- Cover.** Cartoon illustration by Mark Cullum of the “Economy Train.” Originally appeared in *The Birmingham News*, 1991. Use courtesy of Mark Cullum, Abilene, Texas.
- VIII.** © Lance Nelson/Corbis/ca. 1995.
- XIV.** © Bob Krist/Corbis/ca. May 1999.
- XVI.** © Najlah Feanny/Corbis Saba/October 22, 1992.
- XVIII.** © James Marshall/Corbis/October 1987.
- 3.** Federal Reserve Bank of Kansas City Archives, unknown photographer, undated.
- 4.** © Bettman/Corbis/October 25, 1990.
- 7.** Terry Ashe/Time & Life Pictures/Getty Images/October 3, 1990.
- 8.** Associated Press, photo by Ron Edmonds, May 31, 1984.
- 10.** Cartoon illustration by Clyde Wells of the “Recession Road.” Originally appeared in *The Augusta Chronicle*, 1991. Use courtesy of *The Augusta Chronicle*, Augusta, Georgia.
- 12.** Bloomberg Contributor/Bloomberg via Getty Images/February 25, 2004.
- 15.** © Bettman/Corbis/November 30, 1973.
- 16.** Cartoon illustration by Ed Gamble of “And The Shorts Too.” Originally appeared in *The Florida Times-Union*, 1991. Use courtesy of King Features Syndicate, Inc.
- 18.** Alex Wong/Getty Images News/Getty Images/January 21, 2003.
- 20.** Cartoon illustration by David Swann of the “Recession Semi.” Originally appeared in *The Huntsville Times*, 1991. Use courtesy of David Swann, Honolulu, Hawaii.
- 23.** Associated Press, photo by Doug Mills, July 11, 1991.
- 27.** Associated Press, unknown photographer, March 10, 1993.

30. Cartoon illustration by Jim McCloskey of “U.S. Economy Flying Level.” Originally appeared in *The Staunton Daily News Leader*, 1991. Use courtesy of Jim McCloskey, Staunton, Virginia.
32. Associated Press, photo by Kevork Djansezian, January 20, 1998.
34. Ted Thai/Time & Life Pictures/Getty Images/September 1, 2000.
36. Cartoon illustration by Dale Stephanos of the “Interest Rates Gallows,” © 1991. Originally appeared in *The Haverhill Gazette*, 1991. Use courtesy of Dale Stephanos, Foxboro, Massachusetts.
39. © Najlah Feanny/Corbis Saba/October 31, 1994.
42. Cartoon illustration by Brian Duffy of the “Economy Roller Coaster.” Originally appeared in *The Des Moines Register*, 1991. Use courtesy of King Features Syndicate, Inc.
45. Bloomberg Contributor/Bloomberg via Getty Images/April 11, 2006.
48. Cartoon illustration by Joe Hoeffcker of “For Cryin’ Out Loud”. Originally appeared in *The Business Courier of Cincinnati*, © 1991. Use courtesy of *The Business Courier of Cincinnati*, Ohio.
54. Cartoon illustration by Bruce Beattie of the “Economy Rock.” Originally appeared in *The Daytona Beach News-Journal*, 1992. Use courtesy of Creators Syndicate, Inc.
57. © George Steinmetz/Corbis/October 1, 1992.
60. Cartoon illustration by Dana Summers of “It’s Not Over Yet.” Originally appeared in *The Orlando Sentinel*, 1992. Use courtesy of Dana Summers, Orlando, Florida.
64. Reproduced with permission from the March 28, 1996 issue of *The Christian Science Monitor* (www.CSMonitor.com). © 1996 *The Christian Science Monitor*.
70. © Larry Downing/Reuters/Corbis/January 31, 2006.
71. Luke Frazza/AFP/Getty Images/November 18, 1992.
74. © Tribune Media Services, Inc. All Rights Reserved. Reprinted with permission.
92. © Ho/Reuters/Corbis/March 19, 2009.

Index

A

Angell, Wayne D., XIII, 6, 11, 17, 22, 33, 37, 51-53

B

Baker, James, 3

Banking Committee of the United States Senate, 27-28, 33-34

Beckner, Steven, 7, 31, 52-53, 56

Bernanke, Ben, 98

Berry, John, 27, 58

Black, Robert P., XIII, 5, 22

Blinder, Alan, 68

Boehne, Edward G., XIII, 43

Boykin, Robert H., XIII, 6, 49, 69

Brady, Nicholas, 40, 51

Broadus, J. Alfred, Jr., XIII

Brusca, Robert, 2

Bush, George H.W., XVI, 4, 7, 12, 21, 23-24, 27, 31, 33-34, 39-41, 49, 51-53, 55, 57-58, 61, 71-72

C

Carville, James, 40, 71

Central Exchange, 93

Chase Manhattan, 24

Citibank, 24

Clinton, William Jefferson, 40, 71

Commodity Futures Trading Commission, 33

Conference Board, 38

Continental Bank, 37

Cordova, Lu, 93

Corrigan, E. Gerald, XIII, 1-2, 13, 17, 52, 57
Council of Economic Advisors, 3, 15, 99

D

Darby, Michael, 3
Duke University, 61

F

Federal Deposit Insurance Corporation, 24
Federal Deposit Insurance Corporation Improvement Act, 24
Federal Open Market Committee, (FOMC), IX, XI, XIII, XVII-XVIII, 2-9, 11-15, 17-19, 21-22, 25-28, 31-34, 37-40, 45-46, 49-50, 52, 56, 58, 65, 67-68, 95-98
Federal Reserve Act, 35
Federal Reserve Bank of Atlanta, XIII, 17, 23, 43
Federal Reserve Bank of Boston, XIII, 12, 17, 24, 43
Federal Reserve Bank of Chicago, XIII, 17, 32
Federal Reserve Bank of Cleveland, XIII, 6
Federal Reserve Bank of Dallas, XIII, 32, 49, 69
Federal Reserve Bank of Kansas City, XV, XVII, XVIII, 3, 17, 49, 67
Federal Reserve Bank of Minneapolis, XVIII, 22, 43, 45
Federal Reserve Bank of New York, IX, XV, XVIII, 1, 13-14, 17, 57
Federal Reserve Bank of Philadelphia, XVIII, 43
Federal Reserve Bank of Richmond, XVIII, 5, 22, 35, 49
Federal Reserve Bank of St. Louis, XVIII, 6, 26, 44, 45
Federal Reserve Bank of San Francisco, XVIII, 23, 32, 56
Ferguson, Roger, 70
Ford, Gerald, 3, 15
Forrestal, Robert P., XIII, 17, 23, 43
Friedman, Benjamin, 55

G

G-7, 19

Gainor, Tom, 43

Goldstein, Steve, 71

Gonzalez, Henry, XV

Government Operations Committee of the United States House of Representatives, 7

Greenhouse, Steven, 28

Greenspan, Alan, XIII, 1-3, 5-8, 11-14, 17-19, 21-25, 31, 37, 43-44, 46, 50-53, 56-57, 61, 65-67, 69-71

Guffey, J. Roger, XIII, 3, 11, 17, 49

H

Hamilton, Lee, 27-28, 33

Harvard, 35, 51

Havrilesky, Thomas, 61

Heinz, John, 39

Heller, H. Robert, XIII, 33

Hoening, Thomas M., XIII, XVII, 49, 67-68, 91-99

Hoskins, W. Lee, XIII, 6

I

Iraq, 4

J

Jackson, Andrew, XV

Jefferson, Thomas, 49

Joelson, Walter, 38

Johnson, Manuel H., XIII, 1-2, 13, 33

Jones, David, 41

Jordan, Jerry L., XIII

K

Keehn, Silas, XIII, 17, 32
Kelley, Edward W., Jr., XIII, 37-38, 52-53
Kohn, Donald, 68-69
Kuwait, 4

L

LaWare, John P., XIII, 17, 43, 46, 52-53, 69
Lewis, Finlay, 28
Linden, Fabian, 38
Lindsey, Lawrence B., XIII, 33-35, 49, 52-53
Lipsky, John, 66

M

Mack, Connie, 28
Martin, William McChesney, Jr., 66, 71
McDonough, William J., XIII
McTeer, Robert D., XIII, 32, 49
Meltzer, Allan, 55
Melzer, Thomas C., XIII, 6, 26, 44-46, 68-69
Moore, Geoffrey, 56
Mullins, David W., Jr., XIII, 33, 49-53, 56, 61-62, 65, 72
Murray, Alan, 1, 3, 4, 13

N

National Bureau of Economic Research, 56
National Economics Club, 50
New Jersey, XVI
Nixon, Richard, 3, 15

O

Olson, Mark, 69

P

Parry, Robert T., XIII, 23, 32, 56

Patman, Wright, XV, 26

Paul, Ron, XV, 26

Pearlstein, Steven, 70

Philadelphia, XIV

Phillips, Susan M., XIII, 33-35, 49, 52-53

Q

Quint, Michael, 2

R

Reagan, Ronald, 1, 3, 14, 34, 39, 52-53, 57

Resolution Funding Corporation, 11

Riegle, Don, 33

Rosenbaum, David, 7, 21, 26, 72

S

Sanford, Terry, 35

Sarbanes, Paul, 26-27, 33-35

Sasser, James, 34

Schmidt, Susan, 25

Second Bank of the United States, XIV-XV

Seger, Martha R., XIII, 6, 8, 9, 14-15, 17, 33

Seidman, L. William, 24

Silk, Leonard, 40

Sinai, Allen, 37

Stein, Herbert, 15, 99

Stern, Gary H., XIII, 22, 45

Subramanian, Sridhar, 69

Syron, Richard F., XIII, 12, 17, 24, 43

T

Taylor, Bill, 24

Thomas, Clarence, 35

Thornburgh, Dick, 39

Toner, Robin, 40

U

United States Congress, IX, 11, 15, 26, 33, 38, 50, 56, 61, 66, 72, 98

United States Department of Commerce, 25, 44

United States Department of Labor, 58

United States Supreme Court, 35, 98

United States Treasury, 40, 51, 61

V

Volcker, Paul, 1-2, 8, 14, 66, 97, 99

W

Ways and Means Committee of the United States House of Representatives, 21, 50

Wessel, David, 1, 61-62

White House, XV, 4, 21, 24, 26, 31, 35, 38, 40, 72

Wofford, Harris, 39, 40

Wolf, Frank, 25

Woodward, Bob, 1, 51, 67, 71

“ THAT *the recession of 1990-91* IS THOUGHT BY SOME TO HAVE CONTRIBUTED TO THE DEFEAT OF A PRESIDENT WHO APPEARED UNBEATABLE AT THE POLLS A YEAR EARLIER ILLUSTRATES ALL TOO WELL THE INCENTIVE TO CONTROL AND TO BRING MONETARY POLICY MORE FULLY INSIDE THE ‘POLITICAL’ TENT. THESE EVENTS SHOW HOW TEMPTING IT CAN BE FOR ELECTED LEADERS TO RISK LONG-TERM DAMAGE FOR SHORT-TERM POLITICAL GAINS AND THE IMPORTANCE OF THE FEDERAL RESERVE’S DECENTRALIZED STRUCTURE. ”



Throughout its 100-year history, the Federal Reserve has come under pressure from those seeking to influence monetary policy. Perhaps one of the better examples to help understand how that pressure can be applied – through means both overt and subtle – came in the early 1990s when the nation faced a recession and sluggish recovery while the White House prepared for an upcoming presidential election.