Federal Reserve Chairman Paul Volcker led the Fed as it fought both inflation and growing public anger. He would regularly receive heartbreaking letters from struggling Americans, but to the outside world, Volcker remained calm, puffing on his trademark cigar.
Carter replaced Miller with Paul Volcker, the president of the New York Fed, who in October 1979 was at the helm when the Fed announced it would not target the federal funds rate, but concentrate instead on the money supply and let the market determine interest rates. As a result, the federal funds rate eventually reached a record high of 20 percent in 1981, and inflation peaked at 13.5 percent the same year.

The solution to the inflation problem was putting the economy into a severe recession where, amid high interest rates, the jobless rate hit nearly 11 percent and businesses had liquidity problems. It is not surprising that the Fed during Volcker’s tenure came under widespread public criticism.

“Farmers surrounded the Federal Reserve building to protest the high interest rates,” wrote Daniel Yergin and Joseph Stanislaw in their book The Commanding Heights. “Auto dealers sent in coffins with car keys to symbolize the vehicles that went unsold because of high interest rates. Volcker himself would read heartbreaking letters that people wrote to him – about how they had saved for years to buy a house for their parents, but now, because of the high rates, could not. He was deeply upset by these letters, but he still saw no choice.”

The economy, along with the Iranian hostage crisis, led to Ronald Reagan’s easy victory over Carter in the 1980 presidential election. With the Fed in a position to play a crucial role in the success of the new administration, Reagan’s staff wanted to arrange a meeting between the new president and Volcker.

“We offered to have the president go to the Federal Reserve,” Reagan aide Martin Anderson said later. “We thought that would be nice, right? Wrong. Volcker was so upset about that, didn’t like that idea at all. The reason was that it would in some way be seen as compromising their independence if the president went over there. On the other hand, there seemed to be some reluctance on his part to come to the White House. So finally, we came up with a Solomon-like solution to go to the Treasury.”

The two discussed several issues during the meeting, but none to real depth. A member of Reagan’s Council of Economic Advisors noted on behalf of the administration that they

recognized the Fed’s independence.\textsuperscript{92}

That view was not held by everyone.

Reagan’s Treasury Secretary Donald Regan told his senior staff during one of their first meetings, “I don’t know why we need an independent Federal Reserve Board.” \textsuperscript{93}

With interest rates high in the Volcker-led fight on inflation, the attacks came from both political parties.

“We are destroying the small businessman. We are destroying Middle America. We are destroying the American dream,” conservative Congressman George Hansen said during a 1981 hearing.\textsuperscript{94}

During that same event, Democrat Frank Annunzio shouted and pounded his desk, accusing the Fed of favoring big business, and Texas Congressman Henry Gonzales threatened to introduce a bill to impeach Volcker and most of the Fed’s other governors.\textsuperscript{95}

A couple of weeks later, the Treasury secretary directly criticized the Fed’s position during an interview with a \textit{New York Times} reporter.

“What I am suggesting is that if (money supply growth) stays here, you’re going to have a severe recession,” said Regan, who then went on to suggest how the money supply needed to be adjusted going forward.\textsuperscript{96}

It was an important turning point in the Fed’s relationship with the administration, which had publicly supported the Fed in the slow growth of the money supply.

Volcker responded to Regan’s guidance at an American Bankers Association meeting in San Francisco two months later, saying the Fed had no plans to ease the tight money supply despite “some unusual public communication from the secretary of the Treasury.”\textsuperscript{97}

He went on to say that the Fed’s concern was to restrain the money supply.

“Inflating the money supply now would only aggravate the situation,” he said.\textsuperscript{98}


\textsuperscript{94} The Washington Post, \textit{July 22, 1982}.

\textsuperscript{95} The Washington Post, \textit{July 22, 1982}.

\textsuperscript{96} The \textit{New York Times}, \textit{Aug. 7, 1981}.

\textsuperscript{97} The \textit{Chicago Tribune}, \textit{Oct. 8, 1981}.

Regan, who was at the same meeting, told reporters that the administration did not want the Fed to pump money into the system, but wanted steady growth: “We don’t need flat money supply; we don’t need negative money supply.”

Regan later tried to downplay the apparent fight with the Fed, saying that the central bank and the Treasury both wanted slow growth of the money supply.

“This tourniquet at this time apparently has been a little tighter than the doctor ordered,” Regan said. “We are suggesting that it should be in its normal position.”

Volcker, after a reporter asked him what it would take to reverse his policies to align more closely with the Treasury, responded with a one-word answer: “Impeachment.”

In early 1982, Volcker and the president sat down in a closed door meeting. The session came after Senate Majority Leader Howard Baker said the White House and the Fed needed to “sit down and get away from this business of acting like they are so independent they never communicate.” The meeting also followed Reagan saying publicly, “I think we need to have more cooperation from the Federal Reserve Board with regard to money supply and a more consistent pattern” in order to bring interest rates down.

By the summer of 1982, House Majority Leader James C. Wright, Jr., was calling for Volcker’s resignation. Wright said he had met with Volcker eight times in hopes of giving the Fed chairman an “understanding” of what high interest rates were doing to the economy, but Volcker was apparently not getting the message.

Volcker “is very pleasant; he smiles, puffs on that cigar and looks at you like a benign Buddha (who) pats you on the head” and promises that everything will eventually turn out fine.
Volcker’s forced ouster was just one of several ideas circulating through congressional halls.

Rep. Henry Reuss supported a bill that would order the Fed to increase the money supply: “We in Congress are the Federal Reserve’s masters,” Reuss told fellow lawmakers.  

Sen. Alan Cranston told a press conference in San Diego that Congress had to curb the Fed’s independence: “It’s inconsistent with representative democracy – and contrary to consistent fiscal policy – to have seven people appointed to 14-year terms with vast sweeping powers over the lives and fortunes of the American people who are accountable to no one, not the President, not the Congress, not the people.”

Sen. Ted Kennedy agreed with Cranston’s call for greater control, launching his own effort: “Put (the Federal Reserve) in the Treasury Department where it belongs.”

In late June, it was revealed that the Treasury secretary had ordered his staff, the Council of Economic Advisers and the Office of Management and Budget, to work jointly on a major review of monetary policy and the Federal Reserve. The effort would consider numerous issues, including many of the ideas offered by various lawmakers from both parties.

“There is, on the one hand, an argument to keep the Fed independent to avoid the problem of an administration running away on an inflationary policy,” Treasury Undersecretary Beryl W. Sprinkel told a reporter. “But on the other hand, the president is elected by all the people and he has a right to put his policies into being and to be held accountable for them. And since we have been down here we have not gotten the kind of monetary policy that we asked for.”

News that the study was being conducted angered Wall Street.

“Interference with the central bank would be taken very poorly in the investment community,” an unnamed money manager told The New York Times. “Paul Volcker … has become the whipping boy for high interest rates and the administration is delighted to have somebody they can point the finger at.

“But, in truth, the administration would be lost without him – and so would the credibility of the fight against inflation.”

With investors turning angry, Treasury Secretary Regan seemingly backed off, saying during a press conference, “I think the Fed’s independence is a good thing.”

Despite Regan’s comment, the battle between the administration and the Fed would be largely determined by one factor:

whether or not the Fed had made the right move.

In July, the data showed that the recession had bottomed out. Volcker told lawmakers that he was backing off his previous targets for tight monetary policy and that a recovery in the second half of the year – long touted and targeted by the Reagan administration – was “highly likely.” ¹¹ For the Fed, it couldn’t have happened at a better time.

**The Constitutionality of the FOMC**

Reagan appointed Volcker to another term, but his difficult days were not done. Reagan appointees on the Board of Governors held four positions, and in February 1986, the Board outvoted Volcker to lower the discount rate. Volcker stormed out of the room, but before the vote was reported to the public, which was scheduled for 4:30 that afternoon, the group reconvened and cancelled the vote. The issue of the cancelled vote became public two weeks later and was followed by the resignation of Vice Chairman Preston Martin, who had led the opposition to Volcker.

Meanwhile, on another front, the Fed was facing a legal battle related to the Federal Open Market Committee.

Seven Federal Reserve governors, who are appointed by the president, and five presidents of the regional Reserve Banks are the voting members of the FOMC. Sen. John Melcher filed a lawsuit claiming that the Reserve Bank presidents, who are selected by the boards of their respective Reserve Banks, should be presidential appointees if they are in a position to determine the nation’s monetary policy. Instead, they were unaccountable private citizens.

“The country’s economy is too important to be decided by invisible officials who work behind closed doors without any accountability,” Melcher said. ¹²

Although the suit was given little chance for success, a Melcher victory carried major ramifications for both the Fed’s immediate future and long-term prospects.

While Reagan appointees had taken a majority of the seven Federal Reserve governor

positions, Volcker had strong support from the regional Reserve Bank presidents. That support, along with his minority backing among the governors, gave him a majority in the 12-member FOMC. Losing the votes from the Reserve Bank presidents would put Volcker in the minority on important policy decisions.

More troubling, however, were the long-term prospects that could lead to a rewriting of the Federal Reserve Act — a task many Fed watchers of the day did not think Congress was up to. Assuming Congress was unwilling to reopen the entire 1913 act for revision, the result of a Melcher win would have an ironic outcome: The Democrat Melcher would see the Republican White House gain even more influence over the nation’s monetary policy through the appointed Fed governors.

In September 1986, a Federal District Court dismissed the suit, finding that the Constitution does not prohibit private citizens from carrying out public functions.

“While the composition of the Federal Open Market Committee may be unusual, it is not unconstitutional,” U.S. District Judge Harold H. Greene ruled.

The mixed system of central banking in the United States had a long history and it is “an exquisitely balanced approach to an extremely difficult problem.”

**Greenspan, Gonzalez and Reforming the Fed**

Melcher appealed the ruling, taking the matter all the way to the Supreme Court, which refused to hear the case.

Volcker, meanwhile, although continuing to hold sway over the FOMC, continued to battle Reagan appointees among the governors. With his term set to expire in August 1987, and with no offer forthcoming from the White House to return for another term, Volcker submitted his resignation on June 1, 1987. He was succeeded by Alan Greenspan.

With Greenspan’s appointment, Reagan had appointed the entire Board — a development that troubled some who feared the Fed would be too closely aligned with the White House.
“We are sure Mr. Greenspan will keep himself insulated from political temptations, but (we) would like to hear him say it,” an unnamed Senate aide told a reporter. \(^{114}\) “It’s the kind of thing you want on the record so you can hold someone to what they said.”

In response to questions about the Fed’s independence during his confirmation hearing, Greenspan responded that his policy decisions “certainly would not be made on the basis of politics rather than economics.” \(^{115}\)

A year after Greenspan took office, Texas populist Henry Gonzalez was appointed head of the House Banking Committee. Although the Fed would face other battles in the years to come – in 1989, Rep. Lee Hamilton sponsored legislation to put the Treasury secretary back on the Federal Reserve Board; in 1991, Sen. Paul Sarbanes introduced legislation to strip the Reserve Bank presidents of their FOMC votes – for the Fed, Gonzalez would be like a second coming of Wright Patman.

“We shouldn’t have such an embedded, self-perpetuating group in power dictating the monetary and fiscal policy,” Gonzalez said shortly after being named chairman. \(^{116}\)

Before taking over the House committee, Gonzalez already had a reputation for being an eccentric. He would regularly give lengthy late-night speeches on the House floor long after his counterparts had departed. These sessions, which drew some media criticism because of the cost of keeping the House chambers open essentially for Gonzalez’s private use, attacked numerous targets including the Fed. \(^{117}\) One reporter wrote, with a seemingly joking tone, that House doorkeepers were relieved when Gonzalez became Banking Committee chair because he used those hearings as his forum instead of keeping the House open all night.

Among other things, Gonzalez introduced a bill to have one regulator for all banks and thrifts, and he wanted FOMC meetings video-recorded with the tapes broadcast 60 days later. Gonzalez also wanted to have the regional Reserve Bank presidents appointed


by the president and confirmed by the Senate.

Although his efforts to reform the Fed got sidetracked by the savings and loan crisis, he was finally able to schedule a series of hearings to explore the Fed in 1993.

“I am very determined about reforming the Fed,” Gonzalez told a *New York Times* reporter. “This is no subterfuge. If the Fed became more accountable to the public on its own, it would be cause for celebration.”

Ironically, the committee’s October 1993 hearing with Greenspan on reforming the Fed was held in a room named after Patman.

“This is not radical reform,” Gonzalez said during the hearing, “and there is no cause for the Federal Reserve to proceed as if barbarians are at the gate and it is the end of Western civilization. We should not pretend the Federal Reserve, of all institutions in government, is infallible.”

Greenspan warned that giving politicians too much control over the Fed would be a “major mistake” that would likely hurt the economy in the long run.

“The temptation is to step on the monetary accelerator or at least avoid the monetary brake until after the next election,” Greenspan told the House committee. “Giving in to such temptations is likely to impart an inflationary bias to the economy and could lead to instability, recession and economic stagnation.”

Greenspan, along with five other Federal Reserve governors and 10 of the 12 Reserve Bank presidents, was back in front of the committee a week later. Although the Fed contingent seemed willing to allow the release of detailed meeting minutes five or more years after FOMC meetings, much of what Gonzalez sought, such as videotapes of the meetings, was strongly opposed.

A month later, Gonzalez requested tapes and minutes of every FOMC meeting from the previous 17 years. Greenspan offered a compromise: transcripts of meetings through 1988.

Although Gonzalez was able to make the Fed uncomfortable, and create much work for Fed employees with numerous requests for information, he was not able to generate support for his legislative agenda. President Bill Clinton vocally opposed tinkering with the Fed’s structure, and Gonzalez, who some considered a loose cannon — colleagues called him “Gonzo” behind his back and there was a well-known story about him punching a San Antonio constituent who called him a communist — could not generate support among his fellow lawmakers.