The Volcker Tightening Cycle: Explaining the 1982 Course Reversal

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Abstract

This article studies the factors that led former Federal Reserve Chairman Paul Volcker to stop and then reverse course in the most famous monetary tightening cycle in U.S. history. I explain how the Fed began cutting its policy rate target, thus ending the tightening cycle, in July of 1982. Although the Fed had gained some ground in its fight against inflation, in mid-1982, inflation was running above 7 percent, well above the 2 percent inflation rate that the U.S. enjoyed before the Great Inflation. Beyond the Federal Open Market Committee's (FOMC) partial success at taming inflation, I describe how economic pain and financial market stress were two practical and related considerations in the summer of 1982 that likely contributed to the monetary policy pivot. Finally, I discuss the political pressure facing the FOMC at that time.

JEL codes: E52

Federal Reserve Bank of St. Louis *Review*, First Quarter 2025, Vol. 107, No. 1, pp. 1-12.
https://doi.org/10.20955/r.2025.01

1. INTRODUCTION

Between the middle of the 1960s and the early 1980s, the U.S. experienced a period of large and volatile inflation known as the Great Inflation. The Fed's overly easy monetary policy largely drove this sustained inflation. Meltzer identified the main causes as "analytic errors," stemming from the widespread adherence to the simple Keynesian model with its downward-sloping Phillips curve, political choices, and decision-making as well as "the entrenched belief that inflation would continue" (Meltzer, 2005, p. 145).[1]

In large part, the analytic errors were due to the popularity of Keynesian economics. This view took the empirical regularity of the Phillips curve—the negative relationship between the observed inflation rate and the unemployment rate in the U.S. and U.K. over various historical periods—as a "menu" for policymakers. Policymakers could choose how much inflation the public could withstand in order to achieve low unemploy-

1. There are explanations besides Meltzer's. For example, Orphanides (2001, 2002) argued that the Federal Open Market Committee (FOMC) was underestimating the inflationary effect of its easy monetary policy because, using real-time data, it was mistakenly overestimating the level of potential gross domestic product (GDP) before and during the high inflation period. Because the FOMC had "missed" the 1970s productivity slowdown, productivity growth and therefore potential output were lower than initially projected.

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ment. A citizenry experiencing a high unemployment rate could have its central bank reduce unemployment by raising the inflation rate through easier monetary policy.

There was an abrupt change in policy with Paul Volcker's confirmation as Federal Reserve Chair in August 1979. Volcker changed Fed operating procedures to target the money stock as well as entered into a monetary tightening cycle. Much has been written on the Great Inflation, the change in operating procedures, and the Volcker disinflation (particularly its start). See, for example, the Federal Reserve Bank of St. Louis *Review*'s 2005 Proceedings of a Special Conference "Reflections on Monetary Policy 25 Years After October 1979."

Much less has been written on the Fed's decision to switch to an easing policy once inflation began to decline. In this article, I address a narrow topic: What drove Volcker and the FOMC to end the tightening cycle that they began in 1979? There is no doubt that Volcker and the FOMC dramatically brought down inflation from an elevated level by tightening monetary policy. In the summer of 1982, they reversed course by beginning to lower their "tolerance ranges" for the federal funds rate. This reversal occurred despite the fact that inflation remained at 7 percent at the time, with internal Fed forecasts from the time anticipating about a 5 percent inflation rate for 1983. By contrast, in the decade or so before the Great Inflation, average inflation was around 2 to 2.5 percent.

In this article, I describe how economic pain and financial market stress were two practical and related considerations in the summer of 1982 that likely contributed to the monetary policy pivot. Finally, I discuss the political pressure facing the FOMC at that time.

2. PRE-VOLCKER BACKGROUND

By early 1974, core inflation was above 5 percent.[2] Over the next several years, it would increase even further, reaching its peak of over 13 percent during the summer of 1980, as shown in Figure 1. Panel A plots inflation from 1960 to 1990, and Panel B plots it from 1979 to 1984. The light-blue-shaded area corresponds to the Volcker period before July 1982, while the dark-blue-shaded area corresponds to the post-tightening Volcker period.[3]

During the Great Inflation, nominal price growth was not only high on average but also very volatile. Over the course of a few quarters, inflation often experienced wild swings. The six to seven years preceding the Volcker Fed stood in stark contrast to the smaller and less-volatile increases in the general price level in the first half of the 1960s and several preceding decades.

Contrary to the "menu choice" view that the Philips curve offered above, the increased inflation did not bring with it less unemployment. This is illustrated in Figure 2, which plots the monthly unemployment rate during this period. Here, the mid-1960s through July 1979 are the pre-Volcker stagflation episode. This episode saw both (a) spikes in unemployment during downturns well above those that preceded them and (b) average unemployment during the episode's expansions well above those that preceded the period, as seen during the March 1975 through December 1979 expansion.[4]

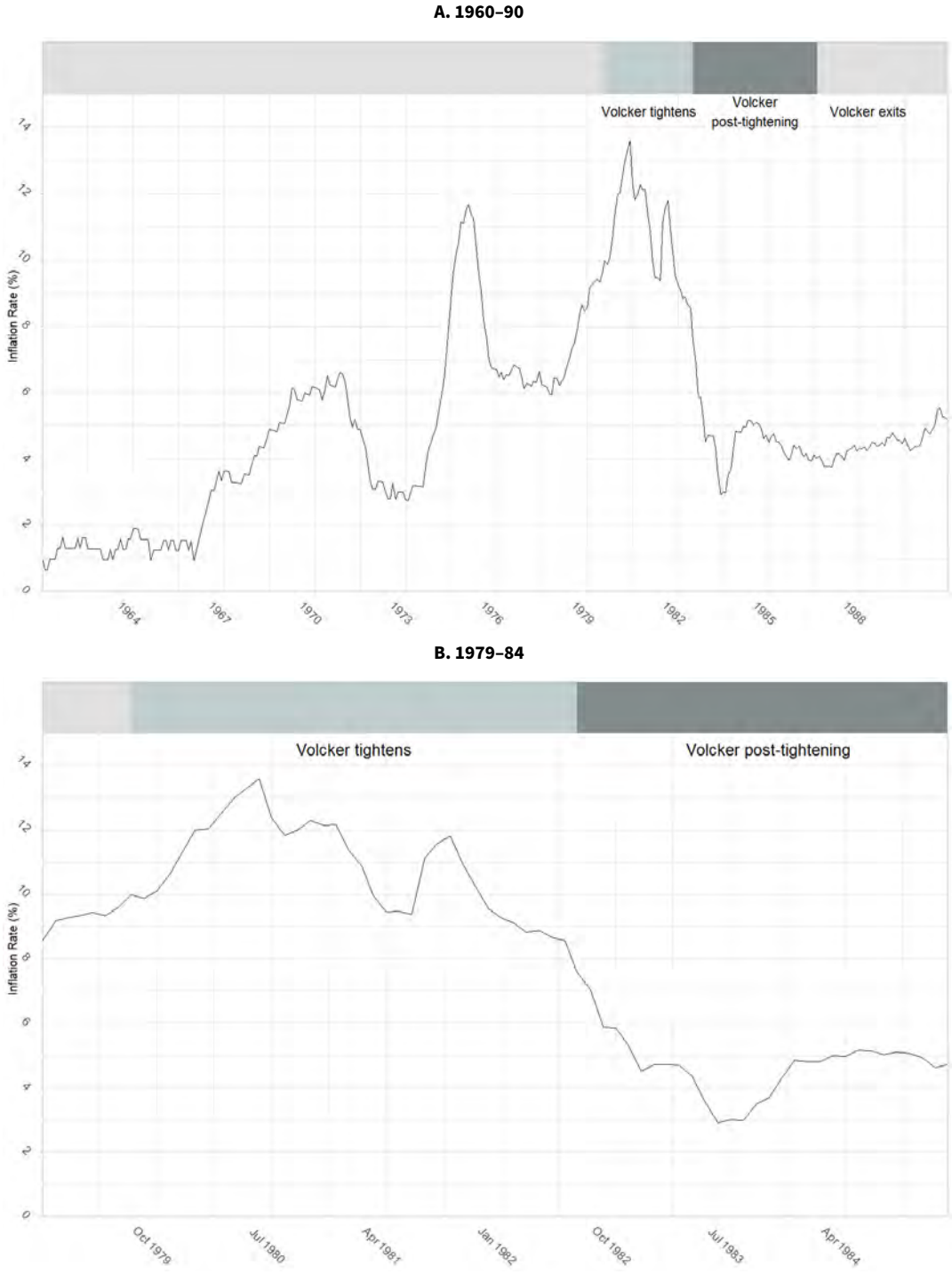
The combined experience of high unemployment and high inflation led economist Arthur Okun to create his "misery index," which was the sum of the nation's unemployment rate and inflation rate.[5] Although Volcker would be known for raising interest rates, they had already increased substantially, likely due to an increased expected inflation premium. Figure 3 plots the 30-year fixed-rate mortgage rate,[6] which had increased from 7.1 percent in April 1971 to above 11 percent by the time Volcker became Fed chair in August 1979. The higher cost of borrowing affected homebuyers, and the higher cost of capital discouraged new investments.

From the perspective of the history of economic thought, there was not total hegemony among economists in support of the menu choice view of the Philips curve. Chari (1998) describes the theoretical arguments that Friedman and Phelps each made separately in the late 1960s:

> [Friedman (1968) and Phelps (1968)] . . . argued that economic theory suggests that sustained inflation can have no effect because people care about real quantities, not nominal ones. Once people anticipate sustained inflation, they will adjust their pricing, employment, and job search decisions

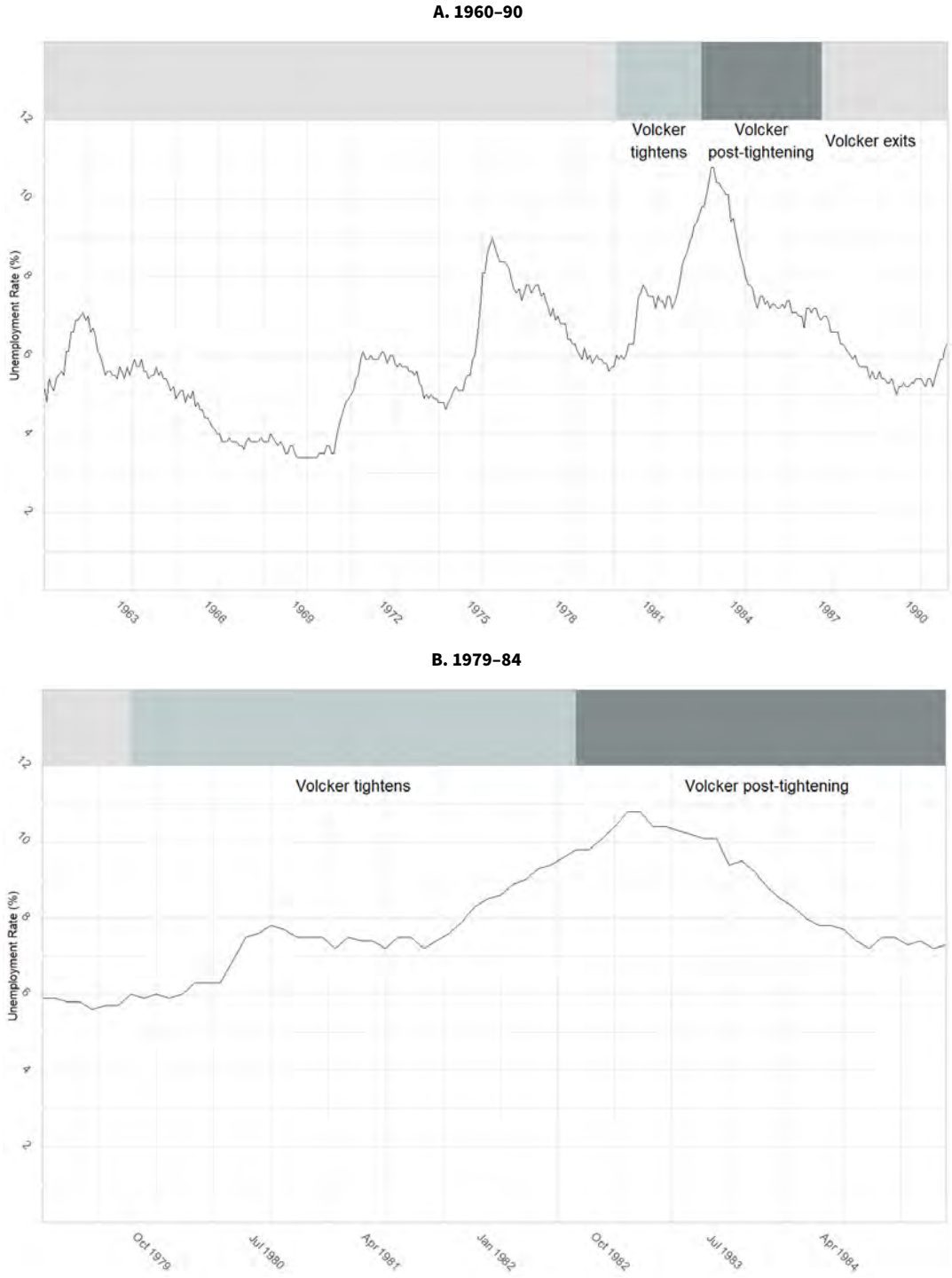
2. Core inflation is the inflation rate excluding food and energy prices.
3. In Panel B, the time series ends in 1984 and thus excludes a portion of the post-tightening Volcker period.
4. "US Business Cycle Expansions and Contractions," NBER Business Cycle Dating Committee.
5. The misery index was originally coined by Okun as a "discomfort factor" for the economy and gained notoriety following a 1971 *Wall Street Journal* article. R.F. Janseen (1971) writes that "[the discomfort factor] is derived by simply lumping together the unemployment rate and the annual rate of change in consumer prices—apples and oranges, surely, but it is those two bitter fruits which feed much of our economic discontent."
6. Source is the Freddie Mac Primary Mortgage Market Survey.

Figure 1
Monthly Year-over-Year Core CPI Inflation



NOTE: The light-blue-shaded region denotes the early Volcker period corresponding to the tightening cycle (August 1979 to June 1982). The dark-blue-shaded region denotes the later Volcker period corresponding to the reversal of the tightening cycle (July 1982 to August 1987). In Panel B, the later Volcker period extends beyond the last period plotted.
SOURCE: U.S. Bureau of Labor Statistics Consumer Price Index release.

Figure 2
Monthly Unemployment Rate, Seasonally Adjusted



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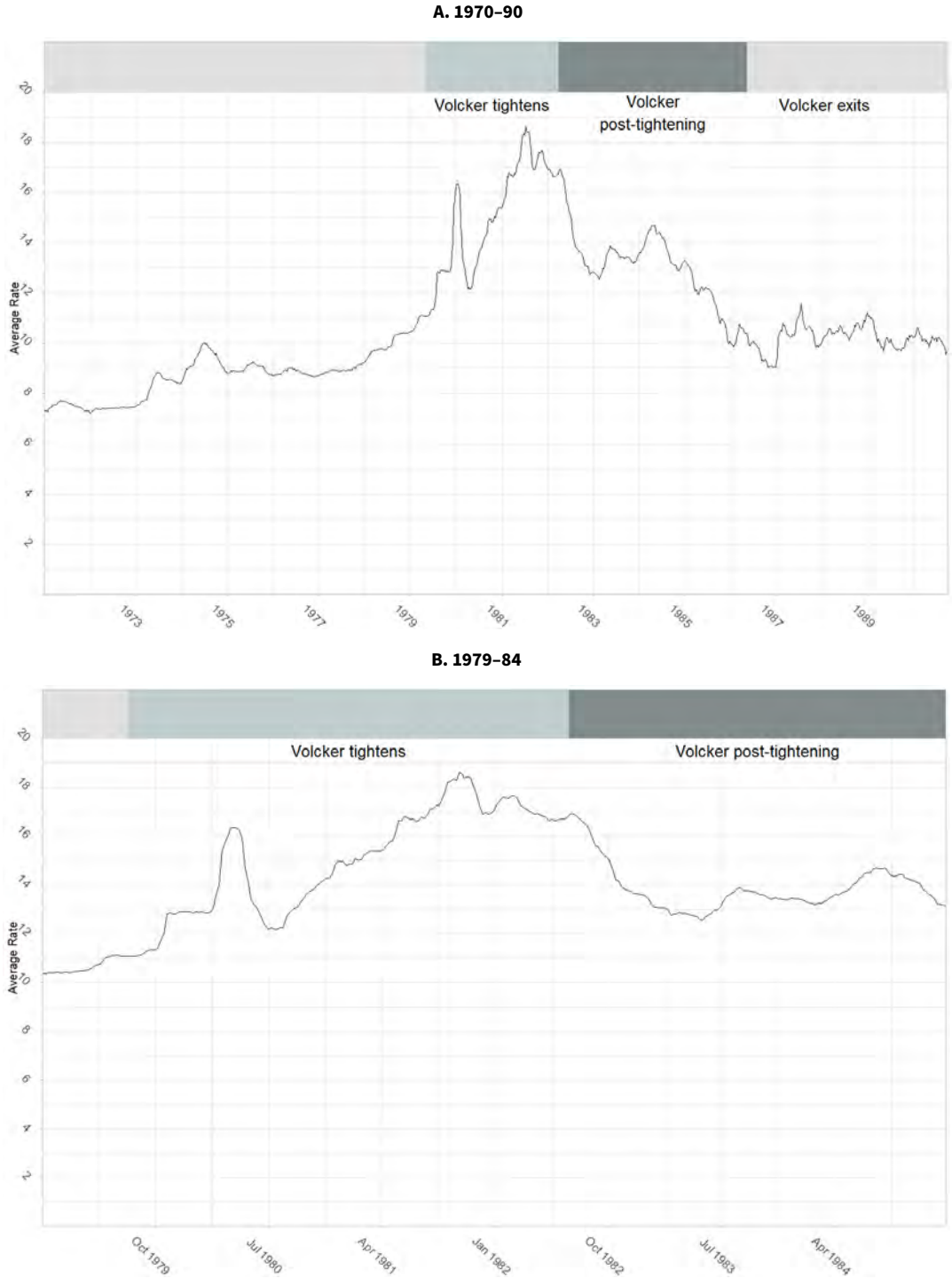
SOURCE: U.S. Bureau of Labor Statistics Employment Situation release.

Figure 3
Weekly Average 30-Year Fixed Mortgage Rate



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SOURCE: Freddie Mac Primary Mortgage Market Survey.

> in ways that take inflation into account, rendering the inflation irrelevant to real economic decisions. These considerations suggest that sustained inflation cannot lead to a permanent reduction in unemployment (pp. 174–175).

Volcker turned the Philips curve argument on its head. Looking back on the disinflation, he wrote "in the end, there is only one excuse for pursuing such strongly restrictive monetary policies. That is the simple conviction that over time the economy will work better, more efficiently, and more fairly, with better prospects and more saving, in an environment of reasonable price stability" (Volcker and Gyohten, 1992, p. 176).

A natural question is: What led policymakers to eschew tighter monetary policy in the face of high inflation in the years before Volcker? First, a few policies attempted to combat inflation with measures besides tight monetary policy. On August 15, 1971, President Richard Nixon issued Executive Order 11615, which froze wages and prices for 90 days (Nixon, 1971). In 1974, President Gerald Ford attempted to combat inflation through voluntary citizen action in his "Whip Inflation Now" campaign, which included having "millions of red-and-white buttons printed up with the 'WIN' slogan on them" (Crutsinger 2006). Both initiatives failed to curb inflation.

In the four years preceding Volcker's chairmanship, the Ford and Carter administrations responded to the high inflation and unemployment with a gradual-recovery approach. Presenting a paper at the January 1979 American Economic Association Meeting, Arthur Okun explained the view that a gradual recovery would leave slack in the economy and thus help combat inflation:

> In January 1976, after the initial inventory snapback from the severe recession and with an unemployment rate of essentially 8 percent, the Ford economists drew a path to a 5.2 percent unemployment rate in 1980. Unemployment was thus to decline by 0.6 percentage point per year. This remains, more or less, the target path of the Carter Administration today. . . . The policymakers apparently judge that those costs of maintained slack are outweighed by its anti-inflationary benefits (1979, p. 348).

While Okun did not favor the gradualist approach, calling it "inefficient" but "not absurd" (p. 350), he did present calculations (based on then-recent Phillips curve estimates) of the GDP loss associated with an inflation reduction. It was extremely large: "the average estimate of the cost of a 1 point reduction in the basic inflation rate is 10 percent of a year's GNP, with a range of 6 percent to 18 percent (p. 348)."

Not surprisingly, faced with these high disinflation cost projections, policymakers may have sought to spread the output cost of disinflation over several years with their gradualist approach.

3. THE VOLCKER TIGHTENING CYCLE: BEGINNING AND MIDDLE

Paul Volcker became the 12th chairman of the Board of Governors in August of 1979, leaving his position as president of the Federal Reserve Bank of New York which he had held since 1975. Several aspects of Volcker's views on monetary policy, inflation, and central bank independence at the time of appointment are worth listing.

First, Volcker placed significant emphasis on leading an independent Federal Reserve. Even in his interview with President Carter, Volcker expressed that "the president not be under any misunderstanding . . . about the importance of an independent central bank and the need for tighter money" (Volcker and Gyohten, 1992, p. 164). In fact, in the spring of 1979 as New York Fed president, Volcker dissented several times from FOMC decisions, favoring tighter policy.[7] Second, Volcker maintained that "if all the difficulties growing out of inflation were going to be dealt with at all, it would have to be through monetary policy" (Volcker and Gyohten, 1992, pp. 164–165). As an implication of this view, Volcker eschewed the usefulness of wage and price controls or fiscal policy in combating inflation.

Third, Volcker also rejected the Keynesian view of the inflation-unemployment trade-off as applicable to the situation the Fed faced. He stated "our current economic difficulties are tightly interwoven. They will not be resolved unless we deal convincingly with inflation" (Volcker, 1979, p. 740). Meltzer (2009a, p. 1021) explains that Volcker thus "dismissed the Phillips curve trade off as irrelevant to current outcomes." Finally, in October, Volcker convinced his FOMC colleagues to implement "new operating procedures to control the growth of monetary aggregates in an effort to restore price stability" (Kliesen and Wheelock, 2021, p. 71).

In simplest terms, a central bank can conduct monetary policy in one of two ways. In a famous article published in the *Quarterly Journal of Economics*, former Federal Reserve Bank of St. Louis president William Poole explained, "Baldly stated, the problem arises as a result of the fact that the monetary authorities may

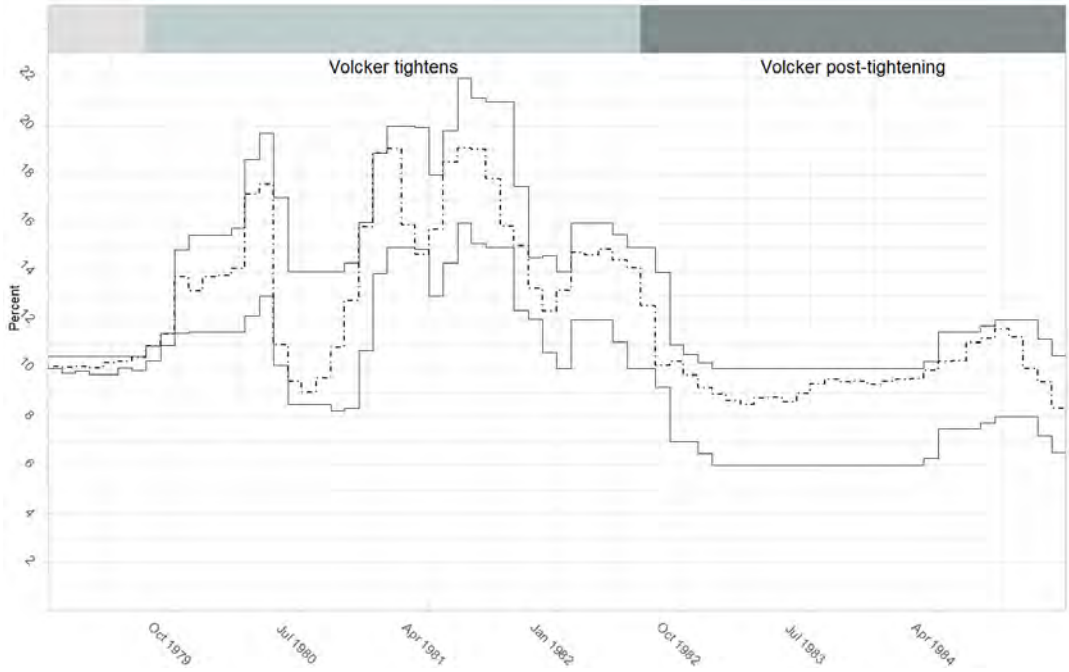
7. See Meltzer (2009a, p. 1011). Also see Thorton and Wheelock (2014) for a history of FOMC member dissents.

operate through either interest rate changes or money stock changes, but not through both independently, and therefore must decide whether to use the interest rate or the money stock as the policy instrument" (Poole, 1970, p. 197). A central bank could control the interest rate and let the money supply adjust or else control the money supply and let the interest rate adjust.

A deep dive into the operational details and challenges of adopting a monetary aggregate control approach is beyond the scope of this article. Importantly, for our purposes, this is a side issue. In fact, as Meltzer (2009a) explains, "Volcker made clear that he did not favor targeting reserves or money growth without restricting the range within which the federal funds rate could move." He further remarked that "[Volcker] recognized that ending inflation required control of money, and he recognized that this could be achieved either by targeting reserve growth or an interest rate. What mattered was how much the interest rate changed to achieve desired control" (p. 1011).

Along these lines, I will describe monetary policy during the period in terms of interest rate policy (specifically the federal funds rate and tolerance ranges) rather than money growth. Figure 4 plots the effective federal fund rates (dashed line) and the federal funds operating ranges (FFOR, solid lines). The operating ranges are the restrictions that are placed on money growth objectives. In describing reserve targeting at the time, Gilbert and Trebing (1981, p. 8) wrote "these short-term objectives for money growth are chosen by the Committee to guide open market operations over intermeeting periods. The Committee also specifies ranges for acceptable movements in the federal funds rate for intermeeting periods."

Figure 4
Effective Federal Funds Rate and FOMC "Tolerance Ranges" for the Federal Funds Rate, 1979–84



NOTE: Tolerance ranges correspond to the first day of the month. Data are from FOMC Secretariat (2019) "Historical Changes of the Federal Funds Rate and the Discount Rate (1971–Present)." Effective federal funds rate data are from the Board of Governors, H.15 Selected Interest Rates release.

The middle of 1980 saw a dip in both the FFOR and the effective federal funds rate, as shown in Figure 4. The decline was short-lived and due to the interaction between two factors: temporary credit controls imposed by the Fed along with a desire to achieve the money growth targets that the FOMC had set for itself.

Soon after imposing credit controls, the challenge of excessive money growth above target growth rates was replaced with a different problem: too little money growth relative to targets. The FOMC faced the choice of losing credibility by missing its money growth targets to the downside versus reducing the FFOR in order to slow money growth. Of the episode, Meltzer (2009a, p. 1052) wrote that "in place of the conflict over how high to place the upper band on the federal funds rate, the FOMC argued over how low to place the lower band. Following the March meeting, the federal funds rate reached a weekly average of 19.38 percent. By the April meeting it was 17 percent. A week later, the rate was 13.5 percent."

The decline in the federal funds rate led to communications problems for the FOMC. Meltzer (2009a, p. 1054) writes that "market participants continued to watch the federal funds rate and other short time rates," interpreting these declines as easier monetary policy rather than simply actions to defend its money growth objectives. Market participants likely interpreted these falling rates as an abandonment of the Fed's anti-inflation program.

The credit controls were lifted in July; the FOMC began raising the FFOR in the fall. Reflecting on these actions, Volcker later remarked that "as I look back, that mistake cost us six months" (Volcker and Harper, 2018, p. 111).

This middle period in the tightening cycle saw high nominal rates, rising unemployment, and stubbornly high inflation. Between November 1980 and August 1982, the upper bound of the FFOR fluctuated between 14 and 22 percent, while the lower bound fluctuated between 10 and 16 percent. In most months, the effective federal funds rate operated near the top of these ranges. Over this time interval, the unemployment rate increased from 7.2 to 9.8 percent. For many of these months, the U.S. was in the midst of the 1981–82 NBER-dated recession. This recession was widely viewed at the time as the most series U.S. downturn since the Great Depression.

4. THE SUMMER OF 1982: THE FED REVERSES COURSE

The critical pivot in monetary policy—as measured by the federal funds rate—began with the July 1, 1982, FOMC meeting. While there was no major change in the FFOR, the effective federal funds rate fell about 5 percentage points over a two-month period. In the weeks that followed, the Board approved a series of discount rate reductions, which accompanied declines in the federal funds rate. Measured as the end-of-week rate, the effective rate decreased from 14.92 percent on July 2 to 10.4 percent on September 3. Thus, peak tightening ended in July 1982.

It might be natural to conclude that Volcker began to cut the policy rate because inflation had been conquered. In reality, the story is a more complicated one. Unlike the present-day Fed, Volcker's Fed did not have an explicit inflation target. In the decade prior to the Great Inflation (1958-67), headline and core Consumer Price Index (CPI) had grown, respectively, at 1.7 and 1.8 percent annually. This is fairly close to the Fed's current 2 percent target. However, Volcker began cutting the policy rate even while core CPI growth remained significantly above this historical benchmark.

Recall Figure 1, where Panel A plots year-over-year, monthly core CPI inflation from 1960 to 1990 and shows the low inflation that held in the first half of the 1960s. As explained above, the FOMC began reversing its tightening cycle in July. The annualized 1-month core CPI inflation rate was about 7.8 percent in July 1982 and over 10 percent a few months earlier in April. The July data were released in August, suggesting that the Fed decided to pivot even before the high inflation of the past several years had abated for good. Panel B plots the same series but restricts the period plotted from 1979 to 1984.

One might argue that—even if the actual encouraging inflation numbers had not come in—forecasts of lower inflation might have played a role. There is some evidence that this was the case. Figure 5 plots the actual inflation series (black line) from October 1979 through July 1984, along with the Fed's internal Greenbook forecasts of the inflation series.

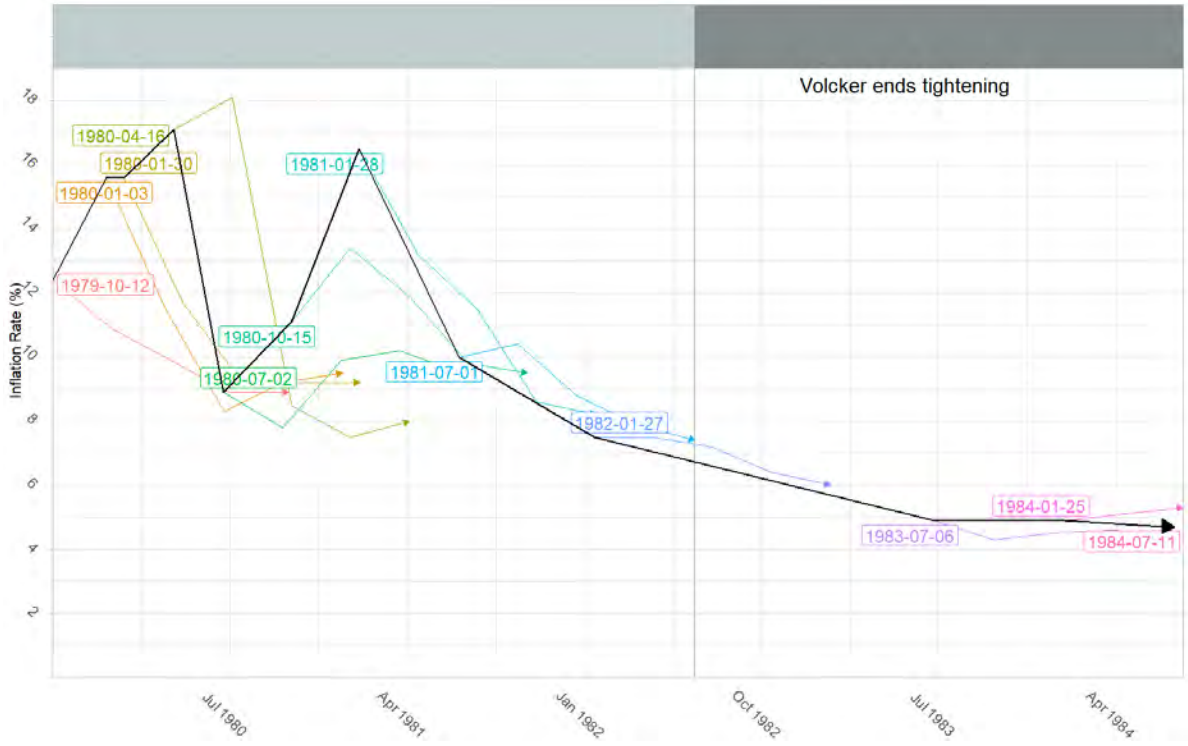
The general pattern of Figure 5 is that, for the most part, the Fed forecasts predicted inflation would be falling throughout the plotted years. For example, the September 1981 Greenbook forecasted that inflation would be about 6 percent by the end of 1982 even though actual inflation was nearly 12 percent in the month of the forecast. As actual inflation began to fall, the Greenbook forecasts began marking down their end of 1982 forecasts. Both the March 1982 and June 1982 forecast for end-of-year inflation were about 5 percent. Each of the two forecasts also predicted inflation would stay close to 5 percent throughout 1983.

According to the Fed's Greenbook forecast in June 1982, headline CPI inflation over the following year was expected to be 4.9 percent. This was only moderately lower than its year-ahead forecast of 5.3 percent from just six months prior.

Next, consider private sector forecasts at that time. In the early 1980s, there were not market-based inflation measures based on the spread between nominal and indexed bonds in the U.S. The Survey of Professional Forecasters (SPF) also did not yet exist. However, the Livingston Survey was an antecedent to the SPF that compiled forecasts from industry, academy, banking, and government biannually (Federal Reserve Bank of Philadelphia). Using this survey, I compute year-ahead CPI inflation measures averaged across participating forecasters. In June 1982, the year-ahead forecast was 5.7 percent compared with 7.2 percent just six months earlier. This suggests that the private sector was also predicting declining inflation.

Thus, by July 1982, Volcker and the FOMC were forecasting that inflation would stabilize around 5 percent

Figure 5
Snapshots of Headline Inflation Forecast Paths for 1981–83, Taken from Federal Reserve Greenbook Forecasts in Chosen Months



NOTE: The black line corresponds to the actual inflation series. Every other line is labeled by the month of the corresponding Greenbook forecast. To avoid clutter, only every third calendar month of forecasts is plotted.
SOURCE: Federal Reserve Bank of Philadelphia historical Greenbook data.

by the end of 1982. This could explain why the Fed reversed course on its tightening cycle in mid-1982. It does raise another question: Why did the FOMC stop at 5 percent, whereas before the Great Inflation, the average inflation rate was less than half that value?

In the next section, I describe two factors and one potential factor that led the Fed to reverse course on monetary policy at this time in particular, beyond the intermediate success it had won in reducing inflation. These are: economic pains caused by the recession, the prospect of a financial crisis, and potentially political pressure.

5. EXPLAINING THE FED'S COURSE REVERSAL

5.1 Economic Pain

Arthur Okun's predictions that the FOMC's disinflationary actions would cause Great Depression–sized economic pain turned out to be overstated; however, there was a substantial downturn. Second quarter output growth in 1982 was –1 percent, compared with +3 percent the year before.[8] In June 1982, the unemployment rate was 9.8 percent, compared with 7.2 percent in April of the preceding year.[9]

In testimony before the U.S. Senate, Volcker acknowledged the economic situation, noting "I need not dwell on the fact that we are in most difficult economic circumstances, with unemployment far too high, with strong pressures on financial markets, and with a sense of widespread uncertainty. We cannot build a sound program against inflation on a base of continuing recession" (U.S. Senate 1982, p. 7).

A major factor driving the macroeconomic slowdown was a weak housing market, driven by escalating mortgage rates. At its peak, the mortgage rate reached almost 19 percent. Monthly new starts of privately owned single-family houses, another measure of housing market conditions, fell from about 1.4 million just

8. Each output growth measure is the 1-year percentage change in real GDP.
9. Excluding the COVID-19 recession, the peak unemployment rate in the post-WWII U.S. was 10.8 percent, reached in December 1982. By comparison, the peak unemployment rate during the 2007–09 Recession, i.e. the Great Recession, was 10 percent.

before Volcker's appointment to around 500,000 (seasonally adjusted annual rate) in the summer of 1982, close to record lows (U.S. Department of Housing and Urban Development).

Interestingly, despite the poor housing market and detractors from various circles, Allan Meltzer, in a 2009 *New York Times* opinion piece, describes some positive feedback Volcker received:

> At the 1982 convention of the National Association of Home Builders, Paul Volcker said that if he were to let up on anti-inflation efforts prematurely, "the pain we have suffered would have been for naught and we would only be putting off until some later time an even more painful day of reckoning." As always in periods of high interest rates, home builders had been especially badly hurt, but when the chairman finished his speech, they gave him a standing ovation (Meltzer, 2009b).

The broad stock market was one area in which the Fed's actions did not appear to have a substantial negative effect. From the start of 1979 to July 1982, the S&P500 grew at an annualized rate of about 3 percent.

5.2 Financial Market Stress

The high interest rate environment as well as the 1981–82 recession were together causing stress in some parts of financial markets. This stress also played a role in the FOMC's decision to end its tightening cycle, a journey lasting nearly three years. Meltzer (2009a, p. 1105), based on an interview conducted with Volcker in 2001, said that "Volcker . . . cited the difficulties of controlling money, especially in 1982, his reluctance to raise interest rates during a deepening recession, the failure of the recession to end, as predicted, in the second quarter 1982, and the developing problem of Mexico's external debt."

Likewise, Volcker recognized that "by the summer of 1982 the financial fabric of the United States itself was showing clear signs of strain" (Volcker and Gyoten, 1992, p. 180). These included, for example, problems in the savings and loan industry, the bankruptcy of Penn Square National Bank, and difficulties at Continental Illinois Bank. Volcker noted, "All this contributed to the timing of our decision to ease policy in July 1982" (Volcker and Gyoten, 1992, p. 180).

Although there was awareness of a possible Mexican debt crisis in late 1981, Volcker recalled that this possibility was not sufficient on its own to motivate cutting rates before July 1982. He asked, "Should we have announced, in effect, that we were willing to live with more inflation in an attempt to ease the debts of a foreign country, particularly when the effort almost certainly would not have been big enough to have made much difference anyways?" (Volker and Gyoten, 1992, pp. 179–180.)

At the July 1982 FOMC meeting, Volcker told the committee that they "would have to respond to it" (FOMC Minutes, July 1, 1982, p. 57) in the event of a systemic financial crisis. Citing the minutes from the October FOMC meeting, Meltzer (2009a, p. 1112) explains that at the meeting, "[Volcker] proposed to keep the same range as before, 10 to 15 percent for the funds rate . . . 'with the knowledge that I would feel very hesitant [to accept it] if in fact the market produced rates of 15 percent continuously for any period of time.'"

5.3 Political Pressure

Volcker and the FOMC faced political pressure as they tightened monetary policy. In contrast to economic pain and financial market stress, it is difficult to assess how much (if any) role this pressure played in the policy reversal in the summer of 1982. Nonetheless, the political environment merits some discussion.

Even early on under the Chair's leadership, a few political leaders questioned Volcker's approach. For example, in July 1981, Congressman Henry Gonzales (TX) introduced a resolution to impeach Volcker and, later, a second resolution to impeach the rest of the FOMC.[10]

The more serious criticism from national political leaders came later. By the spring of 1982, Volcker had been Fed Chairman for about two-and-a-half years. The unemployment rate was over 9 percent and had been above 7 percent for most of Volcker's tenure through that point. Nineteen eighty-two was also an election year. As Meltzer (2009a, p. 1108) explains, "Many in Congress supported the disinflationary policy, but as the 1982 election approached some became restless."

Although the Fed was independent, it existed as a result of the Federal Reserve Act, which of course could be amended or even repealed. While there was no serious discussion of dissolving the Fed during the period, there were moves to reign in Volcker's power. In fact, on June 10 of that year, the House Budget Committee passed a resolution advocating for the coordination of fiscal and monetary policy in a way that would result in the Fed easing its policy stance. The resolution declared

10. House Resolutions 196 and 352–97th Congress. See also Silbert (2012, p. 203).

> it is the sense of Congress that if Congress acts to restore fiscal responsibility and reduces projected budget deficits in a substantial and permanent way, then the Federal Reserve Open Market Committee shall reevaluate its monetary targets in order to assure that they are fully complementary to a new and more restrained fiscal policy (House Budget Committee Concurrent Resolution 352, 1982).

Volcker understood that legislation was different than a resolution, writing that "if Congress had a law that told us to do something, we'd have to do it. But a resolution is a much more tricky thing to handle" (FOMC Minutes, May 18, 1982, p. 43).

In addition to Congress, top officials in the Reagan administration had concerns about continued high interest rates. Melzer writes:

> At the White House, James Baker, a main adviser, worried about the coming election. He dropped hints about legislation reducing system independence. At Treasury, Secretary Donald Regan, a frequent critic, considered legislation restoring the Treasury Secretary to the Board and FOMC, as in the original Federal Reserve Act. . . . [Baker] tired of failed forecasts of recovery and was concerned about Republican prospects in November. He wanted lower interest rates. The prospect that the administration might support one of Congress's proposals was a significant threat (Meltzer, 2009a, p. 1109).

White House influence over the Board may have increased over time as additional Reagan appointees joined the Board of Governors. By the end of 1986, four of the seven Governors had been appointed by Reagan. For example, Governor Martha Seger dissented in favor of easing six times between her confirmation in 1984 and the end of Volcker's tenure in 1987 (Thorton and Wheelock, 2014). However, there was only one Reagan-appointed Governor (Preston Martin) during the summer of 1982, suggesting a limited capacity for White House influence through this channel during this critical episode.

6. CONCLUSION

At the cost of putting the U.S. economy through a deep recession, the FOMC achieved a large reduction in the inflation rate by July 1982 that would be sustained for over 40 years. However, Volcker's FOMC did not continue its tightening cycle even though in the summer of 1982 inflation remained elevated in the summer of 1982 relative to the stable, low inflation period before the Great Inflation

In fact, year-over-year core CPI inflation did not fall below 3 percent for another decade (January 1994). Using the historical record, I documented two factors that influenced—and a third factor that potentially influenced—the Fed's decision to reverse its tightening cycle during that summer.

It took about 20 more years for the FOMC to adopt an official inflation target. In January 2012, it announced that "the Committee judges that inflation at the rate of 2 percent, as measured by the annual change in the price index for personal consumption expenditures, is most consistent over the longer run with the Federal Reserve's statutory mandate" (Board of Governors, 2012).[11] Without an explicit inflation target, Volcker's FOMC in July 1982 did not face a "credibility crisis" because it reversed its course of interest rate policy before inflation had been fully vanquished.

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11. Shapiro and Wilson (2019) document that even before the 2012 explicit target declaration, historical FOMC transcripts show that "in numerous instances during deliberations, FOMC participants made explicit statements regarding their preferred inflation target."

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