Federal Reserve Board Oral History Project

Interview with

Frederick H. Schultz

Former Vice Chairman, Board of Governors of the Federal Reserve System

Date: January 7, 2008, and January 8, 2008

Location: Jacksonville, Florida

Interviewers: David H. Small and Lynn Fox

Federal Reserve Board Oral History Project

In connection with the centennial anniversary of the Federal Reserve in 2013, the Board undertook an oral history project to collect personal recollections of a range of former Governors and senior staff members, including their background and education before working at the Board; important economic, monetary policy, and regulatory developments during their careers; and impressions of the institution's culture.

Following the interview, each participant was given the opportunity to edit and revise the transcript. In some cases, the Board staff also removed confidential FOMC and Board material in accordance with records retention and disposition schedules covering FOMC and Board records that were approved by the National Archives and Records Administration.

Note that the views of the participants and interviewers are their own and are not in any way approved or endorsed by the Board of Governors of the Federal Reserve System. Because the conversations are based on personal recollections, they may include misstatements and errors.

Contents

January 7, 2008 (First Day of Interview)

MR. SMALL. Today is Monday, January 7, 2008. This interview is part of the Oral History Project of the Board of Governors of the Federal Reserve System. I am David H. Small from the FOMC (Federal Open Market Committee) Secretariat in the Division of Monetary Affairs. I am joined by Lynn Fox, a senior adviser in the Office of the Staff Director of Management. We are interviewing Frederick H. Schultz, former Vice Chairman of the Fed. He served on the Board from July 27, 1979, to February 11, 1982. This interview is taking place in Jacksonville, Florida. Vice Chairman Schultz, thank you for agreeing to this interview.

MR. SCHULTZ. I'm delighted to do it. My years at the Fed were an important part of my life. I enjoyed those years, although they were difficult for me. I didn't have the kind of background that most Fed Governors have, but I became very attached to "Mother Fed" after three years.

Background

MR. SCHULTZ. I had a checkered career both before arriving at and after leaving the Fed. My academic career was not very distinguished. After Princeton, I went to the University of Florida law school. My father had been a lawyer and thought that was a good grounding for me, because I had no idea what I wanted to do. After about a year and a half, it was clear to me that I never wanted to practice law, so I left law school and went to work in the training department of Barnett Banks here in Jacksonville.

MR. SMALL. In what area of the law did you specialize?

MR. SCHULTZ. I never got to that point. The first year and a half of law school was just general grounding, starting with the procedural parts of the law. I found that fairly interesting. I was third in my class or something like that. But, as I said, I knew I didn't want to practice law, so I decided to leave. I went to work at Barnett Banks.

While I was at Barnett, I became good friends with the fellow who was in charge of the training department whose name was Andrew P. "Andy" Ireland. He was a little younger than I, because he had not gone to Korea. I had spent two years in the army before I went to law school. We decided that if we were going to ever do anything on our own in banking that we would try to work together.

After we both left the training department, he went to south Florida to become executive vice president of a bank down there. I joined my father in our family investment offices. While at Princeton, I had done a fair amount of investing in the stock market. I enjoyed that. I should've gotten an M.B.A. That would've suited me far better than law school. I did some venture capital investing.

A few years later, I got a call from Andy Ireland; he later became Congressman Andy Ireland (1983–93) and spent eight terms in the Congress.[1] He had found this little bank in central Florida that he thought was attractive, and he asked whether I was interested in going in with him. I said I was. We went to central Florida and spent a couple of weeks looking at the bank. We thought it was a good little bank—well positioned, very clean. So Andy decided that he would quit his job, move to Winter Haven, Florida, and run this little bank if we bought it. Andy put up most of the time, and I put up most of the money, although I was on the board and stayed pretty close to it. Andy was successful with the bank, and we started a couple of other little banks.

[1] Editor's note: Andrew Ireland represented Florida's 10th Congressional District from 1983 to 1992. He previously represented Florida's 8th Congressional District from 1977 to 1982.

In the meantime, I had become the youngest member of the board of directors of Barnett Banks. My father had been on the board, and I had gotten pretty active in civic affairs. At a very young age, I became chairman of the Downtown Council. Nobody else wanted it, and I was talked into doing it.

Then—I'd never been interested in politics—a friend of mine talked me into getting involved in the governor's race. After Ferris Bryant was elected in 1960, he appointed me to the Jacksonville Expressway Authority. We were in a growth period. While I was on the Expressway Board, we finished the designs on two bridges across the river. I was the secretary of the Expressway Authority. The chairman and I spent a lot of time in New York choosing an investment banking house. We sold something like $110 million worth of bonds. It doesn't sound like much now, but that was a fair amount in those days. We got started building a couple of those bridges.

It was at the end of that period when they asked me to be on the board of Barnett Banks. At age 30, I was the youngest member of the board. I decided that I really liked public service, ran for the legislature, and got elected. Guy W. Botts was the chairman of Barnett. He decided to put together a statewide banking organization. He needed somebody to run the banks while he was out making the acquisitions. He was impressed with my friend Andy Ireland.

So Guy came to us and said he'd like to buy our three little banks, because he wanted Andy to run Barnett Banks while he was out there making the acquisitions. He really wanted Andy, and he made us an offer we couldn't refuse. He apologized for the fact that he was going to have to give us stock because, in those days, cash was king and everybody wanted cash. I wanted stock because I didn't want to have to pay capital gains taxes. He made us this generous offer. Since I was the biggest stockholder in the three little banks, I ended up as the third largest individual stockholder in Barnett Banks of Florida. It was [laughter] a real financial coup. I'd had a couple other little successes in the venture capital business, but this was a home run.

When I went to the Federal Reserve Board, I had to sell all my bank stocks. I sold my stock for almost $20.00 a share. I think my cost was $.05 a share. After my father died, my net worth was a little less than $2.5 million. When we made the deal with Barnett 10 years later, my net worth was about 10 times that much. It jumped me up into a different level and enabled me to pursue a career in public service. It certainly made a big impact on my financial life when Barnett was later bought by NCNB—North Carolina National Bank.

MS. FOX. We're interested in your perspective on interstate banking and the deregulatory impulse in the banking industry.

MR. SCHULTZ. Sure. During the early period when I was on the board of Barnett, the effort was made to create a major banking institution in Florida. This was just before Guy Botts started his effort. Frank Norris at Barnett [former chairman], William "Billy" Dial [founder] at Sun Bank, Harry "Hood" Bassett at First National Bank Miami, and I can't remember the name of the guy in Tampa—they had reached an agreement to put everything together, but the OCC (Office of the Comptroller of the Currency) turned it down. That was the impetus for Guy to put something together just for Barnett, using that effort as the base. There were problems with the state laws in Florida that eventually were worked out, and we were able to put together the major holding company that became Barnett Banks during that time. There was the feeling that Florida was a growing state, and it was important to have a major banking institution that could meet the needs of a growing state rather than having to go to the money center banks for the financing to do a lot of the major deals that were going on. So there was a big push at that time to work hard to do something like that.

Anyway, I was going to tell the story that when NCNB bought us, my wife said, “If you hadn’t had to sell your Barnett stock when you went to the Fed, how many shares would you have?” I said, “About 850,000.” And she said, “Well, how much would that be worth today?” I said, “It would be worth between $63 [million] and $64 million.” She said, “Oh, my God.” I said, “Now honey, what would you do with all that money?” She said, “I can think of things.”

MS. FOX. It didn’t cost you at the time, but it cost you later, didn’t it?

MR. SCHULTZ. [Laughter] I’ve often been asked if I regret having to sell all of my Barnett stock and taking that huge financial hit. The answer is “no,” I don’t. I thoroughly enjoyed my time at the Federal Reserve. Public service has been important to me. When I was 16 years old, my mother asked me what I wanted to do, and I said I wanted to help other people. She never let me forget that.

When I was in the Florida legislature, things worked out well for me. I became speaker of the Florida House of Representatives after constitutional revision. I was the first speaker to preside over annual meetings. I led the reorganization of government as a whole in the state. I was in the legislature during the most interesting period in the history of this state and one of the most interesting periods in the history of any state. Then I went to the Fed at what I would contend is the most interesting period of the history of the Federal Reserve.

MS. FOX. Do you recall what was happening in the economy and in banking in those years before going to the Fed?

MR. SCHULTZ. While I was in the Florida legislature, it was not a difficult period. The inflationary problems were nowhere near what they were later on. You had President Richard M. Nixon and some of the problems he created. And, of course, there were some wage and price controls in that period, too. The general economic problems in the time that I was in the Florida legislature were nothing like the problems that we had to deal with in the 1970s. I was speaker in 1969 and 1970. I was presiding over annual sessions, and I was consumed with that. Then I ran for the U.S. Senate in 1970.

The main banking problems involved issues of statewide banking. There was a big battle that went on between the big banks and the little banks in the state. Eventually, the big banks won, and there was a law passed to allow statewide bank holding companies.

MS. FOX. Was Florida one of the first to do that?

MR. SCHULTZ. No, there were a lot of other states that had statewide banking. I don't know where Florida fits into the chronology.

My period as speaker was busy doing a lot of things. I think that when I was speaker, we passed the statewide banking law. I think that was the case, because I recall that was the only time that I had to replace somebody. One of the members said that under no circumstances would he ever vote for statewide banking. It was going to be impossible to get a fair, balanced, impartial hearing. And so I replaced him. That's the only time I ever replaced any member on any of the committees. So my recollection is that I was speaker at that time. But I didn't really get much involved with it. I kind of recused myself from that issue.

I had a successful period as speaker of the [Florida] House [of Representatives]. That thrust me in the limelight, and I ran for the U.S. Senate. I was the favorite early on, but then, as others began to enter the race, that split up my strength. For instance, I had the support of practically all the black leaders in the state. Then Alcee L. Hastings decided to jump in the race. He's currently in the U.S. House of Representatives. He's not a very admirable character, but some of my opponents put up the money for him to run. It became obvious that he was going to get the black vote in the first primary, and the first primary was the only place where I could've been beaten. In those days, the Democratic nominee won the general election. The only place I could've been beaten was in that first primary. Once I got the nomination, it would have been smooth sailing, but I lost by 13,000 votes out of over a million cast. Alcee Hastings got a little over 100,000 votes. We figured that at least 90,000 of those were mine. I was opposed to the war in Vietnam; I was a decorated veteran of the Korean War, so I could be against the war, whereas some of the other people didn't have the latitude that I had. One of the other guys felt that I wasn't strong enough in my opposition, so he jumped in the race. He got 40,000 votes. Again, I only lost by 13,000 votes. I lost the Senate seat to Lawton Chiles. He was the senior senator from Florida when I was nominated for the Board. When he introduced me to the Senate Banking Committee, he said, "But for 13,000 votes, Fred Schultz would be sitting where I am. I doubt that I would be sitting where he is," which I thought was a classy thing to say.

After the Senate race, I went to Harvard as a Kennedy fellow for one semester. I came back and became active in educational affairs. The governor [Reuben Askew, 1971–79] asked me, and I suggested to him that he appoint a commission to study education in Florida. When he decided to do so, he asked me to be chairman. I had promised my family that I would take them to Europe when my political career was over, not thinking that was going to happen. When I was defeated, I took my family to Europe. We were in Istanbul, Turkey, when I got a call from the governor telling me he was going to set up this commission and wanted me to be chairman. I said, "Of course, I'll accept," since it was my idea, and I was very interested in it. He said, "I want you to come right back and get started." I said, "Reuben, I'm in Istanbul, Turkey. I can't come back right now." He said, "Well, I'll tell you what I'll do. I'll give you veto power over all the members of the commission if you come back now." I said, "Reuben, that is an ugly thing to do. You know perfectly well I can't resist that"—having the ability to, in effect, appoint the commission that I wanted. So I came back. I spent about 50 percent of my time for two years working on a study on education in Florida. It worked out very successfully. We came out with 104 recommendations, 91 of which were passed by the legislature, which was remarkable.

Nomination to the Federal Reserve Board

MR. SCHULTZ. My interest and involvement in education led to my appointment to the Fed. After those two years working on the education study, the governor asked me to be chairman of the Democratic Party in Florida. At the same time, Guy Botts at Barnett asked me to be chairman of a new investment banking subsidiary that he was starting at Barnett. I put the issue to the vote of my family. They voted unanimously against my becoming the chairman of the Democratic Party of the state. The reason that Reuben wanted me to do it was because he wanted me to be elected to the Senate. There was going to be another seat coming up. He figured that if I were chairman of the party, after having run once, that it would be a walk-in for me, which may or may not have been true, but he was convinced it was.

So I accepted the job as chairman of this new investment banking subsidiary. During that time, James E. "Jimmy" Carter was elected President. I was active in his campaign. He then appointed me to the policymaking board for the National Institute of Education. After a couple of years doing that, the Congress and the President created the Department of Education. I was on a long list of people who were going to be considered to be the first Secretary of the Department of Education. At that time, Charles "Charlie" Kirbo was senior partner in the largest law firm in Atlanta, and he was Jimmy Carter's éminence grise. He vetted all the major appointments of the Carter Administration. He asked me to come to Atlanta and meet with him. We met for about 45 minutes; he was interviewing me for the spot as first Secretary of the Department of Education. Finally, he said, "Would you come to Washington for anything else?"

I said, “No, I don’t think so.” He said, “How about being on the Federal Reserve Board?” I said, “Well, I’d think about that.” This was on a Monday. On Wednesday, I got a call from G. William “Bill” Miller, who was Chairman of the Federal Reserve Board at that time. He said, “Would you come to Washington and have lunch with me and talk about the Federal Reserve?” I said, “Sure.” He said, “How about Friday?” I said, “Fine.” So I got on a plane to Washington. Bill Miller and I spent an hour and a half—maybe more—together, talking about the Fed. He was looking for a banker from the Atlanta District. He had tried the three biggest bankers in the District. They had all turned him down because they had big stockholdings in their banks, and it would have been a major financial blow to them.

MS. FOX. Did you know who those three were?

MR. SCHULTZ. They were Guy Botts; the guy at Wachovia; and Joel Wells, who headed Sun Trust in Atlanta. My memory is not what it used to be, by a long shot. But they were well-known, well-respected bankers. Each one of them turned the job down.

Bill Miller was looking for somebody who could be kind of an executive vice president, somebody who could be the operational head of the System. I’d had some management experience in various ways. Bill and I got along well. The whole thing had started on Monday with Kirbo. When we ended the lunch meeting on Friday, Bill said, “If we were to offer you the job at the Fed, would you accept?” I said, “I’d have to ask my wife.” He said, “When could you get back to me?” I said, “I’ll talk to my wife over the weekend. I’ll get back to you on Monday.” Nancy wasn’t crazy about the idea of my going to Washington. She’s very family oriented, and she felt we’d already made a lot of sacrifices. She said, as she has always, “If you really want to do it, it’s fine.” So I called Bill back and told him that I would accept. He said, “You need to get vetted by the Vice President and the Secretary of the Treasury. You have to come to Washington." I said, "Fine." He said, "When can you come?" I said, "When do you want me?" He said, "How about tomorrow?" I said, "Okay." So I got on a plane to Washington and met with Richard "Dick" Moe in the Vice President's office. I had a meeting with W. Michael "Mike" Blumenthal. I flew home that afternoon. The next day, Wednesday, I got a call from Bill Miller saying, "They've signed off on you, and your name has gone to the President." I relaxed. because I thought that was going to be the end of that foolishness for a while. On Friday I got a call saying the President has sent my name to the Senate. I said, "That's interesting. Are you going to have a press conference to announce this?" They said, "Yes." They were going to have a press conference on Monday at 1:00. Monday morning, I got a call from the White House saying that they were not only going to nominate me to be a Governor of the Fed, they were going to nominate me to be Vice Chairman. [Laughter]

So this was moving with blinding speed, but it slowed down very quickly after that, because William Proxmire was not at all happy. He was willing to confirm me as a Governor of the Fed, but he wanted Philip E. "Phil" Coldwell to be the Vice Chairman. Phil was very experienced and was, at that time, the most hawkish of all of the Board members. Proxmire was already concerned about inflation. He saw me as a political hack that, A, didn't know anything about monetary policy, and, B, wasn't going to be as firmly opposed to inflation as he felt that the nominee should be. At that time, I was a proponent of gradualism. I was becoming increasingly concerned about inflation but hadn't pushed the panic button. During my two years as head of Barnett Investment Services, I wrote a monthly economic letter. At Princeton, I had majored in economic history. At Harvard, I had audited a course in macroeconomics from Francis Michael Bator. I'd done a good deal of reading. So I had some background in economics and monetary policy, but nothing like most of the Board members had.

I had written these monthly letters, and at my confirmation hearing, they came back to haunt me, because Proxmire had gotten ahold of every one of them and had read them. He picked them to pieces and pulled out the things that he didn't like. My confirmation hearing was really something else. He had seven staffers behind him. They would pass him questions to ask me. I went through that for about two hours and finally said, "Senator, I'm willing to answer all the questions you may have, but I would very much appreciate it if you would listen to my answers." He hadn't listened to them at all. He just asked a question and reached back for another question. He wanted to make me look as bad on the record as he could. Fortunately, my briefing papers from the Fed were very good. They were long—about 500 pages—but they were very well done. I'd studied them hard. I was well prepared. He didn't make me look quite as bad as he wanted to make me look. My nomination had come in February 1979. Proxmire dragged his feet on scheduling the hearing. In the meantime, we were working hard to see where I stood with the various members of the Banking Committee.

MS. FOX. Who was helping you with that process?

MR. SCHULTZ. Donald J. "Don" Winn was helping work the committee. I don't know who was in charge of putting together briefing papers, but they did a good job. They were excellent, and I worked hard studying them. And, as I said, I had some experience and involvement in economics and monetary policy—not like the other members of the FOMC, but I did have some background.

MS. FOX. Did you feel that the White House was working hard for you as well?

MR. SCHULTZ. Yes, they did work hard for me.

MS. FOX. Did you have a special defender? Senator Chiles was supportive, of course.

MR. SCHULTZ. Yes, but he wasn't on the Banking Committee, so he didn't make any difference, really. Did I have a defender on the Banking Committee? No, not really. As we went on with the process, we kept getting a count of where the senators were. I went to see every one of them except Proxmire, who refused to see me.

Interestingly, I was more acceptable to the Republicans on the committee than the Democrats because of my background as a successful businessman and with Barnett Investments. Those things appealed more to the Republicans than to the Democrats. And some of the Democrats were opposed to the kinds of things—I was on the board of a lot of corporations, one of them being an insurance corporation. In addition to many other types of insurance, we sold the kind of insurance product that went to people when they died suddenly. The Democratic senator that most opposed me was Paul S. Sarbanes from Maryland. He didn't like that kind of insurance, so he blamed me for it. There were different people that opposed me for various different reasons. I was in real trouble early on. But the American Bankers Association was having its annual meeting at the Homestead resort. I went to Homestead, met with the bankers from the states that had senators on the Banking Committee, and answered their questions.

MS. FOX. Did they invite you to the meeting, or was that somebody's idea to help push the Congress along?

MR. SCHULTZ. It was Guy Bott's idea. Guy was very helpful to me. He contacted the bankers that were the heads of the ABA from different states. So he paved the way for me to do that. I had a good deal of success with that effort. Many of those bankers contacted their senators and said, "This guy looks okay to us, and we'd appreciate it if you could vote to nominate him."

So we were coming down to the wire. My recollection was, there were 22 members of the committee. And the vote for Vice Chairman, as best Don Winn could put it together the day before, was going to be 12 opposed and 10 in favor. But Guy continued to help. There were bankers that continued to make calls. And, lo and behold, on the next day, when the vote came, it had been reversed, and it was 12 in favor and 10 opposed. The vote for me as Governor was reasonably lopsided. But, again, Proxmire didn't like it; for a while, he put a hold on the Senate vote on my nomination. Finally, he agreed to let it come to a vote.

MS. FOX. Did you like that fight, or were you miserable going through it?

MR. SCHULTZ. It was a tough fight. I don't know that there was anything to like. The interviews with both Dick Moe and Mike Blumenthal were easy. They didn't attempt to elicit any promises from me on any subject; they just wanted to talk generally about my ideas. I've always been reasonably conservative on the economic side. I'm more of a social liberal but an economic conservative. They were not unhappy with me, nor did they ask for any commitments of any kind.

The confirmation process was not fun. I met with each one of the senators. Some of them would talk to me in general terms, quietly, to get to know more about me. Others were much more specific. Senator Alan Cranston, for instance, tended to be a liberal, and he was pushing me because he was not someone who, at that time, believed that we needed to tighten monetary policy. So he was trying to press me on issues. I made it quite clear that I'd be happy to talk in general terms, but I was not in any position to make commitments. All of the interviews went fine except the major hearing with Proxmire. That was rough. He was hitting me as hard as he could hit me on everything he could think of. He wanted to discredit me. He was opposed to me as Vice Chairman. He thought that it should have gone to Phil Coldwell. Phil was the most conservative member of the Board at that time.

When I left the Board, Proxmire took the floor of the Senate and started out by saying, “When Fred Schultz was nominated to the Board of the Federal Reserve, I opposed his nomination. I was wrong.” And he went on to talk about the fact that I had become Paul Volcker’s right-hand man, and that I had gone outside the Board and made so many talks and was kind of a chief communicator of what we were trying to do in a period when it was difficult.

People were under such pressure. I’d talk to homebuilders, automobile dealers, and other people that were really being hit hard. When I finished a talk, some guy would usually get up and say, “You dumb SOB. Do you really know what you’re doing?” It was easy to respond to those types of comments, but I remember once, when I spoke to the Automobile Dealers Association, an older man got up and said, “Mr. Vice Chairman, I want you to know I’ve been in the automobile business for more than 35 years. Next week I’m closing my doors.” It got very hard during that period of very high interest rates. The homebuilders sent us two-by-fours that filled up a huge room. It was rough, but my experience as speaker of the [Florida] House [of Representatives] and as a candidate for the United State Senate was very valuable to me at that time in talking to various groups about the problems and expressing our point of view.

The only time during that period that I ever had pressure from the White House was when, after we changed the operating procedures on “black Saturday,” or whatever you want to call it, I got a call from somebody at the White House who said, “What the hell do you think you’re doing?” I explained why I thought it was necessary, and why we felt that, if we didn’t take these stringent measures, things would only get worse, and we would have a much more difficult time. I said, “We just think it’s something we have to do.” And he said, “Well, you gotta do what you got to do.”

MS. FOX. Was this a domestic policy White House staff person or a political person?

MR. SCHULTZ. This was more of a political person that I knew well and who was very close to the President. So they’d asked my friend at the White House to give me a call.

I had understood Proxmire’s position perfectly. He didn’t know me from Adam’s off ox. And he was getting increasingly concerned about the situation, as we all were. By the time I got confirmed by the Senate, I was no longer a proponent of gradualism. It was clear that something had to be done.

I was confirmed on a Wednesday. I was sworn in on a Wednesday. On Friday, Bill Miller called to tell me he was going to be Secretary of the Treasury. I said, “Thanks a hell of a lot.” On Monday, the first Board meeting I ever attended, I had to chair. [Laughter] That was getting thrown in the pool in a hurry. At that point, things were really beginning to disintegrate. The most humbling experience of my life was when Miller called me to tell me he was going to be Secretary of the Treasury, and it was announced that was going to happen. Over the weekend, the rumor went around that I was going to be the next Chairman of the Federal Reserve. When the currency markets opened that Monday morning, the dollar dropped like a stone. Then it was announced early in the afternoon that Paul A. Volcker was going to be the Chairman, and the dollar shot right back up again. [Laughter] So it was very clear what the people in Europe thought about me.

Impressions of Chairman Miller

MR. SMALL. When talking with Chairman Miller before your nomination, did you get any insights into his views of the Board, his role, or how the Board should be run?

MR. SCHULTZ. Yes. One of the reasons he was so interested in having me on the Board was because he wanted to concentrate on monetary policy. He wanted me not only to be the Administrative Governor at the Board, but he wanted me to take a much greater role in bank activities. Because we were short-handed, I operated as chairman of the Bank Activities Committee as well as the Administrative Governor.

Miller was very interested in my management experience. I found that experience valuable in a number of different ways. In my meetings with the boards of the various Reserve Banks, I had credibility as a businessman that many of the Board members found interesting. I talked Paul Volcker into a three-day conference that we had with all of the Federal Reserve Banks where we set up various operational issues and had them write papers on various things. We got together and talked about those issues to see if there were ways that we could improve the operations.

I had gotten a little concerned about the coordination between the Board and the various Federal Reserve Banks. I used the model of a conference that I had done earlier, which dealt with the issues of coordination with the various parts of the Jacksonville community. It was much more successful than I'd anticipated, and I used that as a template for what I tried to do at the Federal Reserve. Paul was a little concerned about it in the early stages, but when we finished, he felt that it was valuable in creating more cooperation in a number of different areas with the different banks.

MR. SMALL. Bill Miller came to the Board having been a very successful businessman.

MR. SCHULTZ. Yes, Bill was a bright and able guy who worked hard. Stephen H. "Steve" Axilrod used to say that he was an extraordinarily smart guy and grasped monetary policy well for somebody with no real background. I was very fond of Bill Miller, but, in my opinion, he was a disaster as Chairman of the Fed.

MR. SMALL. On the monetary policy side?

MR. SCHULTZ. Yes, on the monetary policy side. He recognized his weakness in that area. That was one of the reasons he wanted to get me on the Board.

MR. SMALL. Perhaps it was not true, but a public perception of him was that, as Chairman, he stayed in the CEO (chief executive officer) mode.

MR. SCHULTZ. Yes. He was the CEO, and I was the COO (chief operating officer). He thought in business terms.

MR. SMALL. But he wanted to spend more time on monetary policy?

MR. SCHULTZ. Yes.

January 8, 2008 (Second Day of Interview)

Experiences in First Year at the Board, 1979

MR. SMALL. Let's talk about when you chaired your very first Board meeting on the Monday after you were sworn in.

MR. SCHULTZ. [Laughter] Yes. I was sworn in the previous Wednesday. Then, on Friday, Bill Miller told me he was going to be Secretary of the Treasury. I've forgotten the subject of the Board meeting, but it didn't take long. Right after the meeting, Axilrod came and said that they were meeting on the issue of what to do in the markets that day. I went down to the Board Room with him, and we were sitting there. A staff member turned to me and said, "Mr. Vice Chairman, our figures indicate the necessity of injecting $3 billion into the markets today. Do you approve?" I sat there and I thought—that's the first $3 billion decision I ever had to make [laughter]. That afternoon, the announcement was made that Volcker was going to be the Chairman, and things calmed down very quickly.

MR. SMALL. What was that weekend like? Were there a lot of phone calls about who the Chairman might be?

MR. SCHULTZ. From my point of view, it was pretty quiet. I gather that the markets were not very quiet, particularly in Europe. I don't think there was as much concern in this country, because I think everybody recognized that I was not going to be the next Chairman. But the Europeans didn't understand the situation anywhere near as well. They did not know me from Adam's off ox. I was a complete unknown to them. I don't know how the rumor got started, but the idea that I might be the next Chairman was very frightening to them. My recollection was, the dollar dropped three pfennig. I caused a lot of consternation in currency markets when they opened on Monday morning in Europe. I love to tell the story, because it certainly was the most humbling experience of my life.

MR. SMALL. Do you have any insights into why Volcker was chosen or insights into the process in the Carter Administration that led to him being the choice?

MR. SCHULTZ. I was told that Volcker was Miller's choice. Miller had been impressed with him as president of the Federal Reserve Bank of New York and as Vice Chairman of the FOMC.

MR. SMALL. But as Vice Chair, Volcker had dissented from Miller and wanted tighter policy.

MR. SCHULTZ. That's correct. But I think that was part of the reason why Miller recommended him. At that point, Miller recognized that things were not going well, and we needed a tighter policy. Things were in a pretty shaky state. I'm not certain, but I believe I heard that Mike Blumenthal also supported Volcker, and I have no reason to doubt it. I think he was still Secretary of the Treasury, although he was resigning and leaving. So they both recommended Paul, partly because they had the feeling that Paul would be acceptable to the markets. They felt that was important, at that time, because things were getting pretty dicey. There were people in the Carter Administration who didn't much like the idea of Volcker. He was too hawkish for a lot of them. Those who were heavily tuned politically were nervous about what Paul would do, and rightfully so. But, of course, that was exactly what needed to be done. We needed to have tighter policies. I don't really know anything more about that situation. I don't know who among Carter's advisers was concerned about Volcker, I just heard that there was concern. I don't know who might have been speaking out against him. Bill Miller himself had told me that he had recommended Paul. I'm not so sure about Mike Blumenthal, although I got to know him fairly well later on.

Some years later, Mike Blumenthal, Volcker, and I were all on the board of the Woodrow Wilson Center at Princeton. We were all three concerned that the Woodrow Wilson School was made up almost entirely of academicians and practically no former practitioners, so we had a meeting with the faculty. I put forth this objection, and one of the senior faculty members said he didn't understand the concern. He said, "If you bring in these practitioners, all they're going to do is tell stories." I said, "Hell, that's exactly what I want them to do." We finally prevailed. The faculty was expanded to include more practitioners. Anyway, I digress. Let's go back to the Fed.

MR. SMALL. You arrived at the Board in July 1979. The first couple [of] months, what was the sense of the place on the transition from Miller to Volcker and the state of the economy—whether the Fed was behind the curve in tightening?

MR. SCHULTZ. Nancy H. Teeters was the most liberal Board member. When I got there, I don't think she had a sense that we were behind the curve. But I think Governors Coldwell, Henry C. Wallich, and, later, J. Charles Partee were more concerned. Partee was not as concerned as Coldwell and Wallich. They were getting upset that we were behind the curve. Nancy Teeters felt we were okay and tight enough. Emmett J. Rice was also not too concerned early on. But things moved rapidly.

MR. SMALL. Inflation had already risen quite a bit at the time. If inflation had been stabilized at that higher level, would the Board have been comfortable?

MR. SCHULTZ. Wallich was dead set against inflation. He used to tell a story about going down to the local swimming pool in Germany with a big basket of currency. He would end the story by saying that he never thought that could happen in the United States. But during that period, he only used one "never." He was really getting upset, as was Phil Coldwell. They were very hawkish. When I first got there, I didn't have the same feeling of immediacy. It took me several weeks of watching this deterioration in the markets. Things were getting really chaotic. I became pretty hawkish after a few weeks. I think Chuck got that way, too, about the same time. Emmett Rice was a little slow to come around. Emmett was not a strong Board member. He was not forceful. So he had a tendency to go along with what the other members of the Board were saying and doing. Within a few weeks, he came around to thinking the problem was pretty serious. And, as I said, Nancy was the last. But I think when we got to the "Saturday night massacre," even Nancy was convinced we had real problems.

MR. SMALL. What was the sense amongst the Governors about how they'd gotten into this mess? Was it leadership at the Fed, political constraints, oil prices?

MR. SCHULTZ. Well, I think that they were happy that Miller was gone. I think they liked him as a person. Most everybody did. He was bright, charming, clearly an able guy. But he also was a guy with very little experience in monetary affairs. He'd been on the board of the Boston Fed, but he didn't have any hands-on experience. He probably had spent as much time following the Fed and watching what it did as I had when he became Chairman.

I don't get the feeling that they thought they were in trouble because of a deus ex machina. They were upset about the oil situation and various other things that happened, but I believe they felt that Miller should have been stronger in opposition to inflation. Certainly Coldwell and Wallich felt that way.

MR. SMALL. Let's explore the period before October 6, 1979, immediately before the change in operating procedures, when Volcker went to the IMF (International Monetary Fund) meetings in Belgrade. What inclinations about, or discussions with, Volcker did you have before that trip on what he felt, whether he was thinking about new operating procedures or, more generally, something dramatic?

MR. SCHULTZ. He had been thinking for some time that we might need to change procedures. He didn't discuss it much with me, but I know that he had considerable discussions with Axilrod. The staff had been working on printouts of various possible approaches. I remember seeing big stacks of printouts about various different approaches to monetary policy. So I know he was concerned.

The story was that he went to Belgrade, and the other central bankers of the world converged upon him and told him that he had to do something. And I'm sure they did. But he had been thinking about it for several weeks. He had been concerned for some time, so their complaints fell on fertile ground. He cut his trip short. I think he returned from Belgrade on the weekend. It was Monday, I think, when he came into my office and said that he was thinking about changing the operating procedures, going to nonborrowed reserves. I said, "Paul, you know more about monetary policy than I do. You know much more about what the effects of such policy are going to be. But the only thing that I can tell you is that I think we have to do something, and we have to do it soon." He looked at me, turned around, and walked out of the office. He knew he had my support in whatever he was going to do.

MR. SMALL. In Volcker's book *Changing Fortunes,* he talks about the trip to Europe. He traveled with the Secretary of Treasury, Bill Miller, and the chairman of the Council of Economic Advisers, Charles L. Schultze. They met with Helmut H.W. Schmidt [West German Chancellor, 1974–82]. Do you think that Volcker felt the need to clear the way politically, to gather support with the Administration by talking with Miller and Schultze to minimize any violent reaction to what he was thinking so that he could move quickly, or was this something that he was dead set on happening regardless? Did he express concerns to you about managing the larger political landscape?

MR. SCHULTZ. Not on that first day when he came in to see me. He did later on. Particularly after he called the meeting on Saturday, he discussed with me that there might be some rather extreme political fallout. So it was certainly something that he had in mind. Now, how much he discussed with Miller and Charlie Schultz on the plane going over, I have no idea. I never had a discussion with him about that. But he certainly was concerned about the political problems, because things were bad enough. And we were clearly going to make it worse on a short-term basis. Paul was always fairly politically sensitive. But he also was a person who, if he felt that something had to be done and it was the right thing to do, he had a great deal of courage of his convictions and the willingness to stand up to a lot of pressure.

MR. SMALL. Is it surprising that he didn't get more political pressure? Do you think he was successful at dealing with the political pressure, or that everyone knew it was such a pressing problem that they were glad they didn't have to do it in the Congress or the Administration?

MR. SCHULTZ. Yes, I think there was a lot of that. You pick up the paper every morning, and the situation had deteriorated. It was getting worse rapidly. So I think everybody recognized something had to be done. I don't think that most people recognized that when something was done, it was going to have such sharp effects.

I don't know that even those of us on the Board, when we voted on Saturday, were prepared for the intense reaction that came on Monday. We knew it was going to be a shock, and we knew people were going to be upset, but I don't think we recognized—we certainly never talked about it in our discussions on Saturday—that the funds rate might get to 20 [percent]. That surprised everybody. I think that even surprised Volcker. We knew it was going to be a lot of trouble. The Administration was kind of prepared for something. I think that when they accepted Volcker, they were nervous about making that appointment. When they made that appointment, I think they recognized that he was going to do some things that they wouldn't be all that happy about. So it wasn't quite the shock from their point of view that it might've been otherwise.

MR. SMALL. The transcript of the October 6, 1979, meeting reveals that the presentation Chairman Volcker made said that we can go one of two ways. We can stay with the current operating procedures and move the funds rate up, perhaps quite aggressively; we need to do something dramatic. The other dramatic way was the change in operating procedures. He had the Axilrod and Peter D. Sternlight analysis behind the new operating procedures. Going into that meeting, had he talked enough with Committee members that he had a good sense of how this would work out, or was it quite uncertain?

MR. SCHULTZ. I'm not sure. In my case, whatever Paul recommended, I was going to go along with, as I always did, but particularly in this case. I was still pretty wet behind the ears. I had no good sense of what the fallout might be other than that interest rates were going to go higher. Paul had pretty clearly indicated to me that he wanted to change operating procedures. I don't know what the conversations he had with the other Board members indicated. But my sense was that when we went into the Saturday meeting, most everybody, at least on the Board, was convinced we needed to change operating procedures and not just kick the funds rate up further. As far as the Reserve Bank presidents were concerned, this was a lot more of a shock to them. Paul had had discussions with the other Board members, but he hadn't had much in the way of discussions with the Bank presidents, because he wanted to keep it secret. So when he got them there, first place he told them it was going to be all day. He did what he always does. He led them along.

I always thought that Paul was masterful in his handling of the FOMC. I thought that was really impressive. And remember, I was someone who had a lot of experience dealing with committees, influencing committees, and bringing them along, both as chairman of committees and as speaker of the House [of Representatives] in Florida. This was a technique that I was familiar with and considered myself pretty good at. So I was really entranced by how Paul did it, because he really led them along. He didn't push or force anything in the early stages. In the latter stages, when you had to come down and make a decision, then he would be much more forceful.

You're aware of the fact you at first got to hear a report on the international situation and then the domestic situation and then the monetary situation. Then each FOMC member, including all the Bank presidents, would go around the room and comment on how they saw the situation. Paul would then get Axilrod, Anthony M. "Tony" Solomon, and me, and the four of us would go back in his office and we'd talk about what we'd heard and what needed to be done.[2] Paul would then talk about how he felt about things. He hadn't to this point said a word about what his feeling was. We would then discuss with him what his position was—trying to be helpful, pointing out some things or ideas. But by and large, Paul would already have his mind made up on what he felt about things and what he was going to propose. He did change the proposal a bit in response to our comments, but it generally wasn't very much.

[2] Editor's note: Anthony Solomon was president of the Federal Reserve Bank of New York and Vice Chairman of the FOMC.

He would then go back in the meeting, present his case, and make a recommendation. I always sat there in amazement at how well he was pulling everything together—how well he was giving everybody in the room an opportunity to feel that they were involved and a part of this. Then he would throw out a proposal, and we'd vote on it. Sometimes it would gain the number of votes we needed. He would, at least during the time I was there, never accept a proposal with less than 10 affirmative votes. If he didn't get 10 affirmative votes, he'd tweak it, twist it, and try something a little different. I'm a great admirer of him and his ability to do a lot of things as Chairman of the Fed. I thought his appearances before the Congress were masterful. And like Alan Greenspan, Volcker was a master of double-speak [laughter]. But I always felt that his performance as FOMC Chairman was the best thing he did.

Period following the Change in Operating Procedures

MR. SMALL. During the first couple of months immediately following the change in operating procedures, did the program seem to be a success? Some people point to long-term interest rates and say they didn't go down as much as the Fed had hoped. Was it a little tougher sledding than you had thought over those first couple of months?

MR. SCHULTZ. I think the general feeling was it was a little tougher sledding, because nobody realized the intensity of inflationary expectations. We didn't realize how bad they were and how long it was going to take to unseat them. I remember going out and making talks the last year I was on the Board—telling people that I thought inflation would get down below 6 percent in the 1990s. Of course, inflation got down there much faster than that, but at the time, I would almost get laughed off the podium. People were absolutely convinced that inflation was something that was there to stay, and nothing could be done about it. They were just going to have to somehow learn to live with it. That was extremely difficult to deal with. So it was tougher sledding than we thought it was going to be.

MR. SMALL. What do you think the consensus view of the FOMC would have been in defining its success on the inflation front? Would a 6 percent inflation rate have been successful, or was the FOMC thinking that inflation needed to stabilize at a lower rate?

MR. SCHULTZ. I think it probably varied some. Some of us on the Board felt it was extremely important to get inflation down to much lower levels. Shortly after I left the Board, I was still making talks, and I'd be asked what I felt acceptable inflation would be. My answer always was that the long-term target for inflation was somewhere between 1 and 2 percent. I was saying that before I left the Board. Sometimes in appearances before the Congress, I would be asked what the acceptable rate would be, and I would reply, "Between 1 and 2 percent." They would say, "Well, that's not zero. If it's important to get inflation down, why don't we get it down to zero?" My answer was that the only thing worse than inflation is deflation. If you get down to zero, there is no way you can keep it from going below zero, and that would create a lot of problems. My feeling was that the lowest you could bring it and keep it there on a permanent basis was in the 1 to 2 percent range. I always thought trying to get inflation below 1 percent would be too difficult to do. Coldwell was gone by that time, but certainly Wallich felt that inflation had to get down to very low levels. I think Partee at that point did too. And Lyle E. Gramley did when he came on. So that was a pretty strong feeling that we had to stay the course.

When I left, I asked Paul if I could address the FOMC, and he said, "All right." I urged them to stay the course, saying that I knew we were causing a lot of pain, but it was important to stick with it and not to cause that pain again. I think that was in February. They eased up in August or something like that. I felt that I might have overstated the case, because the economy was fairly deeply in recession. The pain was pretty intense, but I felt it was important that the FOMC be tough enough to hang in there until it was clear that we were breaking the back of inflation. I'm not ashamed of my little talk, but I think there were some FOMC members who later on thought that I carried it too far. Maybe I did, but I thought it was worth saying.

President Carter's Credit Controls

MR. SMALL. Before you got to that point, it was a pretty wild ride, with the credit controls. And you're a proclaimed monetarist, but money was swinging high and low, and an election was coming up.

MR. SCHULTZ. It was awful. We weren't getting the results that we wanted. Volcker was very concerned about those credit controls. The President had to drag him kicking and screaming into going along with those controls. I wasn't as hard to convince, because I hadn't had Paul's experience. I thought I understood the complexities of our economic system more than I really did. The President invoked the credit controls and said the Fed was going to administer them.

Paul told me that I was going to be in charge. I said, "Whoa, Paul, God, don't do that to me." He said, "Somebody has to do it. You can handle the bankers better than any of the others can." So I took it on. I was going to make it work. We called this meeting at the Fed with 18 CEOs of the largest banks in the country. Paul introduced me as the administrator of the credit controls. I got up and made a tough, macho speech that the controls had been invoked, and that my job was to administer them. I was going to do what needed to be done. I was sure that they were going to give me their cooperation. If they did not give me their cooperation, I assured them that there were a lot of tools at my command to make things uncomfortable for them. I could see a lot of scowls around the room. Who was this upstart character who was reading the riot act? But they got the message. They knew that I was going to ride them hard. I started out with all of these great intentions about making sure that it was going to get done and done right. We were going to invoke these things, and we were going to get inflation down.

Well, I quickly found out that I was messing around with something that was very complicated. This economic system of ours is something else. If you change one thing, it has effects all over the place. I think we had close to 80 economists working on this thing even nights and weekends at the Board and the Reserve Banks. We had issued an edict. Within a few hours after the edict was issued, I would get a call. "Mr. Vice Chairman, do you have any idea what you're doing?" [Laughter] They'd say, "Let me tell you what the effect is on this particular area of what you've just put out." We'd look at that, and then we'd issue another edict to try to take care of that problem. Well, it just was a mess. Never has any man so quickly come to the conclusion that nobody thoroughly understands our economic system. There are so many complexities to the thing. I grew to hate it very quickly. And, of course, we were getting a lot of pressure from the bankers to get rid of this damn thing, particularly from Walter Wriston [Citibank CEO].

Walter was a laissez-faire kind of guy, and in spite of the fact that he had made an enormous mistake on the foreign credit, particularly to South America. This just sticks in my mind. We were all around the Board table. Paul and I were on one side of the table. The Federal Advisory Council was around the table. Paul said that he was concerned about credit, particularly to South America. I can picture where Walter was sitting, and I can hear him to this day saying, "I don't understand why you're concerned about that, Mr. Chairman. Those are the best loans we have. Sovereign nations don't go broke."

In spite of that terrible blunder, I had a good deal of respect for Walter Wriston. He was running the biggest bank in the country. He was very upset about credit controls, and he kept talking to me. Paul and I would talk about it. Finally, we came to the conclusion that we needed to lift the credit controls. Paul told the President we were going to do that. Those credit controls had had some major effects. When we started getting torn-up credit cards in the mail—they were coming in by the thousands—it was clear that the economy was rapidly going in the tank.

So we removed the credit controls, and we were stunned by the rapidity that people started spending. It was amazing that we put the lid on inflation for a very short period of time, but boy, it didn't last at all. It came back rapidly. Again, it took us a long time to begin to recognize how deep seated those inflationary expectations were. We were aware of a lot of the dangers of inflation. I am not sure anybody in the world, with maybe the possible exception of Henry Wallich, understood inflationary expectations and how deep seated they were, how hard it was to get people to accept that we were going to get inflation down, because, as I said, when I went out making those speeches and I talked about inflation getting down, I first started talking about inflation getting down to 5 percent, and everybody just laughed at me. Nobody believed it. I was absolutely convinced the Fed would do the job and that we would get inflation down below that. I was giving myself considerable leeway, because we thought we could get it down to maybe even 4, or miraculously to 3, or something like that. Even I had no sense that we could over time get it down to where we have gotten it. So it's been a great success story, the combination of Volcker and Alan Greenspan.

When he first became Chairman, Alan would call me every three months or so and say, "How do you see the economy?" Then it was every six months. Then it was maybe once a year. But we did have a good relationship. I told him, "Mr. Chairman, you've done a wonderful job."

And he said, "Well, we're just continuing to carry out the policies that were created by Paul Volcker." So it's been a long time, and they have established the credibility of the Federal Reserve and established its reputation worldwide to a remarkable degree. Certainly, when I talk to people now, there are not many people that criticize the Fed—certainly not like they were in the days when I was on the Board. It's not criticized much, and it has great credibility, and there's great belief. There was a lot of nervousness when Ben Bernanke became Chairman, but I think he's done well. People want to believe in the Fed now. They have great respect for the institution.

More on New Operating Procedures

MR. SMALL. What do you think were the decisive arguments or reasons that the FOMC went to the new operating procedures?

MR. SCHULTZ. For some people, I think there was a mistaken belief that we might not have to push interest rates as high under the new operating procedures as we would have to retaining the old ones and kicking the funds rate up rapidly. Nobody had a good feel of how high the interest rates were going to have to go with the new operating procedures. It was fairly obvious we were going to have to do more on the fed funds rate if we were going to use that approach.

I think some people were worried that if we put the interest rates up a lot higher, there was going to be a lot of political pressure. And I think that probably is right. One of the advantages of the new operating procedure was that it didn't require a subjective decision that could be criticized in the same way. If we had just pushed the fed funds rate up, there were bound to be lots of people who would have said, "You people don't know what you're doing. You don't need to put the fed funds rate up that high." With the new operating procedures, you could say, "We are just mechanically following what the nonborrowed reserves are telling us." So I think a lot of people felt that going to the new operating procedures would give us political cover.

There also was the feeling that the mechanical approach might work better, that when you tried to subjectively move the funds rate by a substantial amount—and it was becoming clearer that that's what was going to have to happen, that the fed funds were going to have to change pretty substantially—that using the new operating procedures would be helpful.

MR. SMALL. Did you have a sense that communications would also be easier or more transparent, in the sense that you could just point to money growth?

MR. SCHULTZ. Oh, absolutely, much easier that way, much easier to explain. When you start moving the funds rate by 1 or 2 or even 3 full points, you're in uncharted waters. It's so subjective, and people are saying, "Why do 2? Why not just do 1 or 1½?" So the communications were a lot easier that way, because people couldn't say, "Well, things aren't as bad as you say they are, so you don't need to do that much." What most people don't realize—and I think this is something that is always important for people to keep in mind when they criticize the Federal Reserve—is, the Federal Reserve has more information than anybody else.

I tell a story about the governor of the Bank of England saying, "Next to the Federal Reserve, the Bank of England is the Toonerville Trolley." The amount of data that is collected by the Fed through the Reserve Banks and all the other areas gives the Fed much more information than anybody else has. It doesn't take very long after you get on the Board to learn to use that information if you've got any sense at all. This was a place where I asked a lot of questions. Here was this mountain of information. These were a lot of experts that were giving me information. I wanted to know what they thought about the implications of that information, what they thought the interrelationships were. I had great respect for the staff. And I used them. I asked a lot of questions. I asked for a lot of reports—some not long or difficult or anything. I wanted to be clear in my own mind that I understood the information, what the relationships were, and that kind of thing. Lots of people in the investment banking business, Fed watchers, love to think that they know as much as the Fed does. They love to think that they've got as much information as the Fed does, and that's just not true. Maybe there are other people that are smarter than some of the Fed members, but there have been lots of studies indicating that the collegial approach of the Fed results in better decisions than decisions by any individual. But more than that, the quality of the staff, the amount of data, and the analysis that they do is first class. So we have an advantage over anybody else in making our decision. Even if we're not as smart as some other people are, we have advantages.

MR. SMALL. Does that beget its own problems? There is the promise that targeting the aggregates is simple and clean. But were you drawn into the minutia of M1 and M1A and redefining and shifts between accounts, and then, all the sudden, it's difficult to explain?

MR. SCHULTZ. Oh, sure.

MR. SMALL. Did that become a problem?

MR. SCHULTZ. Oh, absolutely, it was a problem. There were constant discussions about what the aggregates actually showed, what aggregates we should look at, and what they indicated. That discussion, in my judgment, will never be resolved. I think you're always dealing with moving targets when you get into discussing what the aggregates should indicate, what you should have in each aggregate, and how the data should be collected. It's difficult. You do the best you can.

Transition from the Carter Administration to the Reagan Administration

MR. SMALL. Did this cause problems with the monetarists in the profession—in particular, the Reagan Administration—about whether or not you were being true to the principles?

MR. SCHULTZ. Oh, yes.

MR. SMALL. How did it change when the Reagan Administration came in?

MR. SCHULTZ. The Reagan people—particularly that first batch that came in—were not very competent. The Secretary of the Treasury, Donald T. "Don" Regan, came from Merrill Lynch. Don had a high degree of self-confidence. He was often wrong, but never in doubt. He felt it important that he have an impact on the Federal Reserve. From day one, he was talking to Paul all the time about closer coordination and cooperation. He insisted that we have a meeting, I think, every couple [of] weeks. Paul wouldn't attend such meetings. Don Regan started out attending but then turned it over to Beryl W. Sprinkel. Beryl led the Treasury delegation, and I led the Fed delegation. I had Steve Axilrod and usually one other Governor. On the other side, it was Beryl Sprinkel and Lawrence "Larry" Kudlow [with OMB at the time], who now has the TV show. David A. Stockman also attended. He was the chief domestic adviser. Early on, he was a big supply-sider. Sprinkel was the monetarist.

Before Ronald Reagan was sworn into office, David Stockman asked me to have breakfast with him at the White House. Dave spent the whole time telling me how we ought to carry out monetary policy, how we ought to be looking at supply-side economics, et cetera. I didn't say more than two words. Almost exactly one year later, I got a call from Stockman asking me if I'd have breakfast again. That time it was a totally different situation. He just asked me questions about how the Fed saw the situation, what was happening. Dave Stockman was a quick learner. It didn't take him long to recognize that, A, supply-side economics didn't work all that damn well, and, B, we had a lot more information than he did.

Beryl never changed. He was always completely convinced about monetarism. Larry Kudlow is smart, but he can go in a lot of different directions. I need to watch his TV show sometime and see how he is today compared to how he was then. Those meetings were difficult. They tried hard to tell us what kind of monetary policy they wanted and how we should be carrying out monetary policy. We would patiently explain how we saw the situation and what we were trying to do. But it was day and night.

Regan was constantly telling us what we needed to do. Finally, I grew tired of it. I sent somebody out to buy one of those big toys that have a plunger in them—you push it up and down, and the thing goes around. I had the staff paint it four different colors—green for monetarism, yellow for the gold standard, something else for—and one for supply-side. I sent it over to Don Regan with a note that said, "Dear Don, you can have any kind of monetary policy you want if you just push up and down on the plunger." About three days later, I got a box from him that had a yo-yo in it. He wrote, "Dear Fred, if you guys will stop yo-yoing the money supply, we'll be all right."

MR. SMALL. We were talking about the transition from the Carter to the Reagan Administration.

MR. SCHULTZ. The Reagan Administration came in and wanted big tax cuts. Paul and I talked a lot about it. We were in favor of some tax cuts. We thought the Fed in general would be happy to see some tax cuts. But then the tax bills got into the Congress, and the logrolling started. The final tax bills included tax breaks for peanuts in Alabama, pot-bellied stoves in Vermont, and horse farms in Kentucky. Everybody was on that gravy train. The Fed became concerned about the amount of those tax cuts. Paul went up on the Hill and spoke to the senators one-on-one and in a group on occasion. I went up, and I spoke to what were called the "boll weevils." They were the Democrats, primarily southern Democrats, who were voting with the Reagan Administration. I explained what we felt were the dangers of that enormous tax bill. We didn't seem to have any effect at all.

I lived in the Watergate, in the same building as Senator Robert "Bob" Dole. Bob and I were on the elevator about two weeks after the tax bill passed. He said that he thought the Fed was right. It had gone too far. He was introducing legislation to rescind some of the tax breaks, which he did, and it passed.

We had difficulty in developing good relations with the Reagan Administration in the early days when I was there. We felt that a lot of the things they were doing were not helpful to the Fed in monetary policy. But as time went on, things got better. By the time I left the Board, the relationship was much better. At that time, James A. "Jim" Baker was Chief of Staff. Volcker wanted to get me reappointed. But I told him that there was no possibility that the Reagan Administration was going to reappoint me, a lifelong Democrat—one who could be seen as a political appointee. I'd been at Princeton at the same time as Jim Baker. We didn't know each other well, but I knew him.

So I went over and talked to him at great length about what I thought were the important characteristics of a good Vice Chairman of the Federal Reserve. The thing that I stressed the most was the importance—at least in my opinion—of the Vice Chairman having a close relationship with the Chairman and being helpful to him. I felt like the loyalty of the Vice Chairman is much more important than the loyalty of any other Board members.

I recognized that Board members should have considerable independence, be able to speak their piece, and defend their point of view. I felt like it was important for me to have that independence. I exercised it, particularly in bank matters. When we had an issue dealing with mergers and acquisitions at banks, I would often take a strong position and often would carry the day with the rest of the Board. In one case, I was very close to the situation down here when a bank here was not running well. There were problems, and a group of fellows who had a successful company in the mortgage area wanted to buy the bank. Our supervision and regulation division had looked at it and recommended against allowing the acquisition. I said, "Look, you don't understand the situation. They have serious management problems at that bank." Their opposition was that, if the bank were bought by this group, it would remove some competition. I'd been on the board of Barnett for a long time before that. It would've been good for Barnett to refuse to allow this. This is why it's important that Board members have to sell their bank stocks. I thought, from the point of view of the competitive situation, it was important that this be allowed to go through. So I convinced Paul and the Board to approve it.

There were a number of other areas where I would have some impact, where Paul and I didn't agree on something, where I would vote on the other side. But when it came to monetary policy, I never voted against him. We would talk beforehand. I would understand where he was coming from. I would express my opinion, and then whatever he decided, I'd go along with it. I feel that the Vice Chairman should have a close and supportive relationship with the Chairman. That's why I was so disturbed when Preston Martin took my place and acted the way he did. I thought not only had he lied to us, but he was doing something that was, in my judgment, very destructive for the organization.

Vice Chairman Preston Martin

MR. SMALL. After you left the Board, did you talk with Paul Volcker about how the Board was running and how the new Reagan appointees were working out?

MR. SCHULTZ. To some degree, I did. I would talk to my former secretary, Anne Winkler. She would give me the inside scoop on all the things that were going on. I think it's fair to say that people liked me at the Board. And so when Preston Martin came aboard and acted the way he did, people were unhappy.

MR. SMALL. What do you mean, "acted the way he did"?

MR. SCHULTZ. He was constantly in conflict with Paul. There was nothing supportive about Preston Martin. His idea was that he was going to take charge. He was going to push his ideas on the Board. He was going to be the next Chairman. Everybody I talked to was unhappy about that. They were calling and talking to me, and I was calling and talking to them. I understood the problems. The Atlanta Fed needed a president. I talked to Paul about taking the job as president of the Atlanta Bank, but they were happy with an inside candidate. He had probably made it clear that if he were not made president, he was not going to stay. So the feeling on the Atlanta board was that he was a good man, and it would cause a lot of trouble if he weren't chosen, so they chose him, which was fine with me, because I went on to do other things. But I always had great loyalty to both Paul and the organization. I felt like I knew the Fed pretty well by then, felt like I could do a good job in running the Atlanta Fed.

Working with the Reserve Banks

MR. SMALL. Can we talk about your responsibilities and activities working with the Reserve Banks—what issues arose, what projects you had?

MR. SCHULTZ. I tried to visit one of the Reserve Banks each month. It was nice that there were 12 Banks and there are 12 months in a year, so I would visit a Bank once a month. I would usually attend their board meetings. I would talk to the board of directors about how we saw things and answer any questions that they might have. I had a pretty good relationship with all of the Reserve Bank presidents. The only one that I had some difficulty with was Lawrence K. "Larry" Roos [St. Louis Fed]. I had a special kind of a problem with him.

Paul wanted to be very careful in his relationship with the Reserve Banks. He wanted to allow them maximum independence. He didn't want to be seen as dictating to them in any way. He wanted me to have a lot of the relationships with the Banks. I would meet with them. We would talk on the phone. Any time they had problems of any kind, I'd try to help them. Of course, I would see them at the FOMC meetings. I was kind of their contact person.

There were a couple of times when I would carry out sensitive negotiations with the Reserve Banks. The first occurred when the issue came up about a president for the New York Reserve Bank. Paul wanted Tony Solomon, whom he knew and had a good relationship with. The board of the New York Fed wanted Tony and asked him to take the job, but he refused. Paul was upset, and so was the chairman of the board, Boris Yavitz. He was a Professor at Columbia University's Graduate School of Business. [Yavitz served as deputy chairman and director of the Federal Reserve Bank of New York from 1976 to 1982.]

Boris came to Washington, and we got him a room at the Watergate. Paul, Boris, and I had dinner. Boris kept saying, "Paul, the only way that Tony will take this job is if you call him personally." Paul was reluctant to do that. Finally, I said, "Paul, this is something you have to do. He's obviously, in your judgment, the right man for the job. You can't let your nervousness about overstepping your bounds in your relationship with the Bank allow you to pass a man that is well qualified, that you get along well with, and who can be of such value." Paul finally acquiesced, picked up the phone, called Tony, and he agreed.

The next thing that happened was, the Minneapolis Fed was looking for a president. Paul felt strongly that Corrigan should be the president of the Bank. But, again, he was reluctant, so he sent me out to Minneapolis. I met with the chairman of the board. I told him of Paul's reluctance to intervene personally, but I told him Paul felt that Corrigan was the right man for the job, and I did, too. Corrigan and I had a close relationship. Paul, Corrigan, and I would go out to dinner on occasion.

The third time was the most difficult situation. We had gone to the new operating procedures. That, of course, was a monetarist approach. Larry Roos was riding high—he felt that he had finally won his battle to bring a monetarist approach to the FOMC. Of course, nobody on the FOMC was a monetarist—none of us believed in monetarism—but we thought that, given the circumstances, going to these new operating procedures was the thing to do.

Larry was making speeches and talking about how the Fed was now monetarist, but we weren't going far enough in this area, so he was going to get us to do this and that. He was criticizing some FOMC decisions. Paul really started getting upset about it. He said, "It's vital that we present a united front." When the decision is made by the FOMC, everybody should fall in line and agree with it and not publicly dispute it." He said, "I don't know what to do. I really am upset about it." I said, "Paul, why don't you just let me go out there and see if I can find a way to smooth it over?" He said, "Okay."

So I flew out to St. Louis. I met with the chairman of the Bank board, and I met with Larry. I said, "Larry, we respect the fact that you're a monetarist, that your Bank research department is monetarist. That's not only all right, we think it's probably important that there be a monetarist view within the organization. But it's vital that you not publicly criticize the decisions of the FOMC. That can cause a lot of trouble in the markets and within the Fed." We spent half a day discussing this. Finally, Larry and the chairman of the board agreed, and we finally got Larry to agree. The crisis was defused, but it was difficult. So I spent a fair amount of time dealing with the Reserve Banks. Whenever they had a problem, they would come to me, and I would help them. We would try to work things out.

On the governance side, I think that the governance system that the Fed uses is a good one. I think it works. Remember, I came to the Board being a long-time director of a decentralized bank holding company. I had been chairman of the audit committee for years and was when I rejoined them. So I was very much involved in the management of the system. I knew how to operate within that kind of a system and thought that kind of a system was a good one. When I came to the Board and operated for a while as chairman of the Bank Activities Committee, I didn't think that there was enough cooperation and coordination. There was too much of a hands-off kind of a thing. In many areas, the organization could benefit from closer contact by working on certain mechanical things together, by working on some of the issues of dealing with checks, a variety of the mechanical things. That's why I organized that three-day meeting in which I asked certain of the Banks to develop papers on certain subjects. I thought it worked well, and we did establish better communications and better cooperation. But I would not change the governance of the Fed. I think it works very much like a decentralized bank holding company.

Obviously, the personalities make a big difference. They will change from time to time. That's another reason why I feel it's important that the Vice Chairman have a special relationship with the Chairman. I just think it works better that way. And I think it can cause trouble if you don't have a good relationship between the two.

The Fed's Role in Bank Supervision

MR. SMALL. Do you think it's valuable that the monetary policy function and the bank supervision [and] regulation function be housed together?

MR. SCHULTZ. Yes, I do. I recognize the arguments against it, and I recognize it doesn't work that well in other countries. But it's my feeling that monetary policy is basically carried out through the banking system. I think it's important to have a close relationship between the Fed and the banks. In spite of the difficulties that you run into from time to time, I think it's a good idea for the banking function and the monetary function to be housed in the same organization.

MR. SMALL. Is that for reasons of standard, everyday monetary policy, or is it also for financial crisis episodes?

MR. SCHULTZ. Yes—in particular, that, yes. I think that the Fed knows more about what's happening in the banking system when it's housed there. This is, in my judgment, a reasonably close question. I like it the way it is. I can understand and appreciate the arguments on the other side, but I still think it works better this way.

MR. SMALL. Do you think it works well that there are other banking regulatory institutions—the OCC and others? Is there a competition that's healthy? Is it not a good arrangement? Would you unify it?

MR. SCHULTZ. Well, I'm not sure. My gut feeling is that it works well to have other regulatory institutions who have a different point of view and whose relationships are different, so long as the Fed has control of the major banking institutions. I think that it works fine to have other banking functions that they can't oversee, and my gut feeling is that they've worked out a pretty good arrangement. I don't have any strong feeling that it ought to be changed.

Congressional Oversight

MR. SMALL. What about the House and Senate banking oversight committees and the roles they play—are they in the way? Do they pull the Fed kicking and screaming into new and worthwhile innovations? How do you see the role of those oversight committees, the effect they have on the Fed?

MR. SCHULTZ. Well, it depends a great deal on the personalities that have been involved. Since the Fed is a creature of the Congress, you're always going to have to have Senate and House banking committees. And they are going to always have oversight.

That kind of oversight works better sometimes than others, depending upon who the chairmen are. If you've got a Proxmire, I think it is going to work fairly well. He was a great believer in the Fed, and he felt strongly that it should've acted sooner and stronger on inflation. I think he was right. But he was always a big supporter of the Fed. You can get somebody like Henry S. Reuss or Henry B. Gonzalez, who didn't like the Fed. So personalities make a big difference.

In any organization of this kind, personalities are important. How the Board works, how the FOMC works, there are a lot of personalities that are involved in this kind of thing. You're never going to get away from it. So I think we're always going to have to have congressional oversight and congressional oversight committees. You just hope that you get chairmen that you can work well with.

Administrative Governor for the Board

MR. SMALL. How did you become the Administrative Governor, and what accomplishments or activities did you have in that role, in terms of a vision for the Board and programs?

MR. SCHULTZ. I had some managerial experience—one of the reasons Bill Miller wanted me to come to the Board. Volcker was perfectly willing to accept me in that role. It was easy for him to do that, because he was up to his eyeballs in monetary policy, and it didn't take him long to see that I understood something about management and that I brought some expertise there. It also didn't take me long to have great respect for the Fed staff and for the people who worked there. I felt it was my job to make working for the Fed as easy as possible for the people who were there. I determined that I would try never to lose an officer to the outside world that would make less than twice as much as he was making at the Fed. I wanted to help the working conditions.

When I came to the Board, there were some issues on the part of the lower-level staff people. They were unhappy about things; they felt like their complaints weren't being heard. There was a strong effort to create a union. Given the kind of organization the Fed is, I felt that we would be better off without a union.

I created a working committee with an employees committee that I met with regularly. At first it was difficult, because they wanted to see me as adversarial, and I worked hard to change that. I did everything I could to see their point of view and to accede to their desires. I instituted flex time. I think that the Fed was the first governmental organization to institute a policy of flex time. Paul was concerned about it. He said, "Well, it's going to mean a lot of people who work there won't have the face time with their managers and that kind of thing." I said, "Yes, that's a drawback, but I think you'll find that you're going to get a lot more work out of a lot of very valuable people with this."

Also, all my life I have worked well with women. I got along well with women at the Board. If you talk to my secretary—former secretary Anne Winkler, she can give you a better feel for the relationships that I had with employees, with the things that I did in managing the Board, working out the problems and the issues that we had. I think I did a good job in this area. I think the employees liked me. We got along well, I believe.

MR. SMALL. Were some of the issues related to minorities and how they perceived they were valued?

MR. SCHULTZ. Oh, yes. I bent over backwards to work with them and help them. I bent over backwards to try to make sure that they got a fair shake in hiring. I pushed various divisions to hire more minorities. So, yes, I was sensitive to that issue. I had a good deal of experience in dealing with minorities when I was president of the downtown council. Here in Jacksonville, we had race riots. I was involved in mediating and in working with minorities on some of these issues. I was helpful, I think, in that regard.

Commercial Lending by Savings and Loans

MR. SCHULTZ. One other area that I would like to comment on is when the savings and loans were under so much pressure, there were bills to allow them to have a wider scope of responsibility and, in particular, to make commercial loans and get away from the Regulation Q interest rate ceilings. I was very sensitive to the needs of the S&Ls, but I was the last Board member to agree that making commercial loans was something that we should allow S&Ls to do. They argued that they made loans all the time, and they could go out and hire commercial loan officers. I made the argument that making commercial loans is not a science, it's an art. There weren't that many good commercial loan officers walking around. I felt that we would have difficulty. So I was led kicking and screaming into agreeing to that. That was one of the few times in my life I've been right. There were a lot of problems that arose because of problems with S&Ls making commercial loans. It worked out, but it was a tough time as a result of that.

Glass-Steagall Act

MR. SMALL. Were you involved in Glass-Steagall issues?

MR. SCHULTZ. Yes. It was my opinion that something needed to be done about Glass-Steagall. Glass-Steagall was not all that important when it was first passed, although there were a lot of people who thought it was. Glass-Steagall—in my opinion, and most other peoples'—would not have prevented a lot of problems in the Depression if it had been in place. I never felt it was critical. A lot of people felt it came about because banks were blamed for many of the things that happened in the Depression. I don't think that they should've been blamed. I was always on the side of either repeal or substantial amendment to Glass-Steagall.

The Fed's Role in Addressing Financial Crises

MR. SMALL. We have the subprime mortgage crisis now, and we always had and will have financial crises. Some argue there's a danger of "mission creep" for the Fed. Do you have a sense of the proper scope of Fed activities and its tools?

MR. SCHULTZ. In my opinion, it is essential for the Fed to be a powerful institution. It is a strong institution. It's been careful to stay out of political issues. It has tried to hold itself to a higher standard. It has credibility with the country that is important. In my opinion, there are going to be times when we have crises when the Fed has got to step in, because it is a unique organization. Maybe I am too much of a believer and an admirer of the Fed. But when I was there, I learned that it is a unique and important institution. And I was there for a number of the crises. I'm not ashamed of the way the Fed handled any of them. I think that we did as good a job as we could.

And there's the whole issue of "too big to fail" and everything, one which is constantly going to be debated. It's something where there are concerns. There are always going to be arguments about how well the Fed handles crises, but I don't see any other organization which is in the unique position the Fed is in to meet and handle these things. This is another reason why the composition of the Fed, the people that are there, is so important, particularly the Fed staff. It is important that they be the finest financial staff in the world, because they are going to be asked to handle these things. So it's important that they be paid well. It's important that they be treated with respect. No other governmental entity, in my judgment, has the kind of reputation that the Fed has.

The Hunt Brothers and the 1980 Collapse of Silver Prices

MR. SMALL. Do you get questions about the Fed's involvement in the Hunt Brothers' attempt to corner the market in silver as a hedge against inflation? Were there issues about whether Fed involvement was within the scope of the Fed's mission?

MR. SCHULTZ. Yes, we looked at that. And we looked at where the loans were made, the amount of the loans, and what kind of problems it would create if the Hunt Brothers were unable to pay their loans. This was a "too big to fail" issue. One of the investment banks was really strung out. They would have gone out first. The Hunt Brothers had a lot of loans with Merrill Lynch. And Merrill Lynch would have gone under. Republic Bank and First National Bank of Chicago would have gone under. It was a row of dominoes. We looked at it carefully and decided that we couldn't take the chance. We had to step in and deal with the thing. We were rough on the banks. The fellow who was the chairman of one of those banks told me, "You like to pull wings off flies, don’t you?” He said that because we were going to make those banks do a lot of things. It was going to be harsh on them. But there wasn’t any question that we had to step in.

Conclusion

MR. SMALL. I think we’ve covered your career and your involvement in the Fed. I’d like to thank you very much.

MR. SCHULTZ. I’m delighted that you’re doing it.