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Remarks by

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Chairman, Board of Governors of the Federal Reserve System

at the

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of

The American University

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It is a special pleasure for me to be with you today to honor the mid-year graduates of American University, and to receive the honorary degree which your Board of Trustees has seen fit to bestow upon me.

You all know American University has a special place as an educational institution. Its name is symbolic of the nation itself. Its students and faculty, more than most, have been attracted by a desire to be part of what is happening in Washington, in government, and thus in the nation, and in the world.

In that sense, an education at American University means an education with a national perspective -- more than any name, it is the justification for being called the national university.

Washington is like no other city in the world. When you live here you are surrounded by a special feeling, a feeling that you're at the heart of what's happening, not only in the nation but also in the world. Decisions are being made, ideas are being debated, work is being done which changes the course of events.

Of course, that sense of importance is easily overblown -- we are tempted to forget that Washington, instead of seizing new initiatives, often simply responds to strong forces that developed elsewhere, or is frozen into immobility by countervailing pressures. But I hope and believe that the fact that the student body is drawn from every state and from more than 100 countries helps keep your sense of proportion and a healthy

skepticism. And, I understand that, despite all the temptations and diversions of life close to the seat of government, the atmosphere at American parallels that at other colleges and universities in recent years -- a more serious mood, more conservative and harder working, with a tinge of concern about a tougher economic reality out there in the real world.

The challenge of making decisions in the best long-term interests of the nation -- and at the same time taking account of the realities in the "real world" out there -- is common to the institutions of government. I happen to work at one of those institutions, and it is an institution with a very special character.

In some ways, it has seemed mysterious to many. That reputation is partly related to the fact we deal with money, a matter that seems of pressing and concrete importance to most of us in our individual lives, but a great amorphous abstraction when dealt with as a whole. And, partly, the mystery derives from the fact that the Federal Reserve is in some respects unique among governmental institutions -- deliberately so, in the minds of its founders, so that it would reflect both the diversity of the country and be insulated, in its decision-making, from some of the passions and pressures of the political world.

I'd like to take advantage of your captive presence today, before you scatter into the real world, to reflect a bit on that uniqueness, on the justification for our special

role and degree of independence within the government, and on the special responsibilities that independence implies.

When I talk about the Federal Reserve as an institution I am reminded of the story told to me by a recent visitor to my office. The visitor had hailed a taxi and asked the driver to take him to the Federal Reserve building. The driver responded, and I quote: "The Federal Reserve? I didn't know they had a building. I thought they were just on television!"

Well, we're not just on television. We do have not one but two handsome and sedate buildings just down the street. By Washington standards, they are not very large. But it's also true that they are only symbolic of a larger presence -- physically reflected in 12 Federal Reserve Banks and 25 branches around the country and less tangibly reflected in helping to shape the economic environment.

Industrial nations, including our own, nowadays rely heavily -- sometimes too heavily -- on their central banks and on monetary policy to achieve our economic goals; to promote growth and employment, to blunt the forces of inflation, and to maintain financial stability.

At times, the pursuit of those objectives requires speed and flexibility in decision-making, and that flexibility is one of the virtues of monetary and credit policy. But through the necessary process of adaptation and change runs another, more constant, threat -- the need for a sense of

discipline. In the broadest sense, all of economics -- I am tempted to say all of life -- teaches us that our collective desires always exceed the means to achieve them. And history has taught us, again and again, that the creation of money is no substitute for productivity, for savings, and for investment in enlarging our economic welfare. Yet the temptation is always there to try -- with the ultimate result of destructive inflation that, in the end, only undermines those goals.

Under our scheme of government, the Federal Reserve is charged with the responsibility to manage the money supply in a way responsive to the continuing, longer-term needs of the economy. Its structure is designed to encourage that focus, and also to enable us to reach decisions promptly and flexibly on the basis of the best information available. Those broad considerations are easy to state, but in practice are hard to blend in any human institution. What seems to me remarkable is the degree to which the basic framework of the Federal Reserve -- through 70 years of economic, social, and technological change -- has stood the test of time.

The Federal Reserve is, of course, an instrumentality of the Federal Government -- it is a creation of the Congress, and a part of the apparatus of national economic policy-making. What it is not is "just another Federal agency," with all power and influence flowing from a Washington headquarters or at the direction of the Executive. There is, indeed, a central supervisory board in Washington appointed by the President with the

advice and consent of the Senate. But there are also important elements of regional and community participation and counsel in our work.

It was all quite deliberately done by men of political imagination -- designed to assure a certain independence of judgment, a continuity and professionalism in staff, a close contact with economic developments and opinion throughout our great land, and a large degree of insulation from partisan or passing political concerns.

Today, as in the past 70 years, the twelve regional Federal Reserve Banks and their branches benefit from the practical "real world" experience, the knowledge, and the advice of more than 275 men and women who serve as Directors at our regional Reserve Banks. They are industry leaders and union officials, bankers and educators, farmers and storekeepers -- all leaders in their own communities in every part of our nation.

These and other contacts are designed to assure that our policies are not conceived in an ivory tower without a clear sense of the needs of economic and business life.

But the Congress, in its wisdom, had another purpose in mind in creating and maintaining an independent central bank -- an insulation from the passionate partisanship that understandably characterizes some of our political life. Members of the Board of Governors have long terms, their terms are staggered, and they cannot be removed because of

policy differences. Federal Reserve operations are financed from its own resources. And, our decision-making -- both monetary policy and in the area of supervising the banking and financial system -- is not dependent on the Executive Branch. The System reports to, and is accountable directly to the Congress, which was given the Constitutional authority over money by our founding fathers, in part to insulate that authority from the Executive, lest it become too powerful.

The decisions made by the Congress on the independence of the System were not accidental, nor were they a reflection of a particular need at a particular time in history. From time to time they have been reviewed. The more important changes in the law governing the System have been in the direction of reaffirming, or reinforcing, that independence.

I believe the basic reason for these arrangements is that Congress has concluded that achieving the purposes of monetary policy requires the patient application of policy measures -- which may or may not be widely popular at the time -- from a perspective extending over long periods. It has consistently recognized that decisions on monetary policy are not only technically complex but easily distorted by seemingly pressing -- but often passing -- short-term considerations.

Through the centuries, sovereigns and sovereign governments have yielded to the insidious temptation to seek a solution to budgetary or economic problems by debasing the

currency. In the days when gold coin circulated, they "clipped the coins." In the days when paper currency was most of the money supply, they could run the printing presses. Amid today's complexities of credit cards and NOW accounts, money market funds and automated money transfers, the methods may be more sophisticated -- but ultimately no less damaging.

The temptations can be particularly strong when the Government's budget is out of balance; money creation to finance excessive spending or a revenue short-fall then may appear to be a way to postpone difficult, but necessary, decisions on how the government can live more nearly within its income. That is one reason I believe the Congress has not wanted to delegate its power over money directly to those responsible for financing the government. But, I suspect that many in Congress have also wanted a degree of insulation for the Federal Reserve from short-term political or electoral pressures that can arise in the Congress itself.

We do, of course, report to, and are directly accountable to the Congress, which, as I noted earlier, has the constitutional authority over money. There are a number of formal -- and many more informal -- ways for exercising Congressional oversight of Federal Reserve spending and policies, and for expressing its views on these matters. Those procedures have become more explicit and exacting over the years, and one key mechanism is the twice yearly reports and hearings before the Banking Committees of both houses of Congress about our objectives. Indeed, it is the

number and variety of Congressional hearings and inquiries into monetary policy that no doubt led to the taxi driver's conception that we just appear on television!

This dialogue between the monetary authority and the Congress seems to me essential and constructive. In an immediate sense, it gives the Congress regular opportunities to express its views on the appropriateness of our actions. Equally important, it provides us at the Federal Reserve with an opportunity to explain fully the nature of, and reasons for, our actions. No monetary policy, for all its seeming air of mystery and complexity, can be long sustained in our democracy without broad understanding of the objectives and support from the people whose lives are affected. In that sense, we are not independent of the "body politic" in the largest sense of that phrase -- we are after all, part of the "Government" and a "creature of Congress."

In recent years, we have, in Congressional and other forums, emphasized our commitment to seek sustained economic growth in a framework of much greater price stability. Indeed, I believe, in the decade of the 1970's, we learned from hard experience that ultimately we could not sustain high levels of employment and productivity on the drifting sands of a weak and depreciating currency. Now, after the pain and turbulence of the late 1970's and the first years of the 1980's, we can see clear signs of renewed progress, both toward more employment and toward containing inflation.

Indeed, I believe we have an enormous opportunity -- you have an enormous opportunity -- to participate in years of greater growth and price stability.

I won't claim the job is done, or that it will be simple. A successful effort will rest, in considerable measure, on continued discipline in monetary policy. The gap in the Federal budget cries out for correction. We will need to improve the functioning of our labor and product markets.

I won't take the time to expand on those points today, but it is obvious that you will soon be dealing with these economic problems first hand. Maybe in some respects it all sounds exhausting and uncomfortable. But I doubt that your professors led you to believe that life "out there" beyond the Groves of Academe should be confused with a bed of roses. What we can say, with some assurance, is that you will find the environment challenging and invigorating -- and that out of the process will come jobs, the growth in average income, and the satisfaction we all want.

It is a world where hard work, and courage, and human concern can be amply rewarded in more ways than you may now imagine. I also wish you a little luck -- for sooner than you realize, it will be a world shaped not by my generation, but by yours.

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