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The Greenspan Rule

In a country with inflation so low it's almost gone, it is intriguing to see the Federal Reserve on red alert, with Chairman Greenspan madly signaling that the Fed in its meetings today and tomorrow may tighten money to ward off inflation. Leading inflation indicators have been mixed, with May's flat consumer price report canceling the April alarm. The best argument for a boost, maybe the only one, is that the Chairman wants it. In his 12 years as Chairman, Mr. Greenspan has logged a record solid enough that we're prone to bet he knows what he's doing. The question is, does the rest of the world know what Mr. Greenspan is doing? How, precisely, does he decide when and how much to ease or tighten money?

Having spent much time ourselves deciphering the speeches, acts and runic utterances of one of this nation's most successful Fed Chairmen, we figure Mr. Greenspan's technique goes roughly as follows: He fuels up on a few tons of data, checks such vital readings as the consumer price index, the price of gold, the stock and bond markets and the extent to which his countrymen are sounding irrational, exuberant, off on an unsustainable track, or whatever.

Then he flies by the seat of his pants.

This approach has worked for the economy, and is of course politically handy for Mr. Greenspan. It lets him make his own calculations, and the explanations of them let him throw bones to various constituencies. In particular, it spares him having to actually shut down such nonsense as the apparently endless discussion in some dusty quarters of the Fed over the Phillips Curve -- which wrongly preaches that high growth brings inflation. Growth is good for an economy. It creates wealth, not inflation. The job of the Fed is not to decide how much wealth the country should be allowed to create, but to keep the price level steady enough so it's easy to create all we can.

Mr. Greenspan himself made clear in testimony to the Congressional Joint Economic Committee last week that he doesn't think much of the Phillips Curve, or its sidekick notion, known as the non-accelerating inflation rate of unemployment, or NAIRU -- which in the spirit of further nonsense argues that it's bad for everyone who wants a job to actually have one (See related article: "The View From the Fed" -- WSJ June 29, 1999). The Phillips curve has "significant flaws," warned Mr. Greenspan, who also said that growth due to normal rises in employment and productivity should not be seen as "anything other than a plus." Yet the absence of a Phillips curve doesn't mean there are "no limits" to how fast employment can grow without raising a danger of inflation. The Phillips curve doesn't generally apply, that is, but does right now.

Well, OK, we guess. Our worry is that

once the 73-year-old Mr. Greenspan moves on, whoever succeeds him may prove less skilled at off-the-cuff navigation. Word is that Mr. Greenspan might agree to stay, if offered reappointment when his term expires in June 2000, with a Presidential election campaign in progress. But there's no guarantee he won't at some point, say in a Gore or Bradley Presidency, be replaced by a Fed Chairman without such sure instincts. Someone trying to imitate his methods might either actually unleash inflation or, alternatively, crash the economy by picking the wrong time to follow the Phillips curve.

With Mr. Greenspan still in the Fed's top chair, this would be a good time for the Fed to try to codify his technique. Some form of some clear rule for Fed decisions might not be more reliable than Mr. Greenspan's pantseat, but would have the virtue of letting the rest of us understand what the Fed is doing, and giving us a standard against which to measure future action. Most immediately, such a rule could provide enough certainty to help the bond markets avoid the convulsions that come with trying endlessly to second-guess the Chairman.

We know it's a tall order. The Fed's job is to keep the price level stable, and the challenge there starts with simply figuring how to measure whatever it is we call the price level. Any rule amounts to a grab for certainty, which can never be completely achieved in a fast-changing world. There is even a danger that the best of Mr. Greenspan may become outdated by changes in technology and the economy that no one can predict right now. But these dangers pale next to the worry that Mr. Greenspan's departure, whenever it comes, might leave us adrift.

In the long run a Greenspan rule could transform the talents of one man into a useful legacy for the future. Mr. Greenspan has presided over an era of bounty, in which the Fed looked mainly to steadying the money, and left the economy free to grow. That's a great way to navigate, and unless Mr. Greenspan plans to remain Fed Chairman forever, it's time he tried to share his map.