Central Banking and the Triumph of Technical Rationality

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More than any other financial institution, the central bank stands for technical rationality, the application of scientific thought to the solution of administrative problems.¹ No other financial institution so fully frames its major policy decisions in terms of economic models. No other financial institution places these decisions in the hands of a committee of economists who meet on schedule to analyze the latest data and fine-tune policy. None employs such large research departments, even publishing their own prestigious journals². And in no other financial institution are the governors of that institution portrayed by the media as technical wizards; masters of an arcane knowledge that produces a public good. All of this suggests that central banking has become technically rational, thereby eliminating the social and political elements historically associated with controlling the supply of money and credit in a nation.

This paper questions how closely central banking has approached this ideal type. It sees instead a more idiosyncratic application of ideas based in a technical discourse. Elements of custom, compromise, and pragmatism mix with expert judgment in a social process of negotiation. The existence of confusion and uncertainty are strategically obscured from public view, thereby maintaining a more mythic representation of technical rationality. The “scientization” of central banks has allowed them to “gain legitimacy and authority basing their views on, and applying, the language of science” (Marcussen 2009). It has allowed their analyses to become objectified and more readily reproduced by their target audience in the marketplace. But it has not allowed the control of the money supply to become “scientifically” managed. Rather, the aura of technical
rationality that surrounds central banking disguises the limits to rationality and conceals the social character of its policy choices.

The process of rationality identified in this paper reveals a tension between central banks’ *technical discourse* and their employment of experience-based *expert judgment*. The result of this tension is an interpretive process for making sense of and giving sense to policy choices. This process is marked by the use of *interpretive techniques* that explain and justify these choices. These efforts include rationalizing techniques to justify expert judgments and signaling techniques to shape the meaning of these judgments for public consumption. These techniques are tools in the construction of a consensus narrative that central bankers use to legitimate and objectify their claim to technical rationality. They reflect the fact that central banking is not just an economic function, but a political one.

Nevertheless, this paper accepts the premise that central banks, in this case the U.S. Federal Reserve (the Fed), stand for a logic of action based in technical rationality. My concern is not to impugn the Fed’s intended rationality, but to explore what this rationality looks like in practice. I use verbatim transcripts of closed policy meetings to illustrate the Fed’s own form of technical rationality. Transcripts of meetings of the Federal Open Market Committee (FOMC), the Federal Reserve’s most important policy-making group, are ideal for this purpose. They provide real-time policy negotiations that the members believed at the time to be secret. Ten transcripts (485 pages) from November 1978 to October 1979 were analyzed. The transcripts were only released later as the result of a Freedom of Information Act suit. Even members of the FOMC had been unaware of the existence of the transcripts.
The FOMC meets every six weeks for one or two days to interpret current conditions and set monetary policy for the coming period. The Committee has twelve voting members. Seven are the members of the Board of Governors of the Federal Reserve, appointed by the President of the United States and confirmed by the Senate for fourteen year terms. The other five voting members are presidents of one of the twelve regional Reserve Banks scattered around the United States in major cities and are elected by bankers from their home regions. The presidents of all twelve regional Reserve Banks attend the meetings and rotate onto the Committee as voting members for terms of one year.

**HISTORICAL CONTEXT: CHANGING MODES OF CONTROL**

The Federal Reserve, as a central bank, is responsible for controlling the supply of money and credit in the United States. The goals of this control are the legislatively mandated pursuit of price stability and economic growth. The nature of the control of the money supply in the United States has changed over the course of its history. This change has generally been in the direction of increased government control over the market for money, but it has not been without conflict. Farmers, merchants, bankers, and political parties representing their interests have contested the appropriate means and degree of control. Class, occupational and region-based conflict preceded the bureaucratic rationalization of the twentieth century. The conflict over control of monetary policy can be divided into three stages: market-based control, bureaucratic control and technocratic
control. Each form of control is accompanied by its own politics: market-based control by class politics, bureaucratic control by inter-sectoral politics, and technocratic control by organizational politics.

Market-based Control - The Constitution of the United States (1787) gave the Federal government the power to “coin money and regulate the value thereof.” To the Founders this meant that the value of currency in the United States would be defined as a certain amount of precious metal, gold or silver. Such legal tender could be used to pay off all obligations. This system was considered self-regulating in that the supply of currency in the economy would not grow without an increase in the supply of precious metal. As such, the Constitution contemplated no other regulatory device. But the Constitution was better designed to maintain political stability than economic stability, and economic interests were rarely content to rely solely on the benefits of self-regulation.

The monetary history of the nineteenth century is one of severe dislocation wrought by the bank panics of the 1830s and 1870s. Political conflict over how the currency should be valued was nearly continuous (Timberlake 1993, Friedman and Schwartz 1963). Farmers in the South and West, fought to expand the definition of which metals could be exchanged, while merchants and bankers in the East fought for the stability and predictability of “sound money.” The Federal Reserve has its direct roots in the Panic of 1893 and the resulting economic crisis. In the wake of this panic and years of economic instability, an alliance of reform-minded bankers, businessmen and economists called for an “elastic currency” that could be mobilized in economic crisis.
This idea, when married to the idea of “sound money” based on the gold standard was critical to the birth of central banking in the United States (Livingston 1986).

Bureaucratic Control – The Panic of 1907, in which J.P. Morgan famously tried to supply the urgently needed monetary liquidity, provided the critical incentive needed for the creation of a central bank. In the final legislation, enacted in 1913, a system of eight to twelve regional reserve banks was to be created and run by the regional bankers, overseen by a Board in Washington. Although this degree of banker control was to erode over the course of the twentieth century, the long efforts of the banking community paid off for them in the creation of a central bank that could provide for an elastic currency that created enhanced financial stability.

In its early years, the Board in Washington was weak and the regional Reserve Banks, run by the private bankers, took the lead in controlling the System. The efficacy of the Federal Reserve System, as well as the distribution of power between the Board and the twelve Reserve Banks, was somewhat ambiguous. On the one hand, Congress expected the Federal Reserve to be an adjunct to the self-regulating gold standard. On the other, it expected it to intervene in short term seasonal disruptions when currency was needed. From the beginning, the New York Reserve Bank was more powerful and important than the other eleven regional banks and the Board in Washington. But the retirement of Benjamin Strong as Governor of the New York Bank in 1928 left a leadership vacuum (Meltzer 2003, Friedman and Schwartz 1963).

During the numerous bank failures of the early 1930s, the Fed remained passive. Friedman and Schwartz (1963) famously blame this passivity on the leadership vacuum left by Strong in New York and the organizational ineptitude of the Board in Washington.
More recently Allan Meltzer (2003) has argued that the ineptness can be explained by the widespread acceptance of a misguided economic discourse, the "real bills doctrine." According to this ideology, the underlying cause of bank failures was loans made for speculative purposes and the proper response was to purge the economic system of its excesses by letting banks fail. With this approach, depression was the inevitable consequence of speculative excess.

As a result of the crisis and the Fed’s failure to mitigate it, Congress turned to reforming the Fed itself. The Banking Act of 1935 both changed the structure and broadened the power of the Fed. The ambiguities over the distribution of power in the Federal Reserve System were resolved in favor of the Board in Washington. The Federal Reserve Board was renamed the Board of Governors of the Federal Reserve System and given higher salaries and longer terms. At the same time, the Secretary of the Treasury and the Comptroller of the Currency were removed from the Board in an effort to make it less political, “independent within the government.” All the pieces were in place to make the Fed an independent regulator of the money supply. But monetary policy had taken a back seat to fiscal policy in the New Deal, using government revenue to influence the economy. The Fed became the servant of policy set at the Treasury Department.

Technocratic Control – The Federal Reserve chafed under Treasury Control. By the early 1950s, many in Washington believed it was time for an effective monetary policy that did more than maintain a low price for government securities. The Treasury–Federal Reserve Accord in March 1951 gave the Fed its first chance to use the bureaucratic powers it had been given in the 1935 Banking Act. There was another more subtle shift occurring at this time. Congress affirmed the expectation of an activist Fed.
Rather than being an adjunct of the self-regulating gold standard, which had been abandoned in 1933, the Fed was expected to adapt to cyclical conditions using its discretion to identify those conditions and create policy. The automatic discipline of the gold standard was to be replaced by what Allan Sproul, president of the Federal Reserve Bank of New York, referred to as “the discipline of competent and responsible men” (Timberlake 1993:324).” With this and the earlier structural reform of 1935, Congress laid the groundwork for the technocratic, relatively autonomous Fed of modern times. Competence as a central banker was increasingly associated with one’s knowledge of economic theory. In 1960 none of the seven governors were economists. In 1970 four of the seven were and by 1980 all but one were economists.

The major monetary event in the latter half of the twentieth century, one that continues to effect monetary policy today, is known as The Great Inflation. It is this event that provides the immediate macro-context for our close analysis of technical rationality at the Fed. Inflation refers to the rate of increase in the general price level of all goods and services. Inflation rose at the low average rate of 1.2 percent from 1952 to 1964. Between 1973 and 1981, the worst years of the inflation, it averaged 9.2 percent. At the time, many blamed the steep rise in oil prices, but Japan experienced the same oil shocks and only modest inflation. Others blamed the defense spending of the Vietnam War, but defense expenditures were actually lower as a percentage of gross national product than they were in the non-inflationary 1950s. Today it is widely agreed that the inflation is a direct result of the monetary policies of the Federal Reserve. The money supply can only grow if the Fed lets it.
Why then did the Fed adopt inflationary monetary policy? If it were in the agency’s or governors’ self-interest, then we would expect to have seen many more inflationary periods than we have seen since the birth of the Fed. Thomas Mayer (1998) argues it was another misguided discourse, popular among economists at the time, that influenced the Fed to adopt a more inflationary monetary policy. He found that economists were more concerned about unemployment and the stagnancy of the economy than they were about inflation. They believed that the economy was being dominated by what was called “cost-push inflation.” This was inflation caused by the wage setting power of strong unions and the price setting power of large corporations that passed along increased costs to maintain profits. These were considered structural causes beyond the reach of monetary policy. At the same time, policy makers also believed that they could obtain lower levels of unemployment by making more money available. Their bias toward lower levels of unemployment led them to increase the availability of money and credit, allowing inflation to grow. Mayer shows that a significant number of Board members, especially Chairman Arthur Burns, shared these views.

Stagflation: Confusion and Conflict at the Fed

The 1970s were a period of confusion and conflict in economic policy at the Fed and in the United States, more broadly. Concern with the rising rate of inflation was accompanied by stagnating growth, high unemployment, and a severe recession in 1974-1975. “Stagflation” was coined to describe the seemingly contradictory situation that was not predicted by the dominant Keynesian perspective. In 1977, the Joint Economic
Committee of Congress issued a stinging report blaming the Fed for the depth of the recession and for obstructing recovery (Cowan 1977). Senator William Proxmire, in a dissent from the Committee majority wrote, “Personally, I would be somewhat more humble than the report is in its relative certitude that there is an answer to the present problem of both excessively high unemployment and excessively high inflation. Economists may not know the answer to stagflation. Perhaps there is no answer” (Cowan 1977: 51).

This confusion and conflict outside the Fed were matched by confusion and conflict inside it. The Fed’s efforts to control inflation were being blamed for the slow recovery from the recession, but as the decade continued inflation would not abate. The typical recovery after a recession did not occur. The economy continued to stagnate. By 1978-1979, members of the FOMC, especially the Chairman of the Fed, G. William Miller, were openly admitting their confusion.

MR. MORRIS: Mr. Chairman, I don’t think we understand what is really going on in the economy.

CHAIRMAN MILLER: I’ll go along with that.

MR. MORRIS: I think it’s because we haven’t had enough experience judging the reaction of both the consumer and the investor to an economy with a high rate of inflation.

CHAIRMAN MILLER: That’s right; we haven’t had any experience. (FOMC December 1978:11).

MR. SMOOT. Yesterday in meeting with my own staff on this, I think I suffered an information overload. One of the alternatives that was presented to me was called "the pure ignorance theory" That is, we don't know how the economy got here and we don't know where it's going. And I must say that I felt embarrassingly comfortable with that view. Nevertheless—
CHAIRMAN MILLER. That is the most honest comment we've had today! (FOMC April 1979: 12)

In the midst of efforts to control inflation, some members began to fear the onset of another recession. Toward the end of 1978, private sector forecasters began predicting recession. The Committee’s focus on the rising inflation had kept them raising interest rates to tighten the money supply. Over the course of 1979 more members and regional bank staffs changed their forecasts. As a result, some members began to advocate for easing policy, i.e. lowering interest rates.

MS. TEETERS. Well, gentlemen, there's a reason why the econometric models are predicting a recession. They're based on history. And these are conditions in the past that have always produced a recession. Only twice, in the latter part of 1963 and in the latter half of 1966, did we ever have growth this low without having a recession. You are all sounding like the final quarter before the downturn, quite frankly. I think we should take more account of the commercial projections because the econometric models are summaries of past history and there's good reason why they've turned this way. (FOMC Nov 1978:12)

MR. MORRIS: If it's our objective to avoid a recession, I think we have to move today; I don't think we can wait for another month. One thing I've found around this table is that one can always make an impressive case for waiting for another month. But the evidence suggests to me that the time to move is now. I think the issue is whether we seriously are concerned about avoiding a recession or not (FOMC MARCH 1979:21).

MR. MCINTOSH. Our own view is that we are heading toward a recession later this year, and that view is shared by most other forecasts. We think the choice is between easing or staying pat. Historically the Federal Reserve has had a tendency to overstay its policy at peaks and troughs, and it’s our fear that we're about to repeat that performance. Therefore, we would argue in favor of a modest move in the direction of ease at this time in the interest of moderating the impact of the recession that we're expecting. (FOMC APRIL 1979 p. 17)

By the August and September 1979 meetings, as the members increasingly feared a recession, the confusion turned to conflict. Most members assumed that the economy
had already entered a recession, but they were divided on whether to increase the supply of money (ease), as they normally would in a recession, or to tighten it to prevent the inflation from getting any further out of control. Many held that it was time to ease their policy.

MR. RICE. Mr. Chairman, probably not surprisingly, I would associate myself with the remarks made by Dave Eastburn, Nancy Teeters, Frank Morris, and Chuck Partee. I can therefore be very brief. I think it's time to give more weight to what is happening in the real economy. The economy is clearly weakening; the staff analysis is very clear on this. It's really very hard to see where the strength in the economy is that some people are worrying about. Most of the indicators seem to me to point toward weakness and further weakening in the economy (FOMC SEPTEMBER 1979: 28).

Other members felt just as strongly that inflation was the bigger problem and that easing would exacerbate that problem. In 1978, continued tightening was the expected policy, but over the course of 1979, this position became less clear and more conflicted. As the fall of 1979 approached, inflation and inflation psychology, i.e. the fear of uncontrolled inflation, increasingly appeared to be getting out of hand.

MR. MAYO. … I, therefore, find it even more difficult than usual, as I guess Ernie mentioned as well, to try to interpret this for policy. Yet I think we have no alternative on the psychological side but to maintain our resolve in keeping restraint in place even at the chance that we’re going to be accused of causing any recession anyway at this point. I don’t say that in a defeatist attitude, but I think we still have to edge rates up just a little tighter partly because it’s expected of us in the whole aura here of worrying about what to do about inflation. We are the last bastion in the eyes of a great many people and I think it would be a mistake just to hold still right now. (FOMC DECEMBER 1978: 15)

MR. RANKIN. Mr. Chairman, our concern is oriented more toward the inflationary picture than the apparent increasing recessionary tendencies that we see. It seems to us that the markets both here and abroad will no doubt be watching carefully to see whether our recession fears will wear down our
determination to do something about inflation. Our position here at the Richmond Bank is that we should continue to give a high priority to the inflation problems; even though the economy may be moving into a recession, we think it’s important to hold a tight rein on the aggregates at this time (FOMC JUNE 1979: 6).

MR. TIMLEN. I don't think I will comment in depth on all the areas you touched on, but certainly foremost in my mind are the level of inflation, the strong growth in the aggregates, and the tentative position of the dollar in the foreign exchange markets. Sure, we have to be concerned about the prospect of a recession and high unemployment, but now is a time when psychology is a very important factor. I think the perception of the Federal Reserve's resolve may be at issue and I believe it's timely to give an indication of the direction in which we may be going. It's my judgment that there should be a continuing gradual process of tightening and we should adjust to developments over time as they occur. (FOMC AUGUST 1979: 26)

The most consistent advocate for strong anti-inflationary policy was the Vice-chairman of the Committee, Paul Volcker. He wanted the FOMC to continue its tightening of the money supply. As the year progressed, he continued to state his belief that easing would be a mistake. In August of 1979, President Cater appointed Volcker to be Chairman of the Fed. His appointment was widely supported by the business community in the expectation that he would be more aggressive in dealing with inflation than the two previous chairmen, Arthur Burns and G. William Miller. At his first meeting as Chairman of the Fed in August 1979, he was very explicit about his doubts about easing and his deep concern about inflation.

VICE CHAIRMAN VOLCKER. Well, I guess I come out slightly differently than you do, Mr. Chairman. I really have one concern when I look ahead at the 4-week period until we meet again, and that is that we adequately back up the program that has already been announced. I think it has had a good effect internationally. I think it has had a good effect domestically in terms of—"breaking" the inflationary psychology is much too strong a word but I think it has at least shaken thinking of the inevitability of more inflation anyway. And everybody is looking to see whether we will carry through (FOMC November 1978: 22).
VICE CHAIRMAN VOLCKER. We may be one month closer to a recession than we were last month and I think we are late in tightening, but I still am of the view that some greater degree of restriction would be more appropriate than the reverse and more appropriate than standing still. (FOMC April 1979: 15-16)

CHAIRMAN VOLCKER. When I look at the past year or two I am impressed myself by an intangible: the degree to which inflationary psychology has really changed. It's not that we didn't have it before, but I think people are acting on that expectation of continued high inflation much more firmly than they used to. That's important to us because it does produce, potentially and actually, paradoxical reactions to policy. Put those two things together and I think we are in something of a box—a box that says that the ordinary response one expects to easing actions may not work, although there would be differences of judgment on that. They won't work if they're interpreted as inflationary; and much of the stimulus will come out in prices rather than activity (FOMC August 1979: 20).

OCTOBER 1979: THE FED FIGHTS INFLATION

Although the Fed had been raising interest rates gradually since mid 1977, it had little of the intended effect. The rate of inflation continued to rise. Despite unusually rapid growth in measures of the supply of money during the summer of 1979, this gradualism had continued at the September 18, 1979 meeting of the FOMC. The divided votes at that meeting signaled that Chairman Volcker might have trouble creating the anti-inflation policy that the banks and financial markets were expecting. As a result, inflationary expectations increased considerably. Prices in the silver, gold, and other commodities markets rose dramatically. This set the stage for the policy change introduced and voted on at the next meeting.

The October 6th 1979 meeting of the FOMC was a rare unscheduled Saturday gathering of the members. Chairman Volcker called the meeting to discuss his proposal for a dramatic change in the operating procedure. In this proposal, the Fed would change
the target of its major regulatory tool, open market operations, from a short term interest rate known as the Fed funds rate, to a measure of the non-borrowed reserves held by banks. The change offered and signaled a more direct control over the supply of money and a heightened commitment to reduce inflation. Chairman Volcker was determined to see action taken at this meeting because of the agitated state of financial markets. In an unusual departure from custom, the chairman lobbied the governors for their support in their offices before the meeting (Greider 1987). The regional bank presidents only received a summary of the proposed change the day before the meeting. In most scheduled meetings, the chair moderates the policy discussion and identifies a consensus position. In this meeting Volcker defined two possible outcomes for the meeting almost from its beginning.

CHAIRMAN VOLCKER. Now, when it comes to our action here, I think there are broadly two possibilities. One is taking measures of what might be thought of as the traditional type. That would include a discount rate move and so far as this Committee is concerned a significant increase in the federal funds rate—The other possibility is a change in the emphasis of our operations as outlined in the memorandum that was distributed, which I hope you've all had a chance to read. That involves managing Desk operations from week to week essentially, with a greater effort to bring about a reserve path that will in turn achieve a money supply target (FOMC October 1979: 6).

A lively discussion lasting the better part of the day resulted in the ratification of the latter option. This discussion will be used to explore the nature of technical rationality at the Fed more closely.

The Dialectic of Technical Rationality
Technical rationality is generally focused on some relatively complex and uncertain object of knowledge. In the case before us, the technical experts are predominantly focused on a locally recognized set of statistical indicators and predictive models. These objects of knowledge are so well institutionalized that their importance is often taken for granted. Yet, these objects of knowledge are variable, their measures uncertain, and their relationship to other objects of knowledge understood to be changeable. In periods of high market volatility, the synthesis of expert judgment and technical discourse can be contentious, confused, and exploratory. Nevertheless, the demands of an environment laden with expectations require that the experts offer interpretations, take action, and maintain credibility. The result is interpretive techniques that legitimate and objectify the interpretation. This objectification is reproduced by Fed-watchers on Wall Street and in the financial media. More importantly, economic actors, nationally and internationally, make consumption, production, and investment decisions based on it.

In the application of technical rationality, the object of knowledge is a means of controlling a desired outcome. Thus, technical rationality often has a proximate object of knowledge and a more remote object of knowledge. The former is chosen for its immediate efficacy in having an influence on the latter less accessible goal. In the case of the Fed, the proximate object of knowledge is a target over which the Fed has some direct control and the remote object is the supply of money and credit in the United States.

MR. BLACK. I often think of our position as being analogous to that of a monopolist in the sense that we control the money supply. A monopolist has a choice of controlling either price or quantity but he can never control both. I believe we’ve been trying to control the quantity of money by setting the price and we have misjudged. We’ve jiggled the price, in terms of the federal funds rate, one way or the other, and we’ve usually met with less than complete success
Mr. Black uses the discourse of economics to frame the means of control in terms of price and quantity. The Fed had been using the price of money (interest rates) as the proximate means of control. The alternative means is to more directly influence the quantity of money. The remote object of control, the money supply, is elusive as it is ultimately a function of the market and market psychology. The effectiveness of Fed announcements and policy is dependent on a multiplier effect generated by the extension of credit by banks for the expansion or contraction of the money supply. This means that the Fed is not only concerned with the target, but with shaping the expectations of banks and potential borrowers. In October 1979, the Fed feared that inflationary psychology was spinning the markets out of control and with it the Fed’s ability to control expectations.

CHAIRMAN VOLCKER. We wouldn’t be here today if we didn’t have a problem with the state of the markets, whether international or domestic. They were pretty feverish last week—or beginning in the previous week, really. And the phone calls have begun to escalate, reflecting a kind of extreme nervousness in all directions. I think the rumors that were floating around in the market yesterday—first that I had resigned and then that I had died and then that I was mad at Governor Schultz—are symptomatic of the state of the market. Market participants are living with fragile expectations and inspired rumor and all the rest from day to day. I do think that the psychology in that sense is ready to crack open, depending upon what decisions they see coming out of here or elsewhere in a very short-term time horizon (FOMC October 1979:22).

It is under such conditions, where the object of knowledge is “open, question-generating and complex” (Knorr-Cetina 2001:181), that expert judgment is most in demand, dominating in its dialectic with technical discourse. Routine techniques are called into question. In the quote below, Mr. Partee expresses skepticism about the Fed’s
current interest rate targeting and the Committees’ ability to operate it successfully. The
relatively routine interaction of expert judgment and the operating model is no longer
trusted or credible.

Mr. Partee. (I)t seems to me that our traditional method, which is to
estimate the short-term market rates that will adjust the demand functions for
various kinds of money on a lag structure, has inherent in it the danger that we are
going to miss. Either we will miss an intensification in the demand for money and
be behind the gun, as we have tended to be here over the last six months, or we
will miss a decline in the demand for money and overstay and be behind the gun,
as we traditionally have done going into recessions. It's an extremely dangerous,
risky proposition to change our operating mode. But even though it is extremely
risky, I think it's the less risky course than to stay with our traditional system
(FOMC October 1979:14).

Mr. Partee doubts that they have the knowledge and skill, i.e. the expert judgment,
to hit their target. But such doubts must be overcome if policy making is to proceed. In
arguing for reserve targeting, Volcker seeks to convince the members of the FOMC that
the new object of knowledge can be operated successfully, and that expert judgment will
be adequate to the task. He attempts to reassure them that their judgment will be
effectively fine-tuned as the context merits.

CHAIRMAN VOLCKER. (I)nherent in the situation today, and I’ll just put it
very simply, the Committee has to have faith that it can give some general
guidance and that we--basically the staff here at the Board under Mr. Axilrod’s
direction--will translate that as best they can, within these general parameters, into
operational numbers. And then, it has to have faith that Mr. Sternlight will use his
best judgment in taking the figures that are produced here in Washington and
deciding on precisely which day he will provide how many reserves to the
market (FOMC October 1979:41).

The discussion of the Committee suggests that there is agreement that they are in
a situation that the prior discourse, “the traditional method”, cannot dictate. The old
operating model has failed and creative action is necessary. But they do not really blame
their judgment. It is the discourse or traditional method that has failed. In fact, in
thinking about reserve targeting they don’t even consider the formal monetarist approach
of rigid targets that would “perform” the money supply. Rather, they are protective of their prerogative to fit models to context, thereby maintaining their discretion. As the dialectic between judgment and discourse yields a consensus around reserve targeting, interpretive techniques are offered to rationalize the choice and to signal its logic to external audiences.

Interpretive Techniques

Interpretive techniques reflect the fact that technical rationality is not practiced in a vacuum. Not only are the actions of the FOMC highly consequential, they will be closely examined and provide the basis for considerable economic activity. The interpretive techniques at the FOMC respond to the question “How do we justify and explain this action?” The products of these techniques are crafted narratives using the elements of judgment and discourse. In this sense, they are retrospective explanations of a choice that has been made. These explanations may reflect efforts to construct an internal consensus within the policy-making group or efforts to communicate credible and trustworthy intentions to the external audience. In the October 1979 meeting, Chairman Volcker made it clear, by calling a Saturday meeting, that markets were sufficiently unsettled that strong action was needed. He effectively employed his agenda-setting authority. But it remained for the Committee to rally around this assertion of authority, rejecting the old discourse and anointing the new. Much of the discussion in the Committee involves validation and rationalization of this choice. The results of the interpretive techniques are a consensus narrative for rationalizing the outcome.
Rationalizing techniques attempt to link favored actions with ultimate goals. They reflect the efforts of experts to justify an ambiguous choice. Members of the FOMC explain their support for their choice in the pragmatic language of consequences, carefully disclaiming any conviction about either the old or the new model’s general validity. What is important is the ability of the model to justify the favored action. In an earlier quote Chairman Volcker referred to the markets as “feverish, nervous, and ready to crack.” The goal of policy making is strong action to alleviate these symptoms. But as Volcker explains, the remedy involves risky choices. The Committee is forced to choose between fighting inflation and resisting a slide into recession.

Chairman Volcker. … (W)e’re dealing with a situation where that’s an imminent danger on the one side as is the possibility of a recession on the other side. Mr. Schultz had an apt description the other day of where we are--and I certainly share the feeling--in saying that Scylla and Charybdis have now come together. There is clearly no risk-free course for us here; there are risks on both sides. The idea that we can absolutely thread the needle between the risks is probably a nice hope but it may be an illusion. At this stage you’ve got to place your bets one way or the other and move. I certainly conclude from all of this that we can’t walk away today without a program that is strong in fact and perceived as strong in terms of dealing with the situation. (FOMC October 1979:5)

Despite the dilemma, strong action is needed that will be perceived as forceful by market participants. Changing the operating mode, although risky, is justified in that it allows stronger restraint of the money supply. Governor Wallich is one of several members of the Committee that rationalize this choice based on the belief that it will allow the most vigorous anti-inflation action. “I think the main argument in favor of the reserve strategy is that it allows us to take stronger action than we probably could by the other technique. We are much more constrained in the other technique by the appearance
of very high interest rates. In the new strategy interest rates become almost a by-product of a more forceful pursuit of the aggregates” (FOMC October 1979:19).

The logic of such rationalization is intended only for the local audience of policy makers on the FOMC. Mr. Wallich is telling his colleagues that the new strategy will allow them to raise interest rates without really appearing to do it, thereby bringing down inflation faster at the cost of a worse recession. They will literally use the discourse of the new strategy to disguise their intent. So although they have the legitimate power to raise interest rates, they will use a new method that allows them to offer a less politically fraught interpretation. They are manipulating the discourse to achieve a valued goal.

In this context, rationalizing techniques involve an effort to explain a policy’s efficacy. The primary mechanism of efficacy is persuasion that establishes legitimacy. Interpretive techniques are intended to change how people think about what is true and important. In the following quotes, members emphasize that their policy choice must redefine expectations thereby cooling the inflation fears that have resulted in a speculative mania in commodities. As Chairman Volcker and Mr. Rice explain, their traditional method of raising interest rates seems to have exhausted its ability to tame those fears.

Chairman Volcker. I must say that the thought of changing our method of operations germinated--in my mind at least--before the market psychology or nervousness reached the extreme stage it reached over the past week or so. My feeling was that by putting even more emphasis on meeting the money supply targets and changing operating techniques in order to do so and thereby changing psychology a bit, we might actually get more bang for the buck…. the traditional method of making small moves has in some sense, though not completely, run out of psychological gas (FOMC October 1979:8).

MR. RICE. First of all, the psychological impact of a change in operating technique will be strong. … The good thing about moving to this operating technique is that … we introduce new uncertainty into the market. I think that’s a
good thing. The new uncertainty will have the effect of cooling some of the speculative activity and perhaps have an impact on those demands for credit that are based purely on inflationary expectations and on the assumption that money will always be available at any level of interest rates that the Fed tries to establish (FOMC October 1979:22).

As Mr. Rice suggests, Wall Street and, in particular, the banks, had to be convinced that the Fed was serious about controlling inflation and that it might raise rates to a place where banks would stop offering credit. Only this sort of change in operating technique would put an end to the credit expansion by banks that was funding the speculative mania. With this set of rationalizations, the Fed began a sustained assault on inflation and an unprecedented display of power.

*Signaling Techniques* reflect actor’s efforts to shape the meaning of the object of interpretation for public consumption. The message communicated by the signal conveys the organization’s interpretations and intentions. The object of interpretation is often a numerical target, an institutionalized indicator of performance that is well known to the organization’s audience. The use of such targets in signaling calls for skill and experience similar to those employed earlier in expert judgment. Signaling has both routine and creative aspects. In stable periods, the signal reinforces prior messages about the organization’s intentions. Under conditions of uncertainty, the object of interpretation, i.e. the target, is often used to probe the environment as a guide to further action (Shotter 1993). Signaling elicits reactions that provide the critical information for further action. This sort of technique seeks to “capture” its object of knowledge in the sense that it tries to shape and control it, taking advantage of the information asymmetry between the organization and its audience to construct the definition of extant conditions.
Once the FOMC has a consensus narrative of causes and consequences, it moves on to a calculation of how to signal that interpretation to the markets so that buying or selling in the market is consistent with the group’s intentions, thereby leading the economy in the desired direction. Given the multiple possibilities of (mis)interpretation, members try to carefully craft that signal. They discuss what words to use and what values to convey. There is also an issue of how much of this thinking to reveal. They want to confirm their commitment to a dominant value without revealing more about their thinking than necessary. In this instance, moving to a new operating model, the members want to get, as Chairman Volcker put it, maximum “bang for the buck.” In the quotes below several members advocate a tactic of calculated transparency in which they explain how the new operating model will get the money supply under control.

MR. TIMLEN. I'd say it is very important that the announcement connect this new technique with an effort to control the rapid growth in the money supply. The total package must not be perceived, as some have been in the past, as a flash in the pan. I'm not sure how well this will be understood. As a result, I would endorse those people who have strongly recommended that we have an in-depth explanation of this technique and its relationship to coping with the aggregates growth (FOMC October 1979:19).

CHAIRMAN VOLCKER. I will just give you my interpretation of a non-mechanical application, as I put it from the beginning, of the new technique. The difference isn't all that dramatic. There will be more emphasis on the new technique in the press announcement because it will be, in effect, a warning that the federal funds rate is going to be permitted to fluctuate over a wider range. Of course, we can say that in either announcement, but it will be said a little more strongly with the announcement of the new operating method.

MR. SCHULTZ. I think we are going to get a bigger psychological impact than you think we're going to get.

MR. BLACK. I do, too (FOMC October 1979:51)

Both Mr. Timlen and Chairman Volcker put emphasis on communicating the Committee’s intention to control the growth in the money supply. It is a signal that is
intended to shift perception and ultimately change the inflationary psychology in the market. This response suggests that the Committee’s announcement be somewhat less obscure than is customary. By the end of the meeting, there is consensus that the announcement of the new operating model will involve more explanation than is usual. Members seem confident that the calculated transparency will yield the desired effects.

This tactic of calculated transparency is somewhat ironic in this instance given that it is accompanied by a simultaneous tactic of strategic misdirection. *Strategic misdirection* refers to a signaling technique in which elites temper the signal so that it directs audience attention away from something that is controversial. In its weak form, such a strategy is merely obscuring, in its strong form it’s misleading. The purpose is to make the organization’s intended action seem ordinary, even natural. Organizations employ misdirection when they feel compelled to take actions that may be unpopular or too revealing. In our case, the Fed, concerned with being seen as intensifying the risks of a steep recession, is not prepared to publicize this consequence of the policy. The members employ strategic misdirection to craft a signal that will provide cover for the organization.

In the earlier quote from Mr. Wallich we saw that a major argument for adopting the new policy was that it allowed stronger action against inflation. The reason that the new operating model allows stronger action is that it disguises the Committee’s efforts to raise interest rates, which is politically unpopular. In the following quote Mr. Mayo goes so far as to suggest leaving out any mention of the Fed funds rate target from the signal, thereby allowing the inference by observers that rising rates were market–driven. “We could decide--to use an extreme example--
that we don't want to say anything about a federal funds range in the directive today, but keep to ourselves the idea that the (trading) Desk should have plenty of leeway. If the market dictates-- in the way it responds to what we're doing--that the federal funds rate should go temporarily to 15 percent, we'd let it go. I wouldn't worry about that” (FOMC October 1979:17).

The effectiveness of strategic misdirection is dependent on the knowledge and technical skills of the audience. The members of the FOMC are well aware that their arcane discourse is opaque to most of the audience. The Fed’s pronouncements are famously obscure. Mr. Black points out the ongoing advantage of the new method in that very few of the Fed’s stakeholders would be able to infer information about interest rate intentions from announced reserve targets. “If we were to announce on the day of the meeting what in fact the federal funds band was, I think we could have some very disquieting effects in the market, whereas the announcement of a change in our money supply target would not really tell the market a great deal. Only the most sophisticated or lucky would be able to figure out the interest rate implications of that” (FOMC October 1979:24).

The final vote was unanimous (12-0). The announcement received widespread media attention and general approval in the business press. Many journalists interpreted the new procedures as an acceptance of monetarism, an alternative theory of monetary policy most associated with Milton Friedman. But Friedman himself was skeptical that it was anything more than what it was: an alternative means to raise interest rates (Friedman 1979). The new operating procedures produced highly volatile markets, but
Discussion: Technical Rationality and Interpretive Power

“The substance of domination is not dissolved by technical control. To the contrary, the former can simply hide behind the latter (Habermas 1968: 61).”

This paper suggests that technical rationality at the Fed is not a neutral form of action, but rather a tool whose use has significant political implications. This relatively unobtrusive form of power became increasingly important as control moved from the market to bureaucracies and ultimately to the technical elite on the FOMC. By October 1979 that technical elite was capable of engineering a major policy change designed to elicit a dramatic shift, if not reversal, in market psychology. What was explained in the press as a shift in economic theory was really a shift in policy emphasis from a concern with unemployment to inflation and a willingness to tolerate very high interest rates in order to crush inflation.

In the dialectic of technical rationality, both expert judgment and technical discourse have political implications. It is expert judgment that assesses the relative risks of one policy over another and places values on the outcomes. At the same time, technical discourses carry within them the competing interests of various stakeholders. In October 1979, expert judgment seems to have dominated technical discourse. Chairman Volcker’s willingness to lead the Fed into stronger and perhaps riskier action than it has ever taken, action that would surely deepen the recession that was coming, reflected a choice that the risk of higher inflation was greater than the risk of deepening recession. It
is a political judgment call, not a scientific one, as to who in an economy should bear the risk and for how long.

As effective as this application of technical rationality ultimately was, our analysis suggests limits to its efficacy and to the rationalization of technical control. The limits include uncertainty, politics, and unintended consequences. *Uncertainty* is inherent in the application of economic models to understanding and predicting the behavior of the money supply. As Davies and Green (2010:25), two British central bankers, recently explained. “The absence of empirical certainty of relationships over any extended period means that the conduct of monetary policy can only be the continual exercise of judgment. It is inevitably based on incomplete and imperfect information and can never be an exact science.” The following statements by Mr. Coldwell and Mr. Guffey suggest that sense of uncertainty and its associated costs.

MR. COLDWELL. The risks are large, of course, and primarily on the side that whatever recessionary tendencies are already there might be compounded, creating a greater decline. ... I think the risks are equally strong on the other side in that if we don’t put out something fully credible, we face a potential blow-up via a speculative move in the metals commodities that spreads out from there—in effect a flight from dollars (FOMC October 1979:12).

MR. GUFFEY. For us to move to a new technique that has never been tried will be viewed by the markets, it seems to me, as our grasping at the last straw, so to speak. And if indeed it doesn't work to get the aggregates in better position by the end of this year I think we would have shot our last round and missed. I think that's putting the Federal Reserve as a system in a very, very precarious position... If we can get the public reaction that we're trying to get by operating with our present procedures, I would prefer to go that route rather than go into something that we know very little about (FOMC October 1979:18).
There is uncertainty in acting and there is uncertainty in not acting. But as a quasi-governmental agency with a mandate from Congress, the Fed is compelled to shift uncertainty to risk. Much of this risk is political. The “precarious position” mentioned above by Mr. Guffey refers to the legitimacy of the agency and its credibility as a manager of the money supply. The Fed’s efficacy is dependent on firms’, consumers’ and investors’ faith in its interpretations and the commitments they enact to its announced policy goals. The effectiveness of technical rationality is inherently tied to the Fed’s ability to maintain their reputation for credible action. The more a technical elite departs from routine action, the more it puts itself in this precarious position. It is therefore compelled to de-politicize its signals as much as possible, even to the point of misdirection.

Finally, we must directly address the issue that lies only slightly below the surface of this paper, i.e. the dangers of empowering a technical elite to make presumably apolitical decisions. Today, the Fed’s willingness to fight inflation in 1979 is remembered as its finest moment. It took decisive action that ended a decade of inflation. It is rare that government is capable of acting so decisively on an economic issue. Democracy often requires compromise and inhibits the kind of risk-taking in domestic policy discussed above. By empowering a technical elite to interpret the situation and promote that interpretation to the public, some of the sluggishness of democracy is sidestepped. In this case, expert judgment informed by technical discourse was both efficient and effective, though painful for those who bore the brunt of a double dip recession⁴.

But what of moments when the outcome is even less positive? Twenty years later, under chairman Alan Greenspan, the reputation of the Fed was even stronger. Its
The interpretation of financial bubbles in high tech and then real estate was instrumental in causing the greatest economic crisis since the Great Depression (Taylor 2009, Stiglitz 2010, Abolafia 2010). The danger is that proficient masters of spin become so confident in their technical discourse that the restraints of uncertainty and legitimacy are no longer sufficient to encourage prudent questioning of the current operating models. The result is that discourse dominates the dialectic of technical rationality and the pragmatism of expert judgment is neglected.

The dogma of efficient markets has been singularly successful in its capture of disciplinary authority. The threat is that the domination of any technical discourse inhibits the power of judgment to the point where the discourse is performing the policy rather than the experts operating a discourse. This can only occur when such discourse is allowed to become an isolated knowledge domain. In an era of technocratic control, technical rationality is increasingly ascendant, but this makes the responsibility and power of those who wield expert judgment that much greater.

Conclusion

This paper has explored the application of technical rationality to control of the money supply. It argues on the one hand, that developed economies, like the United States, have moved inexorably toward greater control of the money supply by technocrats. On the other hand, we are struck by the dangers of that technocratic control. A technical elite, with significant autonomy from oversight, has interpretive techniques of considerable power. In the end, the Fed’s performance in October 1979 can be seen as
a brilliant piece of political theatre. But, as in the recent financial crisis, the performance is not always going to be reviewed so admiringly.

1. Following Weber, technical rationality is defined as applying scientific knowledge to solve problems. I am indebted throughout this paper to Habermas’s (1968) close reading of this concept.
3. It is noteworthy that the Fed’s failure in the recent financial crisis has also led to a broadening of its powers.
4. The author was entering the job market at that moment and found his opportunities severely reduced.

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